TAX AVOIDANCE: THE SCOPE AND EFFECT OF SECTION 140 OF THE INCOME TAX ACT 1967 [PART II]*

Although section 140 of the Malaysian Act is in some respects adequate for its general purpose, it is certainly not clear as regards the limits of its application. For instance, the characteristics a scheme or transaction must bear before it comes within the section are not clearly defined. If construed literally, the section would extend to every transaction whether voluntary or for value which has the effect of reducing the tax liability of an individual.[1] Taken to this extreme the section becomes meaningless. The question then arises as to the area and limits of its application. Developments in Australia and New Zealand suggest that there are limits or exceptions to the application of sections 260 and 108 of the Australian and the then New Zealand Acts respectively, which sections correspond to section 140 of the Malaysian Act. Accordingly, the limits to be placed on the application of section 140 of the Malaysian Act will be seen in the light of the development of case law authorities in delineating the scope and limits of sections 260 and 108 of the Australian and the then New Zealand Acts respectively.

Bona Fide dispositions

This exception to sections 260 and 108 of the Australian and the then New Zealand Acts respectively can be traced to the case of *Deputy Federal Commissioner of Taxation* v. *Purcell*.[2] In that case Knox C.J. said:

> "[The section] does not extend to the case of a *bona fide* disposition by virtue of which the right to receive income arising from a source which theretofore belonged to the taxpayer is transferred to and vested in some other person. The section is intended to protect the revenue against any attempted evasions of the liability to income tax imposed by the Act — that liability is imposed on the taxpayer in respect only of his income. . . and the *bona fide* gift or sale by a taxpayer of assets producing income is therefore in no sense an attempt to evade his liability to income tax."[3]

*This is a continuation of the article which appeared in JMCL [1982] pp 75-101.

[1] See *Govan* v. *Federal Commissioner of Taxation* [1968] N.Z.L.R. 163 at p. 164. See also the observation of Knox C.J. in *Federal Commissioner of Taxation* v. *Purcell* (1921) 29 C.L.R. 464 at p. 466 as regards the scope of section 260 of the Australian Act.

[2] (1921) 29 C.L.R. 464

[3] *Id*., at p. 466

In this case, it appeared that the taxpayer, an owner of substantial grazing property, had declared himself trustee of that property for himself, wife and his daughter equally. The declaration of trust contained powers of management, control and investment which were described as very wide and unusual.[4] It was held by the court that the declaration of trust was not avoided by section 53 of the Income Tax Assessment Act 1915 (Cth.) which corresponded with the present section 260 of the Australian Act.

On appeal to the Full Court, Rich J. was of the view that:

> ". . . it would be unreasonable to construe it (section 53) so as to include a genuine gift which had the incidental effect of diminishing the donor's assets and income."[5]

In the Privy Council case of *Europa Oil (N.Z.) Ltd. (No. 1)* v. *Commissioner of Inland Revenue*[6] Lord Donovan and Viscount Dilhorne described as an 'absurdity' the proposition that :

> ". . . a gift of income producing property to a charity made for the express purpose of giving a tax-exempted income to the charity would be void under section 108 and the income would be assessable on the donor. If true, this would soon dry up many of the wells of charity in New Zealand."[7]

Similar observations have been made in *Jaques* v. *Federal Commissioner of Taxation*[8] where Issacs J. said of a section which corresponded to the present section 260 of the Australian Act:

> "The section does not include a conveyance or transfer of property, legal or equitable, as such."[9]

Thus these cases establish the proposition that a *'bona fide* disposition' does not attract sections 260 and 108 of the Australian and the then New Zealand Acts respectively. It is submitted that this should also be the position under section 140 of the Malaysian Act.

[4] *Id.*, at p. 471

[5] *Id.*, at p. 476

[6] [1971] N.Z.L.R. 641; [1971] A.C. 760

[7] *Id.*, at p. 659; at p. 783. See also *McKay* v. *Commissioner of Inland Revenue* [1973] 1 N.Z.L.R. 592, 601 where the New Zealand Court of Appeal stated in passing that to 'simply' dispose of property is not within the subject-matter dealt with by s. 108 of the then New Zealand Act.

[8] (1924) 34 C.L.R. 328

[9] *Id.*, at p. 359

Ordinary Business or Family Dealing

The 'ordinary business or family dealing' exception was laid down by the Privy Council in *Newton's* case[10] in the course of laying down the test for the application of section 260 of the Australian Act. Their Lordships said :

> "In order to bring the arrangement within the section you must be able to predicate — by looking at the overt acts by which it was implemented — that it was implemented in that way so as to avoid tax. If you cannot so predicate but have to acknowledge that the transactions are capable of explanation by reference to ordinary business or family dealing, without necessarily being labelled as a means to avoid tax, then the arrangement does not come within the section."[11]

Accordingly for the section to apply it must be possible by looking at the overt acts by which the impugned transaction was implemented to conclude that it was done in that particular way so as to avoid tax. It is submitted that the true inference to be drawn from the remarks of their Lordships is that if the method of implementation of the transaction is such that it is capable of explanation by reference to ordinary business or family dealing without necessarily being labelled as a means to avoid tax, section 260 of the Australian Act does not apply and there is no need to consider the purpose or effect of the arrangement. If, however, the method of implementation is not capable of any such explanation, then its purpose and effect is considered and if its purpose and effect is to avoid tax, the fact that it has other purposes and effects is no objection to the application of the section. The words 'without necessarily being labelled as a means to avoid tax' following the words 'ordinary business or family dealing' go towards characterising the arrangement either as an ordinary business or family dealing or as a means to avoid tax.

However, it is far from clear what is meant by 'ordinary business or family dealing.' In a recent New Zealand case, *Tayles* v. *Commissioner of Inland Revenue*[12] Jeffries J., sitting in the Supreme Court of New Zealand was of the view that the vagueness of the term 'ordinary business or family dealing' cannot be used as a cover for all or any type of transaction within a family.[13] His Honour was of the opinion that there will be an ordinary family dealing where there are merely some 'elements of generosity, risk and eased application of current commercial practices . . . [But not where

[10](1958) C.L.R. 1; [1958] A.C. 450

[11]*Id.*, at pp. 8—10; at p. 466

[12][1977] 1 N.Z.L.R. 668

[13]*Id.*, at p. 678

there is] abandonment of commercial practice, apparent mercantile foolishness or marked artificiality.'[14]

In *Govan* v. *Commissioner of Inland Revenue*[15] Wilson J. took the view that:

> "[A]n 'ordinary dealing' is one which follows a natural and straightforward course for transactions of its ostensible nature. I am unable to accept. . . that it is one which follows the course ordinarily adopted in similar transactions because that makes no allowance for variations in practice or the adoption of improved methods of achieving one's object. It must be remembered, of course, that the fact that an arrangement is capable of explanation by reference to ordinary dealing does not, of itself exclude the operation of section 108. The section will still apply if the arrangement necessarily attracts the label of a means to secure relief from liability to pay income tax."[16]

Accordingly, it is submitted that despite its overtones of usualness, the central meaning of 'ordinary dealing' is rather that of dealing susceptible of reasonable explanation on some basis other than tax avoidance.

It would appear that in New Zealand if the scheme as a matter of ordinary family or business dealing has a purpose or effect that co-exists along with the more than 'merely incidental purpose or effect' of tax avoidance, section 108 of the then New Zealand Act would apply. Thus in *Elmiger* v. *Commissioner of Inland Revenue*[17] Woodhouse J. said:

> ". . . it is my opinion that the family or business dealings will be caught by section 108 despite their characterisation as such, if there is associated with them the additional purpose or effect of tax relief (in the sense contemplated by the section) pursued as a goal in itself and not arising as a natural incident of some other purpose."[18]

In New Zealand, the courts are reluctant to hold that schemes involving a redistribution of family assets are matters of ordinary family dealings. A clear example of this can be found in *Halliwell* v. *Commissioner of Inland Revenue*.[19] Briefly, the facts in that case concerned a classic income split arrangement: sale by a dentist to his family trust of the assets utilised

[14] *Ibid.*

[15] [1968] N.Z.L.R. 163

[16] *Id.*, at p. 165. See also *Grierson* v. *Commissioner of Inland Revenue* (1971) 3 A.T.R. 3 at pp. 7—8; where Henry J., having noted that the arrangement before him has not been shown to be a usual procedure in a professional business said: "But there is no reason why new business procedures should not be adopted. To this extent the term 'ordinary business' may require a benevolent rather than a restricted application."

[17] [1966] N.Z.L.R. 683

[18] *Id.*, at p. 694. This is the position under the present s. 99(1)(b) of the New Zealand Income Tax Act 1976.

[19] [1978] 1 N.Z.L.R. 363

in his practice, followed by their lease back to himself. Thereafter the trust purchased from time to time and from independent sources whatever new equipment was necessary for the conduct of the practice. In that case, Casey J. refused to follow the more liberal view taken in Australia of matters of family dealings involving a redistribution of assets and held that the arrangement came within the ambit of section 108, the then New Zealand equivalent of section 260 of the Australian Act.[20]

In Australia, on the other hand, there is judicial willingness to hold that schemes related to matrimonial assets sharing are matters of ordinary family dealings and hence may be undertaken without fear of violating section 260 of the Australian Act. In *Peacock* v. *Federal Commissioner of Taxation*[21] a registered surveyor sold part of his practice to his wife and subsequently admitted his unqualified wife as an active partner in his practice. The Commissioner sought to challenge the arrangement by assessing to the husband the income derived from the practice. It was held that the arrangement disclosed an ordinary dealing without necessarily being labelled as a means to avoid tax. The court was of the view that it was not unusual for a businessman to take his wife into partnership. The court also regarded the taxpayer's enterprise as not merely a professional practice involving the exercise of a special technical skill, but rather as a 'business' whose range of activities necessarily comprehended more than purely professional work.

A more liberal view as to the concept of ordinary family dealing could be seen in *Jones* v. *Federal Commissioner of Taxation*[22] where there was a sale of an existing pharmacist's business to his wife outright, and the acquisition of a subsequent business in her name. In both cases the pharmaceutical chemist was employed by his unqualified wife as a salaried manager to conduct and manage the pharmacy business which she owned. Bray C.J. expanded the concept of ordinary family dealing when he observed:

> ". . . a redistribution of family assets including a family business, as between husband and wife, is a normal, ordinary, every day family transaction which would not normally attract section 260 where there is no professional element in the business. Farmers, shopkeepers, factory owners do it frequently."[23]

It would seem that his Honour was willing to extend the opportunity to engage in matrimonial asset sharing exercises regardless of its vocational

[20] *Id.*, at p. 375

[21] (1976) 6 A.T.R. 677

[22] (1977) 7 A.T.R. 229. For a similar case, see *Bayly* v. *Federal Commissioner of Taxation* (1977) 7 A.T.R. 215. For some comments on *Jone's* case and *Bayly's* case, see A.J. Myers, 'Recent Developments Concerning section 260 and The Profession' (1977) 6 *Australian Tax Review* 88.

[23] *Id.*, at p. 238

context, without considering it necessary to make any such refinement as the court in *Peacock's* case[24] did. In so doing, it would seem that the warning sounded by Menzies J. in *Peate* v. *Federal Commissioner of Taxation*[25] that:

> "What, outside a profession, might be regarded as ordinary business transaction may, within a profession have an altogether different appearance."[26]

will no longer be heeded. In *Peate's* case the arrangement which consisted of the formation of companies to take over the doctor's business, with the benefits passing to his family but control still remaining with the doctor, was held to be invalid under section 260 of the Australian Act on the ground that the arrangement was not an ordinary business transaction in view of the fact that it was effected by professional men and accordingly was directed at the avoidance of tax.

It is left to be seen whether the Malaysian courts will adopt the Australian or New Zealand positions regarding schemes related to matrimonial assets sharing. However, there is no short answer to the question of whether schemes related to matrimonial assets sharing constitute ordinary family dealings. It is a matter of the court's approach to each set of circumstances which comes before it.

The 'Choice Doctrine'

In Australia the principle of 'alternative choices' has emerged as a defence against section 260. In other words, where the tax Act provides alternative choices to taxpayers, the availing of these choices provided for in the tax Act by taxpayers is a defence against the application of the section. In *W.P. Keighery Pty. Ltd.* v. *Federal Commissioner of Taxation*[27] this proposition was stated thus :

> ". . . the section intends only to protect the general provisions of the Act from frustration and not to deny to taxpayers any right of choice between alternatives which the Act itself lays open to them."[28]

This was also the view of the Court in *Clarke* v. *Federal Commissioner of Taxation*[29] where Rich, Dixon and Evatt JJ. said :

[24](1976) 6 A.T.R. 677

[25](1964) 111 C.L.R. 443

[26]*Id.*, at p. 460

[27](1957) 100 C.L.R. 66

[28]*Id.*, at pp. 92—93

[29](1932) 48 C.L.R. 56

"Where circumstances are such that a choice is presented to a prospective taxpayer between two courses of which one will and the other will not, expose him to liability to taxation, his deliberate choice of the second course cannot readily be made a ground of the application of the provision. In such a case it cannot be said that, but for the contract, agreement or arrangement impeached, a liability under the Act would exist."[30]

A somewhat similar observation was made in *Purcell's* case[31] in the joint judgment of Gavan Duffy and Starke JJ. who stated that:

"The section . . . does not prohibit the disposition of property. Its office is to avoid contracts, etc., which palce the incidence of the tax or the burden of tax upon some person or body other than the person or body contemplated by the Act. If a person actually disposed of income-producing property to another so as to reduce the burden of taxation, the Act contemplates that the new owner should pay the tax. The incidence of the tax and the burden of the tax fall precisely as the Act intends, namely, upon the new owner."[32]

It is important to note at this stage that the observations of the Privy Council in *Newton's*[33] case that :

"Nor can anyone, by seeing a private company turned into a non-private company, predicate that it was done to avoid Division 7 tax, see *W.P. Keighery Pty. Ltd.* v. *Federal Commissioner of Taxation*.[34] Nor could anyone, on seeing a declaration of trust made by a father in favour of his wife and daughter, predicate that it was done to avoid tax, see *Deputy Commissioner of Taxation* v. *Purcell*[35]."[36]

must be regarded as unsatisfactory in so far as they contain an attempt to rationalize or explain these two decisions of the High Court on the ground that in the circumstances there in question no one could have predicated a purpose of avoiding tax.[37] This decision of the Privy Council raised a question whether the dicta that have been set out above were intended to overrule the reasoning that had been adopted in *Purcell's*[38] and

[30] *Id.*, at p. 77

[31] (1921) 29 C.L.R. 464

[32] *Id.*, at p. 473

[33] (1958) 98 C.L.R. 1; [1958] A.C. 450

[34] (1957) 100 C.L.R. 66

[35] (1921) 29 C.L.R. 464

[36] (1958) 98 C.L.R. 1 at pp. 8—9; [1958] A.C. 450 at p. 466

[37] See D.F. Dalton, 'Avoidance of Taxation: Section 260 of the Income Tax Assessment Act' (1973) 9 *Melbourne University Law Review* 95 at p. 114

[38] (1921) 29 C.L.R. 464

Keighery's[39] cases because if the test that the Privy Council laid down in *Newton's* case[40] was satisfied, section 260 of the Australian Act applied even though, for example, an intention appeared in another provision in the Act that that provision should provide a special choice and should have an overriding effect.

It should be noted that the principles that were laid down in *Purcell's* case[41] and *Keighery's* case[42] were approved and applied in *Federal Commissioner of Taxation* v. *Casuarina Pty. Ltd.*[43] In *Casuarina's* case, where a purpose of minimizing Division 7 tax appeared clearly in all the circumstances, it was nonetheless held that the arrangement that had been carried out did not extend beyond the steps that were contemplated or intended by the Australian Act construed as a whole to be open to taxpayers. Walsh J., who delivered the leading judgment of the court, expressed the view[44] that the authority of the decision in *Keighery's* case had been affected neither by the judgment of the Privy Council in *Newton's* case[45] nor by any subsequent decisions. Gibbs J. added that :

> "... [even where] one can predicate that the conversion of a private into a public company was done to escape Division 7 tax, this does not mean that the purpose or effect of the arrangement was to avoid a liability imposed on the company by the Act, since the Act itself imposes the additional tax payable under Division 7 only on private companies, and contemplates that companies will, and lawfully may, choose to become public companies within the description of section 103A and so escape liability to pay the tax."[46]

The 'choice principle' as laid down in *Keighery* and *Casuarina's* cases was applied and extended in *Mullens* v. *Federal Commissioner of Taxation*[47]. In *Mullens'* case there was an arrangement whereby a shareholder in a petroleum exploration company who was entitled to be issued certain shares in the aforesaid company transferred this entitlement

[39] (1957) 100 C.L.R. 66

[40] (1958) 98 C.L.R. 1; [1958] A.C. 450

[41] (1921) 29 C.L.R. 464

[42] (1957) 100 C.L.R. 66

[43] (1971) 127 C.L.R. 62. It is to be noted that the decision in *Casuarina's* case is no longer law in view of specific amendments made to s. 103A of the Australian Income Tax Assessment Act 1936 (Cth.). These amendments are directed at specific avoidance devices. Devices are caught, for example, 'if two or more persons would be in a position to 'affect' rights of the relevant holding company' [s. 103A (4)(d)] and a company shall be deemed not to be a subsidiary of a public company 'if the Commissioner is satisfied that . . . the affairs of the company concerned were managed or conducted in the . . . interests of persons other than the relevant holding company.' [s. 103A(4D)(a)].

[44] *Id.*, at p. 103

[45] (1958) 98 C.L.R. 1; [1958] A.C. 450

[46] (1971) 127 C.L.R. 62 at p. 105

[47] (1976) 6 A.T.R. 504

to the taxpayer, with the intention that the taxpayer would pay up moneys on the shares and obtain thereby rights to deductions, and as part of the arrangement he was given by the taxpayer an option to purchase the shares at par and subsequently exercised that option after the taxpayer had obtained rights to deductions. It was held that the taxpayer had done no more than bring himself within the provisions of section 77(A) of the Australian Act and section 260 of the said Act could not apply to such a situation.

In *Mullens'* case Barwick C.J. observed that:

> "... there will be no relevant alteration of the incidence of tax if the transaction, being the actual transaction between the parties, conforms to and satisfies a provision of the Act even if it has taken the form in which it was entered into by the parties in order to obtain the benefit of that provision of the Act."[48]

This principle was recently reaffirmed in *Cridland* v. *Federal Commissioner of Taxation*[49] In this case, the taxpayer, a University student, had taken a 'unit' entitling him to be considered as a possible 'income beneficiary' in a trust which was carrying on the business of primary production. The object of the creation of the trust was to enable members of the public to benefit from the income-averaging provisions under section 157(3) of the Australian Act. The Commissioner assessed the taxpayer on the basis that his taking up of the 'unit' was void as a tax avoidance arrangement. The High Court held that section 260 of the Australian Act was inapplicable because the taxpayer had merely taken advantage of provisions intended to be available to him. The court was of the view that the *Keighery* principle is not confined to cases in which the said Act offers two alternative bases of taxation; it proceeds on the footing that the taxpayer is entitled to create a situation by entry into a transaction which will attract tax consequences for which the Act makes specific provision and that the validity of the transaction is not affected by a general anti-tax avoidance section merely because the tax consequences which it attracts are advantageous to the taxpayer and he enters into the transaction deliberately with a view to gaining that advantage.[50]

However, in *Mullens'* case it was stated by Barwick C.J. that the 'choice principle' would not apply,

[48] *Id.*, at p. 509. For some comments on *Mullen's* case, see I.C.F. Spry, 'New Limitations on Section 260' (1976) 5 *Australian Tax Review* 265

[49] (1977) 8 A.T.R. 169

[50] *Id.*, at pp. 173—174

> ". . . if there had been some antecedent transaction between the parties, for which the transaction under attack was substituted in order to obtain the benefit of the particular provisions of the Act."[51]

Accordingly, where an arrangement is entered into which gives rise to a deduction, which would not have been forthcoming otherwise, or gives rise to a receipt, which arises only by reason of the arrangement, then the incidence of tax cannot be said to have been altered. However, where a scheme or plan is already under way and that scheme is varied in an attempt to produce a deduction which otherwise would not have arisen or which cloaks a receipt, which would have been received in any event, as a non-income receipt then the Court will consider whether section 260 applied because the incidence of tax has been altered. For instance, in *Jaques'* case[52] it appeared that after various arrangements were under way to effect a reconstruction of a company a new scheme was adopted which did not alter the income of the shareholders or their ownership of property but sought to give them a deduction which they would not otherwise have been entitled to receive. This apparently illustrates what the Full High Court considers as an alteration of the incidence of tax.

Stephen J. in *Mullens'* case[53] distinguished the case before him from *Jaques'* case.[54] He also confirmed that the Full High Court would not consider that the incidence of tax had been altered unless an antecedent transaction had been altered so as to produce a tax advantage for a party to the change.[55] As Stephen J. said:

> "It is clear that the Mullens group entered into this first transaction with no other purpose than to gain the advantage of tax deductions. In the particular circumstances of this case this fact, far from playing any part in attracting the provisions of s. 260 points in quite the contrary direction; it demonstrates that the Mullens group was never in the position of having some transaction in mind or already embarked to which they gave a different form so that they might clothe it with tax advantages. The only transaction they ever contemplated was precisely that into which they entered and no other."[56]

Stephen J. approved of the view expressed by Barwick C.J. in *Federal Commissioner of Taxation* v. *Casuarina Pty. Ltd.*[57] that section 260 does

[51] (1976) 6 A.T.R. 504 at pp. 509—510

[52] (1924) 34 C.L.R. 328

[53] (1976) 6 A.T.R. 504

[54] (1924) 34 C.L.R. 328

[55] (1976) 6 A.T.R. 504 at p. 520

[56] *Id.*

[57] (1971) 127 C.L.R. 62

not apply in circumstances where taxpayers had brought themselves within other provisions of the Act, stating[58] :

> "There is no room for the application of s. 260 where the taxpayer has become liable for the amount of tax 'appropriate under the terms of the Assessment Act to the state of affairs obtaining' at the relevant date; 'steps taken to bring about that state of affairs do not operate to attract s. 260'."

It would seem that the 'choice principle' was further extended in *Slutzkin* v. *Federal Commissioner of Taxation*[59] when the notion was applied that :

> "To adopt a course which produces a result outside the scope of the Act is not to alter the incidence of tax, or to defeat any liability to tax or to prevent the operation of the Act, notwithstanding that such a course is adopted with full knowledge of the provisions of the act and with a conscious intention that the proceeds should not fall within the operation of the Act."[60]

It would appear that the Australian Act also offers a 'choice' whether or not a proposed transaction should be brought within the terms of the said Act and to decline to do so is not to violate section 260 of the said Act. The principle applied in *Slutzkin's* case would seem to be quite different from the 'choice doctrine' previously developed. The latter traceable from *Keighery's* case,[61] is essentially a matter of construction of the statute, involving two provisions that might regulate a particular transaction.

In *Slutzkin's* case[62] it appeared that the shareholders of a company had disposed of their shares to a purchaser. There was no agreement to which the vendor shareholders were parties relating to events that might take place after the sale had been effected but the purchaser carried out a dividend stripping operation in regard to the company. It was held unanimously that section 260 of the Australian Act did not apply in these circumstances. Barwick C.J. summed up the matter in this way :

> "By no manner of torture of the language of the decided cases would the sale of the shares by the appellants . . . fall within the operation of section 260 of the Act."[63]

[58] (1976) 6 A.T.R. 504 at p. 520

[59] (1977) 7 A.T.R. 166

[60] *Id.*, at p. 174

[61] (1957) 100 C.L.R. 66

[62] (1977) 7 A.T.R. 166

[63] *Id.*, at p. 168

His Lordship stated that the choice of the form of transaction by which a taxpayer obtains the benefit of his assets is a matter for him and the taxpayer is entitled to choose that form of transaction which will not subject him to tax or subject him to less tax.[64]

Slutzkin's case has therefore further defined the area of operation of section 260 of the Australian Act. It is authority for the proposition that section 260 of the said Act is not applicable in cases of dividend stripping operation where there is a straight out sale of shares by the vendor to the purchaser where the former had neither control nor knowledge of the steps carried out by the purchaser after the sale had taken place. But if it can be shown that there was more than just selling off the shares, section 260 will apply. Thus in *Sachs & Sachs* v. *Federal Commissioner of Taxation*[65], the facts of which were, for all practical purposes, the same as those in *Slutzkin's* case,[66] Hanger C.J. found that two additional steps were part of the arrangement. They were that the company whose shares were sold would lend money to the purchasing company to enable it to make the purchase and that the company would declare a dividend to the purchaser of the shares immediately after the sale was finalized. On the basis of that finding his Honour held that there was a section 260 arrangement. It could not be said that what was involved was merely a sale of shares and nothing else. There was much more to it. In particular there was the fact that immediately after the sale there took place the dividend declaration. Not only was this part of the arrangement but it was also the only event in the whole transaction which, had it taken place before the sale, would have given rise to a tax liability.[67]

In the light of the recent decisions of the Full Bench of the High Court in *Mullens*,[68] *Slutzkin's*[69] and *Cridland's*[70] cases, section 260 of the Australian Act would only apply in the most exceptional circumstances.

As mentioned earlier, it remains to be seen how far the Malaysian courts will accept the 'choice principle' 'as developed by the Australian courts. It is certainly doubtful that the courts will adopt the 'choice principle' as

[64] *Ibid*. Stephen and Aickin JJ. also applied the choice principle on the ground that the vendor is entitled to realize the shares in a way that it is a capital receipt, not falling within the provisions of the Act. Views that were in many respects similar to those of Barwick C.J., Stephen and Aickin JJ. were expressed in *Patcorp Investments Ltd.* v. *Federal Commissioner of Taxation* (1976) 6 A.T.R. 420 by Gibbs J. The decision in *Patcorp's* case together with the other recent Full High Court decisions in *Mullens* 'and *Slutzkin's* cases are the subject of an excellent article by Y.F.R. Grbich, 'What the Three Sisters Did to Section 260' in *Recent Developments in Taxation|Law* (1977) (Monash University/Tax Institute of Australia) Lecture 7.

[65] (1976) 7 A.T.R. 93

[66] (1977) 7 A.T.R. 166

[67] (1976) A.T.R. 93 at p. 100

[68] (1976) 6 A.T.R. 504

[69] (1977) 7 A.T.R. 166

[70] (1977) 8 A.T.R. 169

extended in *Mullens'* and *Slutzkin's* cases. To do so would undermine the effectiveness of section 140 of the Malaysian Act as a general provision designed to combat tax avoidance. It would restrict the scope of operation of section 140 of the said Act by limiting its application to very exceptional circumstances.

Other Limits

In *Cecil Bros. Pty. Ltd.* v. *Federal Commissioner of Taxation*,[71] the Full High Court of Australia held that section 260 of the Australian Act could not apply to defeat or reduce any deduction otherwise truly allowable under section 51(1) of the said Act. In that case, a shoe retailer (Cecil Ltd.) instead of buying their shoes from their normal wholesaler interposed a company (Breckler Ltd.). Breckler Ltd. was owned by the shareholders and the relatives of shareholders in Cecil Ltd. It was an income-splitting device. Breckler bought the stock from the wholesaler, added almost $20,000 and sold it to Cecil Ltd. The Full High Court held that Cecil Bros. could deduct the full price, including the $20,000 under section 51(1) of the Australian Act as it was incurred in producing income and that section 260 of the said Act did not enable the Commissioner to substitute a different price for that actually paid.[72] The principle in *Cecil Bros.'s* case was affirmed and applied by the majority of the Privy Council in *Europa Oil (N.Z.) Ltd. (No.2)* v. *Commissioner of Inland Revenue*.[73] There the majority held that its finding that the moneys in question were deductible under section 111[74] of the then New Zealand Act, as outgoings incurred in obtaining stock-in-trade, was incompatible with the taxpayer's contracts for the supply of the stock-in-trade being liable to avoidance under the New Zealand equivalent of section 260 of the Australian Act. Their Lordships emphasized that it was not for the court to say how much a taxpayer ought to spend in obtaining his income nor to say from whom he should purchase his stock-in-trade.

However, in *Halliwell* v. *Commissioner of Inland Revenue*,[75] a recent New Zealand Supreme Court decision dealing with the sale of assets and the hire of staff by a family trust, involving a dentistry practice, Casey J. analysed the relation of section 108 and section 111 of the then New Zealand Act and said :

[71] (1964) 111 C.L.R. 430

[72] *Id.*, at p. 441. However, with the enactment of s. 31C in the Australian Income Tax Assessment Act 1936 (Cth.), it is now possible for the Commissioner of Taxation to apportion purchases of trading stock to reflect its true price where the Commissioner of Taxation is satisfied that the parties are not dealing with each other at arm's length and that the purchase price exceeded that which would have been payable on the open market.

[73] [1976] 1 N.Z.L.R. 546; [1976] 1 W.L.R. 464

[74] Now s. 104 of the New Zealand Income Tax Act 1976

[75] [1978] 1 N.Z.L.R. 363

> "Where the need for the expenditure can be regarded as a normal incident of the business or undertaking forming the source of the taxpayer's income, then he may select his own means of incurring it, and may spend what he thinks fit — so long as that expenditure conforms with section 111, it cannot be attacked under section 108. But section 108 can still apply where the need for such expenditure has been contrived in an existing source of income, as part of an arrangement having tax avoidance as one of its main purposes and which is not a usual business or family dealing."[76]

It is hoped that the Malaysian courts would not follow Australian and New Zealand decisions without a critical examination of the criteria used to arrive at their decisions. Despite an expense falling legitimately under section 33(1)[77] of the Malaysian Act such an expense may be set aside by virtue of section 140(6) of the said Act if the relationship between purchaser and vendor are not at arm's length.

Another limitation to be noted may be traced to one of the propositions that the privy Council in *Europa Oil (N.Z.) Ltd. (No. 2)* v. *Commissioner of Inland Revenue*[78] laid down as applying to section 108 of the then New Zealand Act. The Board said :

> "The section does not strike at new sources of income or restrict the right of the taxpayer to arrange his affairs in relation to income from a new source in such a way as to attract the least possible liability to tax. Nor does it prevent the taxpayer from parting with a source of income."[79]

However, this 'new source' limitation is not supported by reasoning or authority. Moreover, there are difficulties in its application. Some of the nagging questions that come to mind are what is meant by a "source of income"? How drastic a change has to be made to existing revenue in order that subsequent income may be said to be "new"? Thus it remains to be seen what guidelines future courts will establish as applying to the "new source" principle.

Transactions Not At Arm's Length

Under section 140(6) of the Malaysian Act, where the Director-General is of the opinion that a transaction is

(i) between persons one of whom has control over the other; or

[76] *Id.*, at p. 372

[77] This is the general deductibility section in the Malaysian Income Tax Act, 1967 which provides for the deduction of 'all outgoings and expenses wholly and exclusively incurred [during the relevant period by a person] in the production of gross income.'

[78] [1976] 1 N.Z.L.R. 546; [1971] 1 W.L.R. 464

[79] *Id.*, at p. 556; at p. 475

(ii) between individuals who are relatives[80] of each other; or

(iii) between persons who are both under the control of some other person;

he may, if he is satisfied that the transaction is not at arm's-length, deem such a transaction as one falling within section 140(1).

A corresponding though not identical provision can be found in section 103(1)(b)(ii) of the South African Income Tax Act, 1962 (as amended). In the United Kingdom Income and Corporation Taxes Act, 1970, section 485(1) provides that:

> Where any property is sold and —
>
> (a) the buyer is a body of persons over whom the seller has control or the seller is a body of persons over whom the buyer has control or both the seller and the buyer are bodies of persons and some other person has control over both of them; and
>
> (b) the property is sold at a price less than the price which it might have been expected to fetch if the parties to the transaction had been independent persons dealing at arm's length, then in computing the income, profits or losses of the seller for tax purposes, the like consequences shall ensue as would have ensued if the property had been sold for the price which it would have fetched if the transaction had been a transaction between independent persons dealing as aforesaid.

Section 140(6)(a) of the Malaysian Act would clearly apply to cases in which a trading company sells at too low or too high a price to an associated company. For example, in the case of a dividend-stripping transaction, securities are purchased and sold at prices well above or below the market values with a view to creating a profit in one company and a loss in another. Such a transaction would not be one which independent persons engaged in a similar activity at arm's-length would make.

Thus in ***Petrotim Securities Ltd.*** v. ***Ayres***,[81] the appellant company carried on the trade of dealers in securities. In early 1959 the appellant company sold for £205,000 some investments which it held as a trading stock to Ridge Security Ltd. of which it was an almost wholly-owned subsidiary; the investments at the dates of sale had a realisable market value of £835,505 (the X transactions). On March 16, 1959 the company purchased some War

80 'Relative' is defined in s. 140(8) to mean a parent, a child (including a step-child and a child adopted in accordance with any law), a brother, a sister, an uncle and aunt, a nephew, a niece, a cousin, an ancestor or a lineal descendant.

81 [1964] 1 All E.R. 269

Loans stock for £104,769, and on March 20, 1959, it sold this security for £10,000 to Black Heath Ltd., which was indirectly a wholly owned subsidiary of Ridge Securities Ltd., the market value on that date being £105,525 (the Y transaction). On March 25, 1959 the company ceased to trade. The company appealed against an assessment to income tax under schedule D for the year 1958 — 1959 in respect of its trade as financier, and claimed relief under what are now sections 168 and 174 of the Income and Corporation Taxes Act, 1970 in respect of a trading loss arrived at by including the X and Y transactions on the basis of the prices realised. It was held by the Court of Appeal that the Special Commissioners were justified in concluding that the transactions were not trading transactions. Lord Denning stated :

> "It seems to me that, when there is a sale at a gross under-value by one associated company to another, the Commissioner are entitled to find that it is not a transaction made in the course of trade. Whoever would suppose that any trader in his right senses would enter into transactions of this kind, that he would sell at a gross under-value, were it not that he had in mind some benefit out of making a loss? It is just on par with a case where a company gives its money away. You might indeed say here that £630,000 was given away by the Company in X transactions. It could have realised the securities for £835,000, but it chose to sell them for £205,000. Such a transaction is so outside the ordinary course of business of any trader that the Commissioners were entitled to find that it was not done in the course of trade."[82]

Similarly in *Ridge Securities Ltd.* v. *Inland Revenue Commissioner*[83], Pennycuick J. said :

> "No doubt, where one finds an arm's-length purchase and an arm's-length sale with a dividend strip-interposed, these transactions are to be treated as in the course of the trade of a dealer; but where, as here, the transactions as planned from their inception include a transaction which is not in accordance with the normal usage of the trade — i.e.; a sale at much less than the market value — the Commissioners are, I think, fully justified in treating the transactions as a whole as not being in the course of trade. They cannot be obliged to treat the purchase and strip as in the course of trade and then adjust the sale so as to equate the whole transaction to a transaction in the course of trade."[84]

In a South African case,[85] the taxpayer's estate was then worth about £125,000 and he considered it advisable to arrange his affairs in such a way as to minimize the effect of estate duty in case he should die. Accordingly he entered into a series of transactions involving companies registered in

[82] *Id.*, at pp. 272—273

[83] [1964] 1 All E.R. 275

[84] *Id.*, at pp. 285—286

[85] I.T.C. No. 1113; 30 S.A.T.C. 8

Northern Rhodesia and in South West Africa and claimed that the transfer of his South African assets to those countries was for the purpose of avoiding estate duty and not for the purpose of avoiding or postponing liability for tax on income. The Special Court upheld the contention of the Secretary that a provision[86] equivalent to section 103 of the South African Income Tax Act, 1962 applied. The Special Court drew attention to several features of the transaction which were not normal and which would not have been incorporated in a similar agreement entered into by ordinary businessmen. The court remarked upon the fact that the taxpayer had transferred rights to a company which had no assets whatsoever other than the rights which had been ceded. Also the taxpayer demanded no security for the performance by the company of its obligations towards him. Another abnormal feature appeared to the Court to be that the taxpayer stipulated for no fixed rate of interest on the purchase price while it remained unpaid. The Court considered that an ordinary businessman would not leave the rate of interest undetermined and subject to further agreement. The Court considered that the making of this agreement in this instance did not seem to be the action of a normal businessman. Such a scheme would fall within section 140(6)(a) of the Malaysian Act being one which no independent persons engaged in a similar activity at arm's-length would have made.

The word 'arm's-length' transaction was defined by Cattanach J. in the Canadian case of *Minister of National Revenue* v. *Merritt Estate*[87] who said :

> ". . . where the 'mind' by which the bargaining is directed on behalf of one party to a contract is the same 'mind' that directs the bargaining on behalf of the other party, it cannot be said that the parties are dealing at arm's-length. In other words, where evidence reveals that the same person was 'dictating' the terms of the bargain on behalf of both parties, it cannot be said that the parties were dealing at arm's-length . . ."[88]

However, it is submitted that if the transaction constitutes a genuine bargain then section 140(6)(a) of the Malaysian Act would not apply. As Lord Wright said in *Craddock* v. *Zevo Finance Ltd.*:[89]

> "It is admitted, and is found by the Commissioners, that there was a genuine bargain, neither colourable nor fraudulent, as between the two companies concerned, which were separate entities . . . No authority was cited for the claim of the Revenue in a case like this to go behind the agreed consideration and substitute a different figure . . . The transaction here being a perfectly straightfor-

[86]The case was based on s. 90 (as amended) of Act No. 31 of 1941 which was similar to s. 103 of the Income Tax Act, 1962 (as amended).

[87]69 D.T.C. 5159

[88]*Id.*, at p. 5165

[89](1946) 27 T.C. 267 at p. 289

ward and honest bargain between the two companies, it seems to me that, if the present claim were upheld, it would amount to a precedent enabling the Revenue to revise every such bargain and to defeat what the parties had agreed on."

Similarly in *Jacgilden Ltd.* v. *Castle,*[90] A, who was engaged in property development, contracted on March 31, 1959, to buy a hotel at the price of £72,000. He later decided that the property should be acquired by the appellant company, which had been incorporated in May 1959 for the purpose. The only two shareholders were A and his wife. When the time came for him to complete his contract, the vendors, on his instructions, conveyed the hotel to the appellant company at a price of £72,000. The value of the hotel at the date of its acquisition by the company was £150,000. A was not a party to the conveyance.

The company raised the money for its purchase by an overdraft from its bank. In February 1960, the company sold the property for £155,000, and went into liquidation. The company was assessed to income tax for 1959 — 1960 in the sum of £68,930. The company contended that the property should be brought into its profit and loss account at its market value at the date of its acquisition by the company, namely £150,000. The special Commissioners decided that the debit to the company's profit and loss account should be £77,000.

Plowman J. decided in favour of the company holding that the company had purchased the hotel at a price which had been fairly negotiated between A and the vendors. Plowman J. said:[91]

"There is no question of the contract for the sale and purchase of the hotel at £77,000 having been an illusory or colourable or fraudulent transaction: it was a perfectly straightforward and honest bargain between [A] and the vendors."

Section 140(6)(b) of the Malaysian Act would catch transactions such as was found in the case of *Cecil Bros. Ltd.* v. *Federal Commissioner of Taxation*[92] which involved a transaction between the taxpayer and his family company. In this case the taxpayer, who was a footwear merchant, usually bought shoes from a wholesaler. But this method of purchase was abandoned in favour of ordering shoes from Breckler Ltd. a company owned by the shareholders and relatives of shareholders in Cecil Ltd. Breckler bought the trading stock from the wholesaler, added almost £20,000 and sold it to Cecil Ltd. By this means the taxpayer paid almost £20,000 more for its trading stock than if it had dealt with the wholesaler direct. The Court held that the Commissioner could not substitute a different price for the contract price. However, under section 140 of the Malaysian Act the Director-General can disregard such transactions entered into and make

[90] [1969] 3 All E.R. 1110

[91] *Id.*, at p. 1121

[92] (1964) 111 C.L.R. 430

adjustments to reflect the true price of the trading stock where the parties in question are not dealing at arms-length. The present position in Australia would be the same as that under section 140 of the Malaysian Act in view of the enactment of section 31C in the Australian Act which provision authorises the Commissioner of Taxation to set aside the price paid for trading stock where the Commissioner is satisfied that the parties are not dealing with each other at arm's-length and he is further satisfied that the purchase price exceeded that which would have been payable on the open market.

The case of *Cecil Bros.* would also come within section 140(6)(c) of the Malaysian Act since Breckler Ltd. and Cecil Bros Ltd. are controlled by the same set of shareholders. However, it should be noted that under section 140(7) of the said Act where a transaction which is caught by section 140 consists of a settlement on a relative or on a relative and other persons, the interests of the relative under the settlement will not be affected.

It is clear then that under section 140(6) of the Malaysian Act, the yardstick or test to be applied in determining whether the transaction is of the kind to which section 140(l) of the said Act applies, is whether the transaction is made on terms which independent persons engaged in similar activities dealing at arm's-length with each other would make. However, it is submitted that the transaction should not be judged solely by the test noted above. It is an important factor to be taken into consideration, but not necessarily conclusive for the circumstances under which the transaction was entered into or carried out may indicate that it was a genuine and not a colourable transaction. However, it would be otherwise if for example a shareholder, with the object of carrying out a tax avoidance scheme, transfers assets to a company which cannot pay him for them. In such a case the shareholder would be inviting the application of section 140 of the Malaysian Act if he sells them at values below the current market prices since such a transaction would not be one which persons dealing at arm's-length would enter into.

B. The Consequences of the Application of Section 140 of the Income Tax Act, 1967

Once the Director-General is of the view that the transaction has one or more of the effects specified therein, section 140(1) of the Malaysian Act empowers him to disregard or vary the transaction and make adjustments with a view to counter-acting the *whole* or any *part* of any such direct or indirect effect of the transaction. Thus section 140(1) of the Malaysian Act can, besides being used as an annihilating provision, be used by the Director-General either to vary the transaction or make adjustments with a view to counteracting the tax avoidance effect of the transaction. Apart from this power granted in section 140(1) of the Malaysia Act, section 140(2)(a) of the said Act enables the Director-General to

(i) treat the income of a person from any source as the income of another person or

(ii) where the income is that of a controlled company,[93] treat such income as having been distributed to any member[94] of such a company

and under subsection (2)(b) to section 140 of the said Act, the Director-General may

(i) by computing or recomputing taxable income, revise the tax liability of any person or for that matter impose a tax liability on any person

and under subsection (2)(c) to section 140 of the same Act, the Director-General may

(i) raise assessments on any person as is necessary in the circumstances,

(ii) nullify any right to the repayment[95] of tax or may require that any tax already repaid be returned to the Revenue.

Furthermore, acting under subsection (3) to section 140 of the Malaysian Act, the Director-General may

(i) charge any person or persons who, but for adjustments made under section 140, would not be chargeable or who would not be chargeable to the same extent.

[93] A controlled company is defined in s. 2 of the Income Tax Act, 1967 as one which has not more than fifty members and is controlled in the manner described in s. 139 by not more than 5 persons. S. 139 states that a person shall be taken to have control of a company —

'(a) if he exercises or is able to exercise or is entitled to acquire control (whether direct or indirect) over the company's affairs and in particular, without prejudice to the generality of the preceding words, if he possesses or is entitled to acquire the greater part of the share capital or voting power in the company.

(b) if he possesses or is entitled to acquire either —

(i) the greater part of the issued share capital of the company;
(ii) such part of that capital as would, if the whole of the income of the company were in fact distributed to the members, entitle him to receive the greater part of the amount so distributed; or
(iii) such redeemable share capital as would entitled him to receive on its redemption the greater part of the assets which, in the event of a winding up, would be available for distribution among members; or

(c) if in the event of a winding up he would be entitled to the greater part of the assets available for distribution among members.'

Where two or more persons together meet the above conditions they are deemed to have control of the company.

[94] Under s. 139 (7) a 'member' includes, in relation to a company, any person having a share or interest in the capital or income of the company, and for the purposes of s. 139(1) a person shall be treated as entitled to acquire anything which he is entitled to acquire at a future date or will at a future date be entitled to acquire.

[95] In order to recover any tax relating to a repayment already made, the Director-General must issue a notice under s. 140(4) to the relevant person. Such a notice will be treated as a proper notice of assessment for purposes of an appeal.

(ii) charge a greater amount of tax than would be chargeable but for adjustments under section 140.

Section 103(1) of the South African Income Tax Act, 1962 (as amended) contains a substantially similar power of reconstruction as that found in section 140 of the Malaysian Act. Not only is the Secretary under the South African Act entitled to determine the liability to tax 'as if the transaction, operation or scheme had not been entered into or carried out' but he may also do so 'in such manner as in the circumstances of the case he deems appropriate for the prevention or diminution of such avoidance, postponement or reduction.' A case to illustrate this power of reconstruction of the Secretary under the South African Act is *Meyerowitz* v. *Commissioner of Inland Revenue*,[96] a case dealing with section 90 which is re-enacted as the present section 103(1) of the Income Tax Act, 1962 (as amended). In this case, rights to royalties, which the taxpayer would have received for his work and labour in connection with certain books and a certain periodical, were by a donation and then a purchase, transferred from the taxpayer to a trust in favour of his children. Subsequently the trust became a member of a partnership which took over, from a company called 'The Taxpayer (Pty.) Ltd.' in which the taxpayer was a shareholder, the publication of a monthly magazine.

The taxpayer appealed against the judgment of the Income Tax Special Court as it affected the royalties and the Secretary cross-appealed in regard to the profits of the trust from the publication of the magazine. In dealing with the cross appeal, the Court was of the opinion that the power which the former section 90 confers on the Secretary is not limited only to the annihilation of so much of the scheme as is objectionable. According to the Court, this was the interpretation given by the Privy Council in *Newton's* case[97] to section 260 of the Australian Act which renders 'absolutely void as against the Commissioner' any arrangement which has the effect of avoiding liability for tax. The Court pointed out that section 90 (the equivalent to the present section 103(1) was couched in far wider terms than its Australian counterpart. Accordingly, *Newton's* case has no bearing on the words which confer this additional power on the Secretary, namely he can determine the liability to tax 'in such manner as in the circumstances of the case he deems appropriate for the prevention or diminution of such avoidance, postponement or reduction.' Beyers J.A. proceeded to state that the Secretary was entitled to ignore completely the 'Taxpayer (Pty.) Ltd.' company and to hold that the income was truly that of the taxpayer. Thus it was appropriate in the circumstances of the case for the Secretary to have taxed the income from the magazine in the hands of the person to whom it in reality belonged (the court having agreed that the income of the trust was in its entirety the product of the taxpayer's per-

[96] 1963(3) S.A. 863(A.D.); 25 S.A.T.C. 287

[97] (1958) 98 C.L.R. 1; [1958] A.C. 450

sonal labours and that the Revenue was entitled to regard that income as having been diverted by means of an artificial manoeuvre from the taxpayer himself to his minor children who were the beneficiaries of the trust).

If the same facts were to arise in Malaysia, the transaction could be disregarded under section 140(1) of the Malaysian Act and the income of the 'Taxpayer (Pty.) Ltd.' company from the magazine could be treated as in reality belonging to the taxpayer under section 140(2)(a)[98] of the said Act.

In another South African case, *Smith* v. *Commissioner for Inland Revenue*,[99] the taxpayer, a director of companies, held shares in a company. Being aware of the fact that the company had large reserves of profit available for distribution, he entered into a series of transactions for the purpose of avoiding liability to tax on dividends which would otherwise have come into his hands. The Court proceeded to tax the taxpayer on the basis that had it not been for the transactions or operations entered into, the dividends would have come into his hands and he would have been liable to tax thereon. The Court added that although the dividend may not in reality be his income, his effective control of the companies he formed would enable him, at such time as he might consider appropriate, to obtain payment of an equivalent amount to himself, in a form or manner which would render it free from tax or subject to a lesser tax.

If the facts in *Smith's* case were to arise in Malaysia, the Director-General could act under section 140(1) of the Malaysian Act to disregard the transactions entered into, treat the dividends received by the other companies he formed as having been distributed to the taxpayer under section 140(2)(a) of the said Act and accordingly assessed him to tax thereon.

If a comparison is made between section 140 of the Malaysian Act and section 260 of the Australian Act, it is clear that section 140 of the Malaysian Act is couched in far wider terms than its Australian counterparts. Not only is the Director-General empowered to vary or disregard the transaction but he may also 'make such adjustments as he thinks fit with a view to counter-acting the whole or any part of any such direct or indirect effect of the transaction.' The conferment of this additional power on the Director-General enables him to reconstruct the transaction in various ways.

In Australia, on the other hand, the courts have been at pains to point out that section 260 is an annihilating provision only,[1] that is, the section only entitles the Commissioner to disregard the arrangement and the steps taken as part thereof, but does not entitle him to assume or introduce additional facts. The facts which remain after the arrangement has been

[98] 'person' is defined in s. 2 of the Income Tax Act, 1967 to include a company.

[99] 1964 (1) S.A. 324 (A.D.); 26 S.A.T.C. 1

[1] This is also the effect of s. 108 of the then New Zealand Act. The Privy Council in *Europa Oil (N.Z.) Ltd. (No. 2)* v. *Commissioner of Inland Revenue* [1976] 1 N.Z.L.R. 546; [1976] 1 W.L.R. 464 held that the section is not a charging section and if there is no taxable situation disclosed upon the avoidance of the arrangement the Commissioner is unable to construct one.

treated as void must support the assessments raised by the Commissioner against the taxpayers who had sought by way of the arrangement to avoid tax.

In *Bell* v. *Federal Commissioner of Taxation*[2] the Court said:

> "The section is, of course, an annihilating provision only. It has no further or other operation than to eliminate from consideration for tax purposes such contracts, agreements and arrangements as fall within the descriptions it contains. It assists the Commissioner, in a case like the present, only if, when all contracts, agreements and arrangements having such a purpose or effect as the section mentions are obliterated, the facts which remain justify the Commissioner's assessment."[3]

Similarly in *Cecil Bros. Pty. Ltd.* v. *Federal Commissioner of Taxation*,[4] the facts of which were noted earlier, Menzies J. in holding that it was not open to the Commissioner under section 260 of the Australian Act to substitute a different price for that actually paid said:

> "I do not think that section [260] authorises the Commissioner to substitute a different price for that actually paid in accordance with those contracts. Indeed section 260 does not authorise the Commissioner to do anything; it avoids as against the Commissioner arrangements, etc. as specified and so leaves him to assess taxable income and tax on the facts as they appear when the avoided arrangements, etc. are disregarded. Here, it is not revealed that the taxpayer company's real outgoing for its supplies were £19,777 less than the price it paid or that the additional £19,777 was not paid or was a gift to [the family company]. To arrive at any such conclusion would, I think, be an unauthorised reconstruction of what occurred . . ."[5]

This is also the view of the Privy Council in *Newton's* case[6] where their Lordships said :

> "In the words of the courts of Australia, it is an 'annihilating' provision — the Commissioner can use the section so as to ignore the transactions which are caught by it. But the ignoring of the transactions — or the annihilation of them — does not of itself create a liability to tax. In order to make the taxpayers liable, the Commissioner must show that moneys have come into the hands of the taxpayers which the Commissioner is entitled to treat as income derived by them."[7]

[2](1953) 87 C.L.R. 548

[3]*Id.*, at pp. 572—573. See also *Peate* v. *Federal Commissioner of Taxation* (1966) 116 C.L.R. 38 at p. 48

[4](1964) 111 C.L.R. 430

[5]*Id.*, at p. 441. See Fn. 72 at p. 165 above.

[6](1958) 98 C.L.R. 1; [1958] A.C. 450

[7]*Id.*, at p. 10. See also the recent case of *Slutzkin* v. *Federal Commissioner of Taxation* (1977) 7 A.T.R. 166 at p. 169 where Barwick C.J. made a similar observation.

Accordingly, in this respect the position under section 140 of the Malaysian Act is wider than that under section 260 of the Australian Act. Thus if a case based on the facts in *Cecil Bros. Pty. Ltd.* v. *Federal Commissioner of Taxation*,[8] were to arise in Malaysia it would be possible for the Director-General to disregard the transactions entered into and make adjustments by substituting for the contracts to purchase the stock for the agreed amount, contracts to purchase that stock for lesser amounts.

In Australia, there are doubts as to the operation of section 260 as having no more than an avoiding or annihilating effect. In *Peate* v. *Federal Commissioner of Taxation*[9] the decision appears to have been based upon assumptions of hypothetical facts. In this case, the taxpayer, a medical practitioner, had been in partnership with seven others. The partnership was dissolved and each person formed a family company with which each of them contracted to serve and by which each of them was to be paid a salary. Each of these family companies contracted to let the services of each of the practitioners to another company — Westbank Ltd. The Commissioner assessed the taxpayer on the assumptions that the dissolution of the partnership, being part of the arrangement, was void and that the partnership continued to exist and in fact derived the income that was derived by the practising company less certain of the expenses that had been borne by the practising company and the family companies. The majority of the Privy Council upheld this method of assessment and in doing so ascribed to section 260 of the Australian Act more than merely an annihilating effect. It is submitted that the majority's conclusion that a partnership was exposed as one of the real facts remaining after the arrangement in question had been destroyed by section 260 cannot be supported. In the first place, nothing in the facts left exposed indicated that the eight medical practices were carried on in common pursuant to some agreement to that effect express or implied. Secondly, the definition of 'partnership' in section 6 of the Australian Act requires the receipt of income jointly. However, Dr. Peate had received no moneys jointly. Thirdly, if no partnership was made out either on normal principles of partnership or by reference to the definition in the Act, the circumstances of 'a group of persons practising together' as found by the High Court has no significance in relation to tax liability.

Another difference to note between section 140 of the Malaysian Act and section 260 of the Australian Act in respect of their effects, is that under the former, the Director-General is empowered to disregard or vary parts of a transaction or the whole if applicable. Accordingly the Director-General has options open to him. However, in Australia the position is far from clear and the problem posed in regard to section 260 is whether

[8](1964) 111 C.L.R. 430. See p. 165 above.

[9](1966) 116 C.L.R. 38; [1967] 1 A.C. 308. See I.C.F. Spry, *op. cit.*, at pp. 81—85 and Y.F.R. Grbich, *op. cit.*, (1977) at 7:9 — 7:22. See also D.F. Dalton, *op. cit.*, at p. 119 in respect of *Newton's* case (1958) 98 C.L.R. 1 on the reconstruction issue.

the Commissioner is entitled under that section to disregard only part of the 'offending' arrangement. In *Polden & Wilson Pty. Ltd.* v. *Federal Commissioner of Taxation*[10] Mahoney J. was of the opinion that the Commissioner cannot select some part as valid and another part as a nullity. In *Newton's* case,[11] the Privy Council was of the opinion that the Commissioner is entitled to accept some part of the arrangement as valid but ignore another part. The part to be held as valid is the part that did nothing to avoid tax. Thus it was stated:

> "In this case, the Commissioner must accept the arrangement insofar as it had the effect of creating special dividend rights in the original shareholders — for that did nothing to avoid tax."[12]

The part to ignore is, in the case of *Newton,* that part of the arrangement which transferred the dividend rights (with the share) to Pactolus for money — for it was that transaction which gave the character of capital to the money received by the shareholders. But in *Peate* v. *Federal Commissioner of Taxation*[13] as in *Polden & Wilson's* case, the Commissioner's ability to do that was denied in the following terms:

> "He cannot treat some of the arrangements which come within section 260 as void and others not. He is given no option."[14]

How then may the conflicting decisions be reconciled, if at all? N.E. Challoner who brought this conflict to light[15] has offered no solutions or suggestions. It is submitted that conflicting opinions have been arrived at, because of particular facts before the courts or of assigning greater significance to certain parts of the 'arrangements' which have brought the operation of section 260. In other words, parts or steps in the course of an arrangement which are not crucial in the overall plan to avoid tax may be accepted as valid while parts or steps which are crucial to the development of the strategy to avoid tax cannot be held valid but are to be ignored even if by themselves they do not avoid tax. Following from this proposition, it is up to the court to evaluate the facts before them and to isolate parts which are crucial from those which are not. It appears that the more recent tendency is to proceed on the basis that only so much of any arrangement having one or more of the material purposes or effects

[10] (1976) 6 A.T.R. 144 at p. 156

[11] (1958) 98 C.L.R. 1; [1958] A.C. 450

[12] *Id.*, at pp. 10—11; at p. 468. See also (1957) 96 C.L.R. 577 at pp. 632—633

[13] (1966) 116 C.L.R. 38

[14] *Id.*, at p. 44

[15] See his article 'Section 260 — Is Its Demise Complete?' (May 1978) 12 *Taxation in Australia* 668 at p. 670.

is void as would itself be effective to avoid the liability that it has been sought to avoid.[16]

However, sections 140 and 260 of the Malaysian and Australian Acts respectively have one similarity in respect of their effects. The former only empowers the Director-General to disregard or vary the transactions as against him for income tax purposes. It does not enable him to disregard or vary the transactions as between the parties. Similarly, section 260 of the Australian Act avoids the contract, agreement or arrangement only 'as against the Commissioner' and not as between the parties. As the Privy Council in *Newton's* case[17] puts it:

> "What is the effect of section 260 on that arrangement? It is quite clear that nothing is avoided as between the parties but only as against the Commissioner."[18]

CONCLUSION AND RECOMMENDATIONS

From the foregoing discussion and analysis of section 140 of the Malaysian Income Tax Act, 1967 in the light of case law authorities on the Australian and the then New Zealand equivalent to section 140 of the 1967 Act, it is clear that the inherent difficulties, deficiencies and uncertainties pertaining to the scope of the Australian and the then New Zealand provisions[19] are also present in section 140(1) of the 1967 Act. This is in view of the marked similarity in wordings of the scope of the Australian, the then New Zealand and the Malaysian provisions respectively.

Criticisms of both the Australian and the then New Zealand provisions have been made by some members of the judiciary.

In *Newton's* case[20] Kitto J. said:

> "Section 260 is a difficult provision inherited from earlier legislation and long overdue for reform by someone who will take the trouble to analyse his ideas and define his intentions with precision before putting pen to paper."[21]

In *Mangin* v. *Commissioner of Inland Revenue*[22] Lord Wilberforce,

[16] See for example, *Mayfield* v. *Federal Commissioner of Taxation* [No. 1] (1961) 108 C.L.R. 303 at p. 319 and *Federal Commissioner of Taxation* v. *Ellers Motor Sales Pty. Ltd.* (1974) 3 A.T.R. 45

[17] (1958) 98 C.L.R. 1; [1958] A.C. 450

[18] *Id.*, at p. 10; at p. 467. This is also the position under sections 108 and 99 of the then New Zealand Act as amended in 1968 and the present New Zealand Income Tax Act 1976 respectively.

[19] Ss. 260 and 108 of the Australian Income Tax Assessment Act 1936 (Cth.) and the then New Zealand Land and Income Tax Act 1954 (as amended in 1968) respectively. S. 99 of the present New Zealand Income Tax Act 1976 has removed many of these uncertainties and deficiencies.

[20] (1957) 96 C.L.R. 577

[21] *Id.*, at p. 596

[22] [1971] N.Z.L.R. 591; [1971] A.C. 739

speaking of section 108 of the then New Zealand Land and Income Tax Act 1954 (as amended in 1968), made the following points of criticism.

> "If one compares it with more recent examples of legislation, it can be seen, and the decisions show, that it is deficient in a number of respects:-
>
> (a) It fails to define the nature of the liability to tax, avoidance of which is attacked. Is this an accrued liability, a future, but probable liability, or a future hypothetical liability? Is it one which must have arisen but for the arrangement, or which might have arisen but for the arrangement, and if 'might', probably might or ordinarily might or conceivably might?
>
> (b) It fails to specify any circumstances in which arrangements, etc which in fact have fiscal consequence may be outside the section, and, if such, exist, to specify on whom the onus lies, and to the satisfaction of whom, to establish the existence of such circumstances . . .
>
> (c) It fails to specify the relation between the section and other provisions in the Income Tax legislation under which tax reliefs, or exemptions, may be obtained. Is it legitimate to take advantage of these so as to avoid or reduce tax? What if the only purpose is to use them? Is there a distinction between 'proper' tax avoidance and 'improper' tax avoidance? By what sense is this distinction to be perceived?
>
> (d) . . ."[23]

These criticisms levelled against the Australian and the then New Zealand provisions apply equally to section 140(1) of the 1967 Act. While specific criticisms may be directed at particular aspects of section 140(1) of the 1967 Act in the light of those criticisms made of the Australian and the then New Zealand provisions, the most fundamental criticism remains the lack of definition of the object prescribed by the section. The subjective nature of the notion of tax avoidance as the object of a general prohibition in section 140(1) of the 1967 Act would inevitably lead to the result that the section in its operation lacks one element which is socially and commercially essential in a taxing statute: certainty.[24] The term 'tax avoidance' without definition is not functional as the basis of anti-avoidance legislation. As Spry said in respect of the doubts and uncertainties in section 260 of the Australian Income Tax Assessment Act, 1936 (Cth.):

> "Section 260 operates in pursuance of a concept of 'avoidance of the incidence of taxation' and this concept is unfortunately not one that can withstand precise analysis. Further, its existence during a long period has been a matter of considerable concern, not because it has been held to be effective in many cases — the number of cases in which the Commissioner has succeeded through reliance

[23] [1971] N.Z.L.R. 591 at p. 602; [1971] A.C. 739 at pp. 755—756

[24] 'The tax which each individual is bound to pay ought to be certain and not arbitrary': Adam Smith, *Wealth of Nations* Book V, Ch. II at p. 414.

upon it being few — but because it has operated very largely *in terrorem*. It has operated *in terrorem* in the sense that members of the community, who have sometimes been concerned with legitimate minimization of future taxation liabilities and who sometimes have been concerned with common commercial transactions, have often experienced considerable uncertainty and apprehension lest a provision expressed in ambiguous and imprecise terms might subsequently be regarded by the Commissioner or held by the courts to be applicable."[25]

One might ask why the Revenue has to resort to general provisions in order to deal with tax avoidance. The classic answer was given by Menzies J. in the leading Australian case of *Peate* v. *Federal Commissioner of Taxation*.[26] His Lordship said:

"It is perhaps inevitable in an acquisitive society that taxation is regarded as a burden from which those who are subject to it will seek to escape by any lawful means that may be found. This is generally called tax avoidance and it is successful if by reason of what is done, what is potentially taxable, is put outside the effective operation of the revenue laws . . . As often as a particular loophole is closed through which it has been discovered that revenue is lost, another is likely to be found, so that as long as it confines itself to stopping gaps the Legislature is always a step behind the reluctant taxpayers and their ingenious advisers. It is not, therefore, surprising that Parliament has sometimes sought to anticipate tax avoidance by general laws rendering ineffectual against the Commissioner arrangements which are not shams but are entered into to avoid taxation obligations that would otherwise in due course be incurred."[27]

Generally, the method of enacting general provisions to deal with tax avoidance has met with disapproval.[28] The *Asprey Report*[29] takes the view that such provisions,

". . . framed in extremely wide and general terms and in language so vague and imprecise that interpretation becomes very difficult [would lead] to inconsistency in their application, with the consequence that liability to taxation becomes to a great degree uncertain and causes dissatisfaction to both the taxpayers and the administration. It has been well said that in fiscal legislation, when the choice lies between general provisions and provisions identifying with precision the kind of transaction which is to be struck at and prescribing with corresponding precision the consequences which are to follow, the second course ought to be chosen."

[25] I.C.F. Spry, 'The High Court Decision in Slutzkin's Case' (1977) 6 *Australian Tax Review* 65 at pp. 67—68

[26] (1964) 111 C.L.R. 443

[27] *Id.*, at p. 445

[28] See Australia, *Full Report of the Taxation Review Committee* (1975) para. 11.5 (hereinafter referred to as the *Asprey Report*) and the United Kingdom, Royal Commission on the Taxation of Profits and Income, *Final Report* (1955) Cmd. 9474, Chapter 32 para. 1027 (hereinafter referred to as the *Radcliffe Commission Report*).

[29] *Op. cit.*

The use of general provisions to deal with tax avoidance has also been criticised[30] on the ground that:

> "A person's liability to pay taxes should be imposed in explicit terms and with the authority of Parliament, . . . this precept is not observed where control of tax avoidance is maintained through the use of some general declaration of principal governing tax avoidance and particularly where the application of that principle . . . is left to . . . some other body. If general . . . provisions are enacted, Parliament does not know when they will be applied or how far they may be extended."

However, it is important to note that there must exist effective anti-avoidance provisions for no modern and effective taxation system can afford to lend itself to wholesale tax avoidance schemes for the following reasons:[31]

(a) loss of revenue to the State.

(b) costly administration at government level to police schemes involving tax avoidance.

(c) shifting of the tax burden from the shoulders of some taxpayers on to the shoulders of others which threatens the equity of the tax system. This will give rise to a sense of injustice and inequality in the breast of those unable to profit by it. Opportunities of tax avoidance are not equal, for it clearly has little practical meaning to salaried and wage-earning taxpayers from whom tax is deducted at source.

(d) the fruitless expenditure of intellectual effort by some of the country's ablest lawyers, accountants and administrators in the economically unproductive tax avoidance battle.

(e) deterioration of tax morality. The widespread practice of tax avoidance may lead to an increase in tax evasion. Taxpayers with little opportunities to practise tax avoidance and seeing others using legal means to reduce their taxes are tempted to employ illegal means to achieve the same result.

Accordingly it is proposed to consider some of the approaches which the writer feels will go some way towards achieving the objective of removing the manifest defects of section 140(1) of the 1967 Act while at the same time preventing the blatant avoidance of tax.

[30] See Canada, *Report of the Royal Commission on Taxation* (1966) Vol. 3 at pp. 553 — 554 (hereinafter referred to as the *Carter Commission Report*).

[31] *Id.*, at pp. 541—542

One approach would be to supplement section 140 of the 1967 Act with more specific provisions which identify with precision the kind of transaction that is to be struck at and prescribe with corresponding precision the consequences that are to follow for the purpose of tax assessment. By this method the provisions enacted will be relatively clear and certain in their application and they tend to produce certainty in the law. The *Radcliffe Commission Report* explicitly rejected any depature from the system of detailed legislative control of the various forms of tax avoidance.[32] Such a system ensures that a person's liability to pay taxes is imposed in explicit terms and with the authority of Parliament.[33] The *Radcliffe Commission Report* concluded that the specific provisions in the British tax legislation were adequate to deal with most forms of tax avoidance.

In Australia, the legislature has recently adopted the approach of enacting specific or particularised anti-avoidance provisions to eliminate the causes that gave rise to the exceptions to section 260 of the Australian Act. Sections 103A and 105A which govern public and private company status and the question of sufficient distribution respectively, are recent examples of a trend which started around 1973. Section 46A which deals with dividend stripping and sections 80DA-80F which deal with loss carryovers, are further examples of this trend.

In New Zealand, the use of specific legislation to deal with tax avoidance arrangements, particularly with arrangements involving the formation of family trusts has met with considerable success in recent years.[34]

Similarly in Singapore, the recent approach of the Revenue is to enact specific provisions to deal with the problem of tax avoidance rather than relying on general anti-avoidance provisions.

However, the enactment of specific anti-avoidance provisions to deal with tax avoidance has several disadvantages.

First, since it is impossible to foresee every technique of tax avoidance, specific provisions can be effective only in so far as the legislators and the draftsmen can foresee the possible actions that might be taken by tax avoiders. Invariably, the Revenue will always be one step behind the moves of resourceful tax avoidance advisers.[35]

Second, the use of highly particularized language assists the potential tax avoider 'because it defines for him the obstacle that he must be ingenious enough to get around.''[36] The United Kingdom Commission was

[32]See *Radcliffe Commission Report, op.cit.*, paras. 1024—1027. The *Asprey Report, op.cit.*, in para 11.5 also favours the enactment of specific anti-avoidance provisions to deal with the various forms of tax avoidance.

[33]*Radcliffe Commission Report, op. cit.*, para. 1026

[34]See 'Problems and Recent Developments in Dealing with Tax Avoidance' a paper presented by the New Zealand delegates at the 8th Meeting of the *Study Group on Asian Tax Administration and Research*, held at Wellington, New Zealand on 12—17 November 1978. (Library, Department of Inland Revenue, Kuala Lumpur).

[35]See *Carter Commission Report, op. cit.*, at p. 554

[36]See *Radcliffe Commission Report, op. cit.*, para. 1023

critical of the tendency of draftsmen, in order to meet this problem, to cast statutory provisions in language that is more and more vague and imprecise in the hope of covering some unforeseen situation.[37]

Third, legislation aimed at specific avoidance often opens new loopholes. That is, particularization breeds avoidance.[38] This is because particularization in a statute leaves less room for the play of judicial interpretation and hence, while a particular device is eliminated, avoidance in general is not decreased.

Fourth, the draftsmen of specific anti-avoidance provisions may attempt to 'cast his net very wide' and 'thereby reach situations never intended to be reached.'[39] Moreover, since the language of the statute is so specific, it is impossible for the court to afford relief through interpretation, for as the specificity of the statute increases, the room for interpretation must contract.[40]

Fifth, specific anti-avoidance legislation is often couched in 'tortuous and obscure language of unrivalled complexity and difficulty.'[41]

Nevertheless, it is submitted that the approach of enacting specific anti-avoidance provisions is still to be preferred for its disadvantages cannot override the fact that taxation legislation is of the highest importance both to members of the community generally and to those entering into commercial transactions in particular, and it is most desirable that it should be expressed with reasonable certainty so that it may be known what consequences will ensue if particular courses of action are taken or not taken. Accordingly, ambiguous provisions directed towards an undefined concept of tax avoidance ought not to be relied upon so as to overcome drafting deficiencies which might or might not be thought to exist. Should it be determined that specific anti-avoidance provisions are inadequate, they can be amended or buttressed with more general ones.[42]

Another approach, which seeks to give clarity and certainty to the law, is to give effect to the decisions that have been given in some of the Australian and New Zealand decided cases[43] as well as the meanings given to some of the terms in the section by these cases. Such an approach involves the amendment of section 140(1) of the 1967 Act and serves the purpose — highly desirable in this area — of reducing the uncertainties inherent

[37] *Ibid.*

[38] See *Carter Commission Report, op.cit.*, at p. 554

[39] *Id.*, at p. 555

[40] *Ibid.*

[41] *Id.*, at p. 556

[42] For example the Canadian Income Tax Act, 1971, s. 15(1) and s. 245(2) and the United Kingdom Income and Corporation Taxes Act, 1970 ss. 460—461

[43] For example *Newton* v. *Federal Commissioner of Taxation* (1958) 98 C.L.R. 1; [1958] A.C. 450; *Elmiger* v. *Commissioner of Inland Revenue* [1967] N.Z.L.R. 161

in a general anti-avoidance provision such as section 140 of the 1967 Act. The New Zealand legislature adopted this approach in 1974 when an entirely new section was substituted for section 108 of the then New Zealand Act. The new section was in a different and substantially more elaborate form than previous sections and the provision which now corresponds with it is section 99 of the New Zealand Income Tax Act 1976.[44]

Under section 99 of the 1976 Act, the definitions of 'arrangement' and 'liability' closely follow the meanings given to the terms in the decided cases and 'tax avoidance' is a compendious expression including the alteration of the incidence of tax, relieving from liability for tax and avoiding, reducing or postponing liability to tax. Under this section, it is not necessary for tax avoidance to be the sole or principal purpose or effect of the arrangement. It is sufficient if it is a minor purpose or effect so long as it is not a 'merely incidental purpose or effect.'[45] This is further emphasised by the express statement that where there is a tax avoidance purpose or effect present other than a merely incidental purpose or effect, the arrangement is void whether or not other purposes or effects are referable to ordinary business or family dealing.[46] A clause incorporating the above New Zealand position could be inserted into section 140 of the 1967 Act.

Furthermore, a clause may be inserted into section 140 of the 1967 Act to the effect that, in determining whether a transaction comes within the scope of that section, the actual steps employed in carrying out the transaction should be compared with the steps normally used by a reasonable man to achieve substantially the same non-tax objectives of the transaction. Such a provision will help in determining whether the effects specified in section 140(1) of the 1967 Act have been brought about by a transaction implemented by artificial means.

Furthermore, in view of the limitation placed by the 'choice principle' on the operation of the scope of the Australian equivalent to section 140(1) of the 1967 Act, a clause could be inserted into section 140 of the 1967 Act to provide expressly that the section shall override all the other provisions in the 1967 Act.

This approach should retain the method of conferring discretionary powers[47] on the Director-General of Inland Revenue to determine whether a particular transaction comes wihtin the scope of section 140 of the 1967 Act as well as to make the necessary adjustments to counter-act the avoidance of liability in question. It is submitted that the use of discretion serves as the only practical instrument available to obviate an unjust result. There is frequently such a very fine line to be drawn between those transactions which offend and those which merit no condemnation that clear

[44] Hereinafter referred to as 'the 1976 Act'

[45] S. 99(1)(b) of the 1976 Act

[46] *Ibid*.

[47] In Australia, there are a number of provisions in the Australian Act which take the form of discretionary power in the hands of the Commissioner of Taxation such as ss. 46A and 80DA—80F.

defination in statutory terms cannot be satisfactorily achieved. To set forth in detail in the statute all the circumstances and factors that would regulate the exercise of the discretion is clearly out of the question. Some guidelines for the Director-General to exercise his discretion there may be but to confine it within rigid limits is in effect to destroy the discretion.

Although there can be no doubt that precise laws and simple administrative procedures are the best means to minimize tax avoidance, it is not always possible to enact legislation to cope with tax avoidance in language that fulfils the ideals of simplicity and precision. The *Asprey Report*[48] gave the reasons as follows;

> "Firstly, most provisions of a taxation statute have an application to so many sets of circumstances of infinite variety that to attain an adequate coverage of all of them necessitates the employment of wording that is correspondingly extensive. Secondly, the ingenuity and complexity of the procedures to be found in the many and varied schemes of tax avoidance compel the use of measures that are sufficiently wide to counter them, and precision usually sits uncomfortably with width of expression. Thirdly, it must also be recognised that in framing legislation sufficiently all-embracing to deter tax avoidance, there is always the danger of penalising those who have a genuine reason for entering into a bona fide transaction which, if carried out by others, has the objective that ought to be prevented . . ."

Accordingly, recourse must be had to an administrative discretion. The conferment of discretionary powers on the Director-General does not mean that such powers can be abused or exercised arbitrarily. As interpreted by the courts, such powers are subjected to some form of control.[49] Even if they are exercised improperly, there are several avenues of redress available to an aggrieved taxpayer.[50]

However, it cannot be denied that a discretion, even if exercised validly and properly, can be exercised in favour of one person but against another on facts and circumstances essentially similar in both situations. It has been suggested by Professor Davis[51] that such inconsistencies can be avoided by 'confining' and 'structuring' discretionary power. By 'confining' discretionary power, Davis means the keeping of such power within the designated boundaries, and by 'structuring' he means the regularizing and organizing of the exercise of the power whereby a control on the manner of its exer-

[48] *Op.cit.*, para 11.6

[49] See *M.P. Industries Ltd. v. Income Tax Officer* A.I.R. 1970 S.C. 1011; *Sheo Nath Singh v. Appellate Assistant Commissioner of Income Tax* A.I.R. 1971 S.C. 2451; *S. Narayanappa & Ors. v. Commissioner of Income Tax* A.I.R. 1967 S.C. 523; *Giris Pty Ltd. v. F.C.T.* (1969) 119 C.L.R. 365; *Avon Downs Pty Ltd. v. F.C.T.* (1949) 78 C.L.R. 353

[50] Such as the process of objection, review and appeal provided for under the Income Tax Act, 1967 and the prerogative orders of mandamus, certiorari, declaration and prohibition provided for under the Courts of Judicature Act, 1964.

[51] K.C. Davis, *Discretionary Justice — A Preliminary Inquiry* (1969)

cise can be maintained. Davis suggests as one of the methods of realizing these objectives, the use of administrative rule making, that is, making rules to govern the limits and the manner of the exercise of discretion by the relevant authority, in this instance, by the Director-General. Further methods suggested by Davis are open policy statements and open reasons. Openness, concludes Davis, is the natural enemy of arbitrariness and a natural ally in the fight against injustice.[52]

Another approach to deal with tax avoidance would be to enact retrospective legislation to catch transactions entered into before the law is enacted. This would appear to be the most effective method in dealing with tax avoidance. Although there is an abhorrence of retrospective legislation, this abhorrence must be balanced against the undesirability of blatant tax avoidance.

It should be noted that both the specific provisions approach and the amendment approach discussed above, suffer from a fundamental weakness as neither guarantees immunity from judicial invasion. Ingenious taxpayers and their advisers, and sympathetic members of the judiciary, will always find ways of developing exceptions to legislation forbidding tax avoidance.

One must recognise the fact that the task of combating tax avoidance effectively cannot solely be the job of the legislature. It is equally the task of the judiciary and the legal profession. Anti-avoidance measures, whether specific or general, cannot by themselves solve the problem of tax avoidance.

As the courts exercise considerable discretion, and therefore rule-making power, they can play a useful role in the battle against tax avoidance. Courts must recognise the fact that tax avoidance is a means by which the affluent and articulate members of the community exploit the complexities of the tax Act to shift the burden of tax on to those less able to bear it. This is inequitable to those taxpayers who do not have the ability or opportunity to practise tax avoidance. A progressive taxation system that seeks to bring to charge the income of each individual upon an ascending scale of tax rate should operate fairly as between all taxpayers and should tax each person upon the amount of income that was truly and realistically his to receive. Fairness to the whole body of taxpayers demands that this principle should have full application, for the loss to the Revenue must be recouped from those who are unable to practise it.

That being the case, the courts in deciding a dispute under section 140 of the 1967 Act must not regard the section as a weapon of the Revenue to undermine judicial protection of the subject but rather as a device to ensure that the shrewd and powerful members of the community do not exploit that section of the community who are unable to practise tax avoidance. It is submitted that section 140 of the 1967 Act seeks to ensure that the complexities of the Tax Act are not the means by which the affluent and articulate members of the community throw a disproportionate

[52] *Id.*, at pp. 97—98.

burden on other sections of the community. It is those taxpayers who are unable to practise tax avoidance that bear the brunt of the consequences of tax avoidance. Accordingly, the courts must pursue faithfully the legislative objectives of anti-avoidance legislation by giving content to the intent communicated in the statutory words of the legislation and bring devices designed to escape them into the tax net.

Lawyers, as members of the legal profession, also have an important role to play in the battle against tax avoidance. They can help in combating tax avoidance in two ways. First, they must recognise the fact that by offering their services for tax avoidance to the affluent and powerful, they are helping the latter to exploit effectively the weaknesses of the tax system to the disadvantage of the other members of the community. Lawyers must not forget that the tax system is attempting to hold a balance between the rights of a tax avoider and other members of the community. By facilitating tax avoidance, lawyers are making available their services to only a small portion of the community who can afford it. In consequence, the role of the legal profession in tax avoidance is socially divisive rather than cohesive. To avoid such a result, lawyers must re-define their whole attitude towards the socially and economically unproductive activity of tax avoidance. They must discard the traditional attitude that it is not a lawyer's job to judge his client, that he must offer his services to any person proferring the proper fee, that provided he acts legally the morality of his client is not his business and that he has no business in imposing his value judgments on society or on his client. To discard this attitude, lawyers must view their role in a different perspective by playing a more responsible role in balancing the competing values and demands of the various groups such that the inequity which exists between them stands corrected.

Secondly, lawyers must realise that they have considerable influence on community attitudes. Being the experts in the tax area and among the few who understand the complex system, they have a powerful influence on the formation of community attitudes to tax avoidance. Being the more articulate members of society, they can, if they choose, expose the erosion of the progressive taxation system by tax avoidance to the electorate. Lawyers are far more than appliers of legislative rules. In many areas they effectively create the rules and their actions do have an impact on the social system they work in.

From the foregoing discussion, it is clear that the scope of section 140 of the 1967 Act suffers from several deficiencies. One method to overcome these deficiencies would be to make amendments to the section. Alternatively, specific anti-avoidance provisions may be enacted to be buttressed by more general provisions should they proved to be inadequate subsequently. However, it is equally clear that the task of combating tax avoidance effectively cannot lie solely with the legislature in either amending section 140 of the 1967 Act or in enacting specific anti-avoidance provisions. The

task is as much one of the legal profession and specifically the judiciary, as it is one of the legislature.

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