

JOINT SUBMISSION BY

The Institute of Chartered Accountants in Australia, The Tax Institute,
the Institute of Public Accountants, CPA Australia
and Taxpayers Australia

Draft Taxation Determination TD 2011/D8

Income tax: does a taxpayer's purpose of 'paying their home loan off sooner' mean that Part IVA of the Income Tax Assessment Act 1936 cannot apply to an 'investment loan interest payment arrangement' of the type described in this Taxation Determination?

Date: 29 July 2011

The Professional Bodies welcome the opportunity to comment on Draft Taxation Determination TD 2011/D8 ("the Draft Determination").

GENERAL COMMENTS

The Professional Bodies generally agree with the position taken by the Commissioner in the Draft Determination.

The Commissioner's position that the investment loan interest payment arrangement (as described in the Draft Determination) may attract the operation of Part IVA of the *Income Tax Assessment Act 1936* (Cth) (*ITAA 1936*) is supported by the decision in *FCT v Hart & Anor* [2004] HCA 26 ("Hart's case") in which Part IVA applied to the taxpayer's split loan arrangement.

We agree that a taxpayer's objective purpose of wanting to 'pay off their home loan sooner' may not be considered to be the dominant purpose of entering such arrangements and that regard must be had to the factors set out in section 177D of the *ITAA 1936*.

While we agree that Part IVA may apply where the dominant purpose of the arrangement is to convert non-deductible interest into deductible amounts, we consider the particular facts and circumstances of each arrangement must be considered on its own merits in applying Part IVA.

In particular, we do not believe that Part IVA should apply in circumstances where loan arrangements are appropriately setup for legitimate purposes, such as maximising leverage on income producing items where the arrangement is not entered into for the dominant purpose of obtaining a tax benefit.

For example, we would expect that if a taxpayer has borrowed funds to acquire shares and subsequently borrows additional funds to acquire a home, then the fact that a bank may allow the taxpayer pay off the home loan account and just accrue the interest on the investment account should not attract the operation of Part IVA.

In this regard, we note that Counsel for the ATO ("Mr Shaw") acknowledged that Part IVA should not apply in such a case in the course of the hearing for Hart's case - see the transcript extract below (emphasis added):

McHUGH J: ... Let me put this to you. Supposing I have two accounts with the bank – I have two loans, one is on a home property, one is on an investment property – and the bank is quite happy for me to pay off the home loan account and just lets interest accrue on the business investment account. Now you would get exactly the same result as in this case, would you not, and you would have no complaint?

MR SHAW: Well, it depends on what your Honour means about result, but as to the question, we would have no complaint, the answer is, yes, we would not have any complaint.

McHUGH J: Well, what is the difference in substance?

MR SHAW: Your Honour will recall that in your Honour's separate agreeing judgment in *Spotless* – if that is the right way to describe it - your Honour said - - -

McHUGH J: Justice Gyles, I know, has called it *Delphic*.

MR SHAW: Your Honour said, the fact that you have a tax benefit is not enough to mean that Part IVA applies. You have to have a lot more than that, and the mere variation of an investment, for example, is unlikely to bring Part IVA into operation. What your Honour said was, you have to look at all the factors which are enumerated in 177D(b) and see what the effect of all of those is. Your Honour will recall the first factors – and by that I do not mean necessarily the most important, but the first ones mentioned – the manner in which the scheme was entered into, the form and substance of the scheme, the timing of the scheme. There are all sorts of matters which have to be taken into account, which go beyond the mere result.

McHUGH J: I understand that, but if I go along to ANZ or the National Australia Bank and I say, "Look, would you lend me \$202,888 so I can invest it in shares?" and they say, "Yes, that is very good", and I ask, "Could you give me \$95,112 to buy a house?" and they say, "Yes, that is very good", and I say, "Well, look, I am a good customer, do you mind if I pay off the home loan account and you just accrue the interest on the other account?" and they say, "No". Now, what is the matter with that? I can get the deduction for the interest on the investment account. Is that not what has happened in this case?

MR SHAW: Your Honour has asked me a number of questions. The answer to the question, "What is the matter with that?" is "Nothing". The answer to the question, "Is this different?" [i.e. the Hart situation] is "Yes".