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AUSTRALIAN TAX ADVISER

2505 : NOVEMBER 2024

The IFX Legal Tax Team

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SECTION 1 – PROFESSIONAL DEVELOPMENT

TAX EVASION, TAX AVOIDANCE AND 'TAX AVOISION'

At one time, the distinction between tax avoidance and tax evasion was relatively clear: the first was legally permissible, whilst the second was not. In more recent times however, there has been a blurring of these two concepts,[1] mainly because the use of tax planning (particularly international tax planning) became more and more widespread.[2]

The term 'tax avoision' is a term that was coined to mean the grey area between tax avoidance and tax evasion. The confusion surrounding this concept has even caused some tax officers to use terms such as 'compliance' and 'noncompliance', rather than trying to explain and counter 'tax avoision'.

Originally, the strategy of 'tax avoidance' was perfectly legitimate and involved reducing one's tax by employing legitimate methods or 'schemes'. It simply involved paying less tax than would normally be the case had the strategy not been implemented (see, for example, *FCT v. Westgarth*[3]).

This process was sometimes also referred to as 'tax minimisation' or 'legitimate tax planning'. Most taxpayers have probably engaged in some form of tax planning, even though they may not have been aware of it.

In the last few decades, 'tax avoidance' has acquired a distinctively pejorative connotation, leading to some forms of tax avoidance being made illegal under amendments to the provisions of Part IVA of the ITAA36 in 2013. These have shifted the focus towards scrutinising arrangements where the *core substance* of the transaction could have been achieved in a more straightforward or commercial manner. This meant that the emphasis is no longer on merely identifying artificial schemes, rather the focus is now on examining whether a transaction's *form* could have been executed differently so as not to secure the associated tax benefit.

It should come as no surprise then that the practice of negatively geared investments (mostly in real estate) has drawn the attention of the current Labor Government. It is well recognised that those in the highest income bracket can benefit handsomely by investing in properties that are 'negatively geared'.

Through careful planning, taxpayers are able to legally reduce their assessable income by diverting income (that would otherwise be subject to taxation at the highest marginal tax rate) into a legitimate property investment that runs at a loss (i.e. has negative income). The net effect is that a taxpayer's equity in the unprofitable investment is increased while his or her overall income (and therefore tax liability) is reduced.

The object of negative gearing focuses firstly on offsetting gains derived from one source of income against losses incurred from the negatively geared investment on the one hand. Secondly, it focuses on making a capital gain that will only be taxed on half of the capital gain amount. This is sometimes seen as unfair because high income earners can potentially derive more of an advantage from it.

1 Ilersic, Alfred Roman & Seldon, Arthur, 1979. *Tax Avoision: The Economic, Legal and Moral Inter-relationships Between Avoidance and Evasion*. Institute of Economic Affairs.

2 The Labor Government abolished exchange controls in 1983.

3 (1950) 81 CLR 396 at 414.

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