



Australian Government
Australian Taxation Office

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Our reference:

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Income Tax: Application of Part IVA of the *Income Tax Assessment Act 1936*

Dear Ms Julia Hartman,

Thank you for your email to [REDACTED] dated 4 November 2012.

As I understand it, what you seek is a clear set of rules as to what your clients can or cannot do in regard to certain financial arrangements. At the outset I should explain that it is not for the Commissioner of Taxation to tell taxpayers how to spend their money. Nor does the Commissioner generally determine whether expenditure is deductible. If expenditure is incurred in gaining or producing assessable income and not capital in character, it is deductible. That is a general proposition which resists subdivision into more specific rules. Nonetheless, we understand that your enquiry is really directed to the question of whether specific kinds of action by taxpayers will attract the operation of Part IVA.

As was explained to you at your recent meeting, the nature of the legal tests set out in Part IVA of the *Income Tax Assessment Act 1936* (the Act) is such that it too resists subdivision into specific rules. It is a purpose-based test. That test requires that careful consideration be given to the precise facts and circumstances of each situation with a view to determining the purpose of each person involved in it. The Part also requires a weighing of various factors, which can only be undertaken in the individual context of each situation. No one feature alone is necessarily decisive; small distinctions of fact may make a considerable difference to the outcome. Thus, quite similar yet distinct schemes may result in different conclusions of purpose. The definition of 'tax benefit' is also such as to be sensitive to small differences. Consequently, in the absence of individual facts and circumstances it is not possible to set out a definitive answer, in a rule based form, as to whether the Part will apply or will not apply to a kind of action or transaction.

This limitation on the provision of definitive general answers can be seen in Taxation Determination TD 2012/1. As is apparent from both the ruling and explanation parts of that Determination, it is the presence of a combination of factors which, when weighed up, indicate whether a taxpayer has obtained a tax benefit in connection with a scheme and their dominant purpose for entering into or carrying out the scheme. The absence of a particular factor, or factors, identified in TD 2012/1 would not necessarily mean that Part IVA did not apply. Nor does the presence of a particular factor compel the conclusion that it does.

The questions you ask relate to transactions that, on any view, are strongly influenced by taxation considerations. Such transactions tend to lie close to the border where Part IVA applies. When taxation considerations constitute at least a substantial purpose of a taxpayer, it is practically inevitable that Part IVA must be considered and cannot simply be ruled out or in.

However, I offer the following observation. There appeared to be a theme to some of your questions: they dealt with an unexpected change in circumstances. In determining whether there is a scheme to which Part IVA applies it will often be necessary to consider whether there has been an unexpected substantial change in the taxpayer's financial situation. For example:

- if a taxpayer has an unexpected illness that means that they can no longer use their salary to pay the difference between the interest on their investment loan and the rent from the investment property, then the taking out of a line of credit to fund this difference would generally be viewed as weighing against there being a scheme to which Part IVA applied, particularly if the use of the line of credit ceased once the taxpayer went back to work; or
- if it was necessary for a taxpayer to make unexpected repairs to their rental property which they were unable to fund from non-loan sources, then the taking out of a line of credit to fund the repairs would generally be viewed as weighing against there being a scheme to which Part IVA applied.

I trust this clarifies the situation. If you have any questions or concerns in respect of any matters currently with the ATO, please contact [REDACTED].

Yours sincerely

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