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# Case Note: *Macquarie Bank Limited v Commissioner of Taxation* [2011] FCA 1076

The decision in *Macquarie Bank Limited v Commissioner of Taxation* [2011] FCA 1076 clarifies the operation of Part IVA of the *Income Tax Assessment Act 1936* (**Act**) as it applies to subsidiary members of consolidated groups.

## Facts of the case

An Australian resident company (**Taxpayer**), being a wholly owned subsidiary of a Delaware limited liability company (**Delaware LLC**), commenced an on-market takeover bid for all the issued shares of the listed entity, Minara Resources Limited (previously known as Anaconda Nickel Limited). The Delaware LLC was a member of the MatlinPatterson Group, a US based private equity firm. The target's majority shareholder (Glencore International AC) rejected the takeover offer, resulting in the Taxpayer only acquiring 36% of the target company's shares. The Taxpayer retained the target's shares for an extended period and their value increased substantially during that time, producing a profit in excess of $317m. Macquarie Group approached MatlinPatterson and sought their agreement to act as the Taxpayer's agent to dispose of their interest in the target. The agency arrangement did not eventuate.

Subsequently, Macquarie Group agreed to acquire MatlinPatterson's interests in Delaware LLC for $122m. Macquarie Group also agreed to lend Delaware LLC $317m, which it then distributed to its shareholders as capital profits. This reflected the underlying increase in the target's shares, which its subsidiary owned. In all, the Delaware LLC shareholders received back their initial investment plus the profit of $277m they made during the holding period.

Macquarie Group is a consolidated group pursuant to the *Income Tax Assessment Act 1997* (**1997 Act**), with Macquarie Bank Limited (**MBL**) as the head company. When Macquarie Group acquired Delaware LLC, its original directors (and those of the Taxpayer) were replaced with MBL nominees who were residents of Australia. For tax purposes, Delaware LLC became an Australian resident. Also, Delaware LLC (and the Taxpayer) automatically became subsidiary members of the Macquarie consolidated group. After this event the Taxpayer then sold its interest in the target. The tax consolidation regime provides that the tax attributes of subsidiaries are assumed by the head company and the group is deemed for tax purposes to be one entity.

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The structure of the transaction meant that Macquarie Group underwrote MatlinPatterson's profit, and Macquarie Group also assumed the commercial risks of selling the target's shares. For these reasons, MatlinPatterson was prepared to share with Macquarie Group some of the profit they otherwise would have earned from the sale of the target's shares. Further, the transaction's structure (which Macquarie Group devised) resulted in the proceeds derived by the vendors of Delaware LLC shares not being subject to Australian tax, because it was a sale by non residents of their respective interests in a non resident company.

MBL, as the head company, included in its assessable income a $40m gain on the transaction, which was substantially greater than what it would have earned if it acted solely as the Taxpayer's agent. This was the amount of profit MatlinPatterson was prepared to share with Macquarie Group.


The Commissioner made two determinations pursuant to section 177F(1)(a) of the Act. In consequence of the determinations he then issued amended assessments to each of the Taxpayer and MBL. The assessments included in each entity's assessable income a purported tax benefit equal to the gain the Taxpayer would have made, had it sold its investment in the target before becoming a subsidiary member of the Macquarie consolidated group.

## Issues

The Commissioner contended that Part IVA of the Act applied. The court noted that the Commissioner's grievance was that the parties availed themselves of the Consolidated Group provisions of Pt 3- 90 of the 1997 Act. In particular, the express provision of the legislation that where a subsidiary member joins a consolidated group, and subsequently disposes of an asset, the subsidiary member is not taxed on the difference between the proceeds and the cost (the profit actually or 'in fact' made by the subsidiary), because of the operation of section 701-1 of the 1997 Act, while the head company is taxed not on the profit 'in fact' made by the subsidiary, but on the economic profit made by the head company (the cost to the head company of the acquisition of the subsidiary is pushed down to become the tax cost setting amount of the asset disposed of by the subsidiary (Div 705)), thus avoiding tax on a substantial portion of the gain on the sale of the target's shares. The Commissioner argued that in the context of the transaction, the result was not a purpose that was consistent with the objects of Pt 3-90 as set out in section 700-10 of the 1997 Act.

The Commissioner submitted that the acquisition of Delaware LLC by Macquarie Group (with the effect that it became a subsidiary member of a consolidated group), the provision of the loan, the change of directors and the subsequent sale by the Taxpayer of the target's shares, was a scheme. The parties to the scheme included MBL, Delaware LLC, the Taxpayer and the vendors of Delaware LLC. The scheme produced a tax benefit to the Taxpayer of around $318m. (This conveniently ignores the fact that Macquarie Group acquired the Taxpayer's holding company (Delaware LLC) for $440m and if this entity had been an Australian resident company, it would have paid tax on any gain.) It was the non resident status of Delaware LLC that is at the heart of this issue.

The Commissioner's counterfactual submission was that, but for the scheme, the Taxpayer would have sold the shares or might reasonably have been expected to have sold the shares in its own right. It would not have sold the shares as a subsidiary member of the Macquarie consolidated group and it would have included the profit (the tax benefit) in its assessable income – which, due to the scheme, was derived in a tax free form by the vendors of Delaware LLC. In the alternative, the Commissioner claimed that MBL had derived the tax benefit in consequence of the scheme.

## Decision

The court rejected the Commissioner's arguments. It held that the Commissioner's counterfactual submission (that is, but for the scheme, it could reasonably have been expected that the Taxpayer would not be part of the consolidated group and *the Taxpayer* would have derived the profit, including it in its assessable income) had the consequence that MBL could never obtain the tax benefit. Therefore, the determination made pursuant to sections 177F(1)(a) & (2) of the Act that MBL had obtained a tax benefit was incorrect.

The court then considered the Commissioner's additional arguments – that he could make a determination, and then raise an amended assessment against the Taxpayer. Alternatively, in raising an amended assessment against MBL, the Commissioner submitted that he was thereby 'giving effect' to his determination that the Taxpayer had derived a tax benefit. Relevant to these matters was whether the operation of the consolidation rules resulted in the Taxpayer **not** being a 'taxpayer', as that term is defined in section 6(1) of the Act. Also, did section 177F allow the Commissioner to make a determination to include a tax benefit as assessable income of a subsidiary member of a consolidated group?

In the present case, the court believed that a determination could be made. However, the court focused on the 'next level' of giving effect to the determination, which can only be achieved by issuing an amended assessment. On this point the court found that, on the facts of the case, it was unlawful for the Commissioner to issue an amended assessment to the Taxpayer, because it was a subsidiary member of the Macquarie consolidated group and, as such, is not a separate entity liable to tax under those provisions.

The court found that Part IVA does not authorise the Commissioner to issue an assessment including an amount in the assessable income of a subsidiary member of a consolidated group. The Commissioner's section 177F power to take 'such action as he considers necessary', is not at large. It is limited to action that gives effect to a determination. A determination under section 177F only informs the calculation of a taxpayer's assessable income on a particular hypothesis; it does not and cannot **authorise** the exclusion of a company from a consolidated group in fact, so as to constitute it an entity liable to tax, nor authorise the Commissioner to disregard section 701-1 and section 701-30 of the 1997 Act and assess the subsidiary member in disregard of those provisions. To do so, the relevant provisions of Part IVA must grant to the Commissioner specifically the power, which they do not.

In respect to the issuing of an amended assessment to MBL to give effect to the Commissioner's section 177F determination, the court held that this position assumed that the Commissioner can issue an assessment to a different taxpayer to the taxpayer the subject of the determination. While accepting that in some limited circumstances this may be possible (for example, making a determination that a tax benefit arises where a trustee omits income and thereby the Commissioner issues an assessment to a beneficiary), the present case was not such a circumstance. The court again held that regard must be had to the counterfactual submission on which the Commissioner's case was founded. It decided that, to give effect to an anterior determination to include an amount in the assessable income of a taxpayer, it must be factually consistent with the hypothesis upon which that determination is predicated, whether the assessment is issued to the taxpayer referred to in the determination or a different taxpayer. The MBL amended assessment was not factually consistent with the hypothesis upon which the Taxpayer determination was predicated – that the Taxpayer sold the target shares otherwise than as a subsidiary member of the Macquarie consolidated group – therefore it follows that the MBL amended assessment could not and did not give effect to the Commissioner's determination. Accordingly the appeals were allowed.

## Further issues

The court, at the request of the parties, also agreed to consider and determine two further issues, because they may be relevant matters in the event appeal proceedings are initiated. This was on the understanding that it only related to the Commissioner's contention that issuing an amended assessment to MBL gave effect to the determination made in respect of the Taxpayer.

The additional issues involved whether:

- the Taxpayer did obtain the alleged tax benefit in connection with the scheme identified by the Commissioner; and if so, whether,
- any one or more of the parties identified as having entered into or carried out the scheme, or any part of the scheme, did so, having regard to the eight factors in section 177D(b) of the Act, for the dominant purpose of enabling the Taxpayer to obtain a tax benefit.

The court concluded that the Taxpayer had obtained a tax benefit in that, but for the scheme, the Taxpayer would not have become a member of a consolidated group and would have or could reasonably have been expected to have sold the target's shares (under the agency agreement) and included the gain in its assessable income. There was no other course of action that was at that time being pursued by the Taxpayer.

In relation to the dominant purpose issue, the court concluded that, having regard to the eight items in section 177D(b), each of the parties to the scheme did not enter into the scheme with the dominant purpose of enabling the Taxpayer to obtain a tax benefit.

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## Conclusion

The Commissioner's position is commercially illogical. Clearly Macquarie paid virtually full market value for Delaware LLC and its Australian subsidiary. From Macquarie Group's perspective, the tax payable should therefore be limited to the gain made in excess of the cost base derived on disposing of the target's shares. However, the Commissioner seems incensed by the fact that non residents escaped paying tax on the gain they obtained from the disposal of their Australian assets owned through a chain of entities, some of which were non residents.

The Commissioner's approach may form part of a strategy to deal with some private equity transactions that are structured in the manner adopted by MatlinPatterson. However, due to the technical architecture dealing with members of consolidated groups, under current legislation, subsidiary members cannot be subject to tax. The position in relation to groups that are not consolidated, therefore, might be more problematic. Each entity could be the subject of a separate determination, given the approach the court adopted in the case. It suggests that entities forming part of an Australian unconsolidated group may need to consider forming a consolidated group before a transaction, in the nature considered by the court, is undertaken.



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