THE JOURNAL FOR MEMBERS OF THE TAX INSTITUTE

Taxation in Australia

VOL 54(5) NOV 2019

Payroll tax game changer? Optical Superstore decision

Matthew McKee, FTI, Gillian Tam, FTI, and Rose McEvoy

Assessing market value ratios for roll-over relief provision

Hung Chu

SA land tax developments: aggregation avalanche

Peter Slegers, CTA, Joshua Pascale and Daniel Marateo

THE TAX INSTITUTE

Contents

Cover article

Feature articles

Insights from the Institute

Regular columns

Invitation to write

We welcome original contributions that are of interest to tax professionals, lawyers, academics and students.

For details about submitting articles, please see Guidelines for Publication on our website taxinstitute.com.au, or contact deborahpowell@taxinstitute.com.au.

Tax News – at a glance

by TaxCounsel Pty Ltd

October – what happened in tax?

The following points highlight important federal tax developments that occurred during October 2019. A selection of the developments is considered in more detail in the "Tax News – the details" column on page 233 (at the item number indicated).

Israel DTA

On 19 September 2019, the government introduced amending legislation (the Treasury Laws Amendment (International Tax Agreements) Bill 2019) into parliament to give effect to a new tax treaty between Australia and Israel. **See item 1.**

Redundancy payments

The Treasury Laws Amendment (2019 Measures No. 2) Bill 2019, which was introduced into parliament on 18 September 2019, contains amendments to give effect to already announced changes that will assist older Australians and help farmers and tourism operators. **See item 2.**

Commercial debt forgiveness

A recently released draft determination is to the effect that the exclusion from the commercial debt forgiveness rules of debts forgiven for reasons of natural love and affection requires that the creditor be a natural person (TD 2019/D9). **See item 3.**

Superannuation: non-arm's length income amendments

The Commissioner has released a draft law companion ruling that clarifies how the recently enacted amendments to s 295-550 ITAA97 (meaning of non-arm's length income) operate in a scheme where the parties do not deal with each other at arm's length and the trustee of a complying superannuation entity incurs non-arm's length expenditure (or where expenditure is not incurred) in gaining or producing ordinary or statutory income (LCR 2019/D3). **See item 4.**

Employee share trust

The Commissioner has released a draft taxation determination which considers what constitutes an "employee share trust", as defined for the purposes of the employee share scheme provisions of the ITAA97 (TD 2019/D8). **See item 5.**

Transfer pricing record-keeping

The Commissioner has released a revised and updated practical compliance guideline that sets out the simplified transfer pricing record-keeping options that have been developed to minimise the record-keeping for eligible taxpayers (PCG 2017/2). **See item 6.**

GST territorial nexus: intangibles

The Commissioner has released a draft ruling which considers when a supply of anything other than goods or real property (an intangible) is connected with the indirect tax zone under s 9-25(5)(a), (b) and (c) and Div 85 GSTA (GSTR 2019/D2). **See item 7.**

Disclosure of protected information

The Federal Court (White J) has held that the disclosure to the Commissioner of Taxation (or to his legal advisers or a court) by a tax officer of otherwise protected information relating to the affairs of a taxpayer who had brought defamation proceedings against the Commissioner was not prohibited (*Jordan, Commissioner of Taxation v Second Commissioner of Taxation* [2019] FCA 1602). **See item 8.**

Special leave refused

The High Court has refused applications for special leave to appeal from decisions of the Full Federal Court in the following cases:

– *Harding v FCT* [2019] FCAFC 29, in which the Full Federal Court considered aspects of the s 6(1) ITAA36 definition of "resident" as it applies in the case of an individual; and

– *FCT v Resource Capital Fund IV LP* [2019] FCAFC 51, in which the Full Federal Court held that a corporate limited partnership is treated (by virtue of Div 5A ITAA36) as a separate taxable entity for the purposes of the income tax law.

Testamentary trusts

Exposure draft legislation has been released in relation to the 2019 Budget measure that will, from 1 July 2019, ensure that minors are taxed at adult marginal tax rates only in respect of income that a testamentary trust generates from assets of the deceased estate, or the proceeds of the disposal or investment of these assets. The proposed amendments are considered in the Tax Tips column of this issue of the journal **(see page 238).**

President's Report

by Tim Neilson, CTA

Why tax is much more than technical skills

President Tim Neilson on what tax professionals need in their tool belt.

In October, I had the privilege of attending the Victorian Tax Forum and the Tasmanian State Convention. Regrettably, logistical and calendar constraints meant that those two functions were scheduled at the same time, so I didn't get to the whole of either of them. But the parts I attended had a great ambience, and I was impressed with the program, the presentations and that trademark collegiate Tax Institute interaction. Congratulations to all involved.

I noticed that the programs of both events included some sessions that weren't solely about tax technical issues, but dealt at least in part with non-tax considerations. That has also been the case at a number of other Tax Institute events I've been lucky enough to attend this year.

That's a good thing.

We're immensely proud of our great tax technical content, and we're determined to maintain and improve on the technical support we give to our members. But to do their job properly, good tax professionals need a lot of other types of knowledge and skills. At the Institute, we're well aware of that. That's why our events often have sessions dealing with things like family law or estate law considerations when planning for individual clients, or the accounting ramifications of tax issues.

It's also why this year's Women in Tax National Congress (29 November, Sydney) will address a broad range of ways for individuals and organisations to improve high performance. These include the imperative "soft skills" such as interpersonal skills, empathy, and what it takes to be an authentic leader.

And I hope you've all seen information about the 2020 Tax Summit, which will combine the best technical content with other highly relevant and beneficial learning opportunities.

Our planning committees are always thinking about what topics might be useful to attendees at the events, even if those topics aren't strictly tax technical. (Incidentally, if there's anything which you'd like to see at an Institute event — tax technical or non-technical — please tell an Institute staff member, a member of an Institute convention or professional development committee, or a state or national councillor. Member feedback is our very best planning tool.)

There are plenty of other ways in which understanding the non-tax world can be important. Many of you will be aware that both taxi rides and Uber rides are usually taxable supplies for GST purposes, but only taxi rides qualify for FBT exemption for late night travel home by employees. Imposing FBT on Uber rides in those circumstances, virtually doubling the cost, could well inhibit an employer from allowing employees to use Uber as an alternative to a taxi. There's no policy rationale for this — it simply results from the FBT rules having been drafted before Uber existed.

I had thought of this issue only as a silly technical anomaly that, in principle, ought to be fixed, but as not being a big deal. But in the course of the Institute's tax policy and advocacy work, I learned that it had a practical importance, which is why we were pushing for it to be corrected. I was told that some women feel safer ordering an Uber than jumping into the front taxi at a rank (maybe some men do as well!) That hadn't occurred to me, but I certainly wouldn't want to second guess anyone's judgment about their own personal safety.

This is an instance where an outdated tax law can create poor outcomes. It's welcome, therefore, that Exposure Draft Treasury Laws Amendment (Measures for a later sitting) Bill 2019 (great title) has a proposed amendment to extend the FBT exemption to Uber rides. We've made a submission asking for aspects of it to be clarified, but it's good to see that the issue is being addressed. As usual, our submission is on the website, so if you're interested in that issue or other aspects of the exposure draft, please check it out.

There are other ways in which we're trying to provide technical and non-technical help to members. I've mentioned before the mentoring program where newer members can get guidance from more senior members, and the speaker's academy to help with an immensely useful non-technical skill. In some places around the country, there are also Institute-initiated tax discussion groups, most of which deal mainly with technical issues, but which are also a great way to share support, practical guidance and knowledge with like-minded tax professionals. You can check with your local regional manager whether there's one near you, and if there isn't, why not start one?

But there's one other type of benefit that the Institute can provide for networking, profile, insights into the key issues of the day, and sharpening up technical or non-technical skills — and that's to get involved with the Institute's activities. Often when I thank someone for their contribution to some Institute initiative, they assure me that, for them, it was well worth it.

I'm conscious that many members live in more remote areas, and may have difficulty participating in conventional face-to-face discussion groups or committees. But still, please do let us know if you'd like to be involved in some way. We'd value your input in whatever way we're able to get it.

Whether it's the committee for a particular event or an ongoing professional development committee, membership of a standing technical committee or just input into a particular consultation that you've got an interest in, or being willing to present at an event, I'm sure you'll find it an immensely rewarding experience. I always have.

CEO's Report

by Giles Hurst

Recognising our family of members

CEO Giles Hurst on the importance of supporting and recognising our membership.

As I write this at the Asia Oceania Tax Consultants' Association Conference in Busan, Korea, I am reflecting on an eventful year and looking forward to what is coming up.

Being part of a membership body is a lot like being part of a family. The Tax Institute is, in my view, a very extensive family unit. We meet often at CPD events to network, learn and support each other. We may not always agree on technical details and what the future of tax will demand, but respect and camaraderie are always part of the mix.

Opportunities to grow

Families raise each other up. And our forthcoming CPD events are designed in the same way.

If you are working in the SME space, the 27th Noosa Tax Intensive provides the ideal environment to assess key issues. Its range of high-quality technical sessions and interactive practical workshops will equip you with the knowledge to advance practical issues you are facing. It's no surprise that its overwhelming popularity has led to Noosa becoming a "member-only" event.

As important as technical skills are, the tax profession of tomorrow demands more. The future of tax is dependent on professionals displaying different kinds of leadership. The ability to communicate simply and clearly will be as important as the capacity to inspire, influence and persuade through involvement. Those who have backed themselves up with strong "soft skills" will rise to the top in the future. There is no better way to understand the benefits of such change than by attending an event such as the Women in Tax National Congress in Sydney on 29 November, where a truly inspiring set of speakers will share new challenges, new opportunities and new insights. We will all have the chance to walk away with valuable practical tools to unlock our full potential. Join us in driving the change.

The Tax Summit 2020

You've all heard about The Tax Summit 2020 by now. I cannot emphasise enough how significant this event is for the tax profession in Australia. Attendees will be drawn from far beyond our shores to make this a must-attend event in our annual calendar.

You can expect the best of what has always been on offer from two compelling events, the National Convention and the NSW Tax Forum, with a focus on the event's theme "Now & When — Exploring Our Futures".

The Commissioner of Taxation, Chris Jordan, AO, will deliver an address, and renowned journalist Tony Jones will facilitate the Q&A Panel. They are just some of the faces set to speak at this new event from The Tax Institute.

There will be more than 60 sessions delivered by local and global tax experts, across SME, corporate and "hot topic" streams. The Tax Summit also includes keynote sessions and four new streams: professional practice, emerging leaders, international, and technology.

The Tax Summit 2020 is the must-attend event for tax professionals next year.

Reflecting on our successes

We are once again approaching the end of another eventful year here at The Tax Institute. Naturally, it is also a time to reflect and celebrate the achievements of our tax family.

In the coming month, we will be producing our much-anticipated end of year video message. I want to celebrate the advocacy work that the Institute has undertaken, and really honour the outstanding voluntary contributions made by so many of you during Bob Deutsch's absence earlier this year. From writing preambles to media commentary, we celebrate your volunteerism. Certainly, this year's end of year video message will acknowledge the amazing work of our members in 2019.

Senior Adviser's Report

by Bruce Quigley, CTA

Review of the Tax Practitioners Board

The discussion paper on the review of the Tax Practitioners Board has a number of proposals that tax practitioners need to be aware of.

Writing about the future of the tax profession in the September 1984 issue of *Taxation in Australia*, the late Justice Graham Hill observed that "if we cannot be bold in thinking of the future and seeking to debate solutions to the problems that arise we will not be later able to complain if the future is imposed upon us with solutions to the issues that we may regard as unacceptable".

This article outlines a few of the issues included in The Tax Institute's submission to the discussion paper (the paper) on the review of the Tax Practitioners Board circulated by Treasury in July 2019.[1]

The TPB is responsible for regulating the services provided by tax agents, business activity statement (BAS) agents and tax (financial) advisers (collectively referred to as "tax practitioners" in the paper), and ensuring that the services provided by these tax practitioners are provided to the public in accordance with appropriate standards of professional and ethical conduct. The paper considers potential reforms to the regulation of tax practitioners in Australia and discusses the effectiveness of the TPB and the operation of the *Tax Agent Services Act 2009* (Cth) (TASA) and the *Tax Agent Services Regulations 2009* (Cth).

Independence of the TPB from the ATO

It is the Institute's view that to effectively regulate the services provided by tax practitioners, the TPB must *be* independent from the ATO and also *be seen to be* independent from the ATO. The chair of the TPB should be its own *accountable authority* deciding all matters that come within the TPB's remit, control its own budget (unlike now), and have the power to appoint its own executive and staff (also unlike now). Seconding ATO staff to the TPB contributes to the perception of a lack of independence from the ATO. The Institute acknowledges that ATO secondees bring a wealth of experience to the TPB. However, if it is considered that there is a need for secondment arrangements in the future, it must be clearly evidenced that the ATO secondees become employees of the TPB and are free from any obligations they may otherwise owe to the ATO.

Under the preferred option put forward in the paper to address the issue of independence, the chair of the TPB would be established as the relevant *accountable authority* responsible for its own budget and reporting. However, the majority of the staff would be ATO secondees and the ATO and TPB would have a "shared services arrangement". While this would be an improvement on the current arrangement, the Institute considers that this option still retains too strong a connection with the ATO and therefore does not go far enough. Our preferred option to achieve the desired outcome of the TPB's real and perceived independence would be for the chair to be established as the relevant *accountable authority* responsible for its own budget and reporting, employing its own staff and located in in its own premises. Any secondment arrangements would be subject to the strict controls mentioned above. Further, in the Institute's view, no ATO officer should be a member of the TPB board.

Qualifications and experience requirements

Tax practitioners should have appropriate levels of qualifications and experience to enable them to satisfy minimum professional and ethical standards. However, the Institute considers that the current requirements are too rigid and outdated.

More flexibility needs to be introduced in the qualifications and experience requirements to respond to the increasing changes in work practices, which is quite different from the traditional "full-time" work model. The requirements should take account of substantive breaks in careers (due to a sabbatical or maternity/parenting leave) and the rise of regular part-time work. Based on members' experiences, the current requirements make it almost impossible for the TPB to register part-time employees or employees who have had lengthy breaks in their careers. The balance of education (perhaps completed more than 10 years ago) and experience also needs to be revisited.

A dynamic Code of Professional Conduct

In the Institute's view, the Code of Professional Conduct (the code) needs to be dynamic. It should be principles-based and codify the standards of behaviour expected of tax practitioners. Currently, the code is contained in s 30-10 TASA, meaning any changes require an amendment of the law and the difficulty that entails. Changes to the code which govern the behavioural expectations of tax practitioners should only be made after a formal process, including parliamentary scrutiny and public consultation. One way to achieve this, while at the same time avoiding the time-consuming process of amending the TASA, would be to prescribe that changes could be made by way of legislative instrument. As "disallowable instruments", they are required to be tabled for 15 sitting days and the parliamentary process requires that they be subject to public consultation.

It remains to be seen whether the outcome of the review will be "bold" in its thinking about the future regulation of tax practitioners in Australia.

Reference

1 The Tax Institute, *Review of the Tax Practitioners Board – discussion paper*, 12 September 2019. Available at www.taxinstitute.com.au/tisubmission/review-of-the-tax-practitioners-board-discussion-paper.

Tax News – the details

by TaxCounsel Pty Ltd

October – what happened in tax?

The following points highlight important federal tax developments that occurred during October 2019.

Government initiatives

1. Israel DTA

On 19 September 2019, the government introduced amending legislation (the Treasury Laws Amendment (International Tax Agreements) Bill 2019) into parliament to give effect to a new tax treaty between Australia and Israel.

The treaty, which was signed in March 2019, is the first tax treaty between Australia and Israel. Key features of the treaty include reducing withholding tax rates to create a more favourable bilateral investment environment, making it cheaper for Australian business to access foreign capital and technology, providing greater certainty for business in both jurisdictions and reducing the incidence of double taxation.

The Assistant Treasurer said that the treaty will allow Australian companies to take greater advantage of Israel's knowledge-based economy — one that thrives on innovation. Israel's innovation eco-system is one of the most developed in the world, shaped by a sophisticated system of major global investors, start-ups and universities.

The treaty builds on other government initiatives to increase trade and investment with Israel, including the opening of an Australian Landing Pad in Tel Aviv to assist Australian start-up companies interested in going global or seeking strategic partners and collaboration.

The new treaty also includes OECD/G20 base erosion and profit shifting recommendations, demonstrating the government's continued commitment to tackling international tax avoidance practices.

The treaty will enter into force once both countries have completed their domestic requirements which, in the case of Australia, includes the enactment of the amending legislation. The legislation will also introduce new deemed source of income rules that ensures Australia can exercise its taxing rights under this new treaty and future tax treaties.

2. Redundancy payments

The Treasury Laws Amendment (2019 Measures No. 2) Bill 2019, which was introduced into parliament on 18 September 2019, contains amendments to give effect to already announced changes that will assist older Australians and help farmers and tourism operators.

First, the Bill extends the concessional treatment of genuine redundancy and early retirement scheme payments to those under age pension qualifying age. This will ensure that more Australians nearing retirement will not be taxed on part of the payment they receive if their job is abolished or if they receive an early retirement scheme payment.

Second, the Bill also provides real relief to farmers and tourism operators who buy heavy-duty passenger cars they need as part of their business. Eligible farmers and tourism operators can now apply for a full refund of any luxury car tax paid, up to $10,000, for relevant vehicles they acquired on or after 1 July 2019.

There are also amendments in the Bill that will enable the Commissioner of Taxation to calculate and pay interest on ATO-held superannuation that the ATO proactively reunites with members' active accounts.

The Commissioner's perspective

3. Commercial debt forgiveness

A recently released draft determination is to the effect that the exclusion from the commercial debt forgiveness rules of debts forgiven for reasons of natural love and affection requires that the creditor be a natural person (TD 2019/D9).

The context of s 245-40(e) of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) requires a direct causal nexus between the forgiveness of a debt and the natural love and affection, and the natural love and affection must arise in consequence of ordinary human interaction. For this to occur, the creditor must be a natural person.

The draft determination recognises that it takes a different view to ID 2003/589. The Commissioner will not devote compliance resources to apply the views expressed in the draft determination in relation to debts forgiven prior to 6 February 2019 that would have been covered by ID 2003/589 which was withdrawn on that date. However, if the Commissioner is asked or required to state a view (for example, in a private ruling or in submissions in a litigation matter), the Commissioner will do so consistently with the views set out in the final determination.

4. Superannuation: non-arm's length income amendments

The Commissioner has released a draft law companion ruling that clarifies how the recently enacted amendments to s 295-550 ITAA97 (meaning of non-arm's length income) operate in a scheme where the parties do not deal with each other at arm's length and the trustee of a complying superannuation entity incurs non-arm's length expenditure (or where expenditure is not incurred) in gaining or producing ordinary or statutory income (LCR 2019/D3).

The amendments, which were made by the *Treasury Laws Amendment (2018 Superannuation Measures No. 1) Act 2019*, apply in relation to income derived in the 2018-19 income year and later income years, regardless of whether the scheme was entered into before 1 July 2018.

By way of background, the taxable income of a complying superannuation fund is made up of two components — a "low tax income component", which is taxed at 15%, and a "non-arm's length income component" (NALI), which is taxed at the top marginal tax rate.

Before the recent amendments were made, the NALI provisions applied where a complying superannuation fund either:

- derived ordinary or statutory income under a scheme where the parties were not dealing with each other at arm's length in relation to the scheme, and the amount of income was more than might have been expected to have been derived if those parties had been dealing with each other at arm's length in relation to the scheme; or
- derived income as a beneficiary of a trust through holding a fixed entitlement to the income of the trust where the fund acquired the entitlement under a scheme, or the income was derived under a scheme, the parties to which were not dealing with each other at arm's length and the amount of income is more than might have been expected to have been derived if those parties had been dealing with each other at arm's length.

While retaining the existing rules, the amendments remove any ambiguity in the application of the NALI provisions by clarifying their application where a complying superannuation fund incurs a loss, outgoing or expenditure (or does not incur a loss, outgoing or expenditure) in certain circumstances.

For example, as a result of the amendments, an amount of ordinary or statutory income will be NALI of a complying superannuation fund where:

- there is a scheme in which the parties were not dealing with each other at arm's length;
- the fund incurs a loss, outgoing or expenditure of an amount in gaining or producing the income; and
- the amount of the loss, outgoing or expenditure is less than the amount that the fund might have been expected to incur had those parties been dealing with each other at arm's length in relation to the scheme.

Further, the income is also NALI if the fund does not incur a loss, outgoing or expenditure that the fund might have been expected to incur if those parties had been dealing with each other at arm's length in relation to the scheme.

The draft ruling gives a number of examples to illustrate the operation of the amendments. The examples relate to the following situations:

- non-arm's length expenditure incurred to acquire an asset;
- non-arm's length expenditure incurred has a nexus to all income of the fund;
- purchase of an asset under a non-arm's length arrangement;
- purchase at less than market value and no in-specie contribution;
- purchase financed through a limited recourse borrowing arrangement on non-arm's length terms;
- part purchase/part in-specie contribution at market value;
- internal arrangement within a self-managed superannuation fund (SMSF) — trustee provides services to the fund;
- SMSF trustee carrying out duties in their individual capacity;
- expenditure relating to a superannuation entity as a beneficiary of a trust;
- SMSF incurs non-arm's length expenditure in acquiring a fixed entitlement in a unit trust; and
- the operation of the market value substitution rules (CGT consequences for the transferor and the fund).

Practical compliance guideline

The Commissioner also released a draft practical compliance guideline which provides a transitional compliance approach for a complying superannuation entity concerning the application of the amendments to s 295-550 where a superannuation entity incurs certain non-arm's length expenditure (or where expenditure is not incurred) in gaining or producing ordinary or statutory income (PCG 2019/D6).

5. Employee share trust

The Commissioner has released a draft taxation determination which considers what constitutes an "employee share trust", as defined for the purposes of the employee share scheme (ESS) provisions of the ITAA97 (TD 2019/D8).

Section 130-85(4) ITAA97 provides that an employee share trust, for an ESS, is a trust whose sole activities are:

- obtaining shares or rights in a company;
- ensuring that ESS interests in the company that are beneficial interests in those shares or rights are provided under the ESS to employees, or to associates of employees, of:
  - the company; or
  - a subsidiary of the company; and
- other activities that are merely incidental to these activities.

In relation to the "sole activities" test, the draft determination points out that it is necessary to examine the actual activities that the trustee has undertaken. While the relevant trust documents may include powers and/or duties that are broad reaching, the mere existence of those powers or duties in the trust documents does not, of itself, mean that the trustee has breached the requirements to be an employee share trust.

The expression "merely incidental" in the last item above takes its ordinary meaning, with further guidance drawn from the particular statutory context and purpose of the legislation. The Macquarie dictionary defines "merely" to mean "only as specified, and nothing more" and "incidental" as "happening or likely to happen in fortuitous or subordinate conjunction with something else".

While the provisions relating to employee share trusts are concessional in nature, the restriction of those concessions to employee share trusts is an integrity measure and ensures that the concessions are only available to a specific subset of trusts that meet the statutory definition of an "employee share trust". As such, the definition is not intended to be construed broadly.

The draft determination expresses the view that activities are merely incidental in this context if they are a natural incident or consequence of the trust obtaining, holding and providing shares or rights under an ESS. If the activities undertaken by the trustee are not a natural incident or consequence of obtaining, holding and providing shares or rights under an ESS, or if the activity is undertaken for or follows from some other purpose, such activities are not merely incidental.

As an example of activities that would not be "merely incidental" in the relevant sense, the draft determination refers to a situation where the governing documents contain a clause that requires the trustee to waive its right to be paid or credited dividends on unallocated shares, where notice is given by the employer. Where such a notice is given, the trust would cease to be an employee share trust when the trustee waives its right to be paid or credited dividends on its unallocated shares, as such activities are not considered to be merely incidental to obtaining, holding and providing shares to participating employees. It does not matter whether the trustee is required to waive its right to be paid or credited dividends, or chooses to do so (that is, if the trust deed gives the trustee a discretion in this regard, or does not contain any clause relating to the waiving of dividends).

Where this type of clause is contained in the governing documents as at 18 September 2019 (the date of issue of TD 2019/D8), the Commissioner will not apply compliance resources to investigate if any action has been taken in respect of such a clause or dividends waived, or the potential tax consequences, for periods prior to 1 January 2020. However, this compliance approach will not apply where the trustee waives the right to be paid or credited any dividends on or after 1 January 2020, nor where the Commissioner is asked to amend an assessment, or is asked or required to state a view (for example, in a private ruling or in submissions in a litigation matter).

6. Transfer pricing record-keeping

The Commissioner has released a revised and updated practical compliance guideline that sets out the simplified transfer pricing record-keeping options that have been developed to minimise the record-keeping for eligible taxpayers (PCG 2017/2).

The options contained in the guideline reflect the types of transactions or activities that the Commissioner believes are low risk in the context of international related-party dealings. The guideline specifies the criteria for taxpayers to self-assess their eligibility to use one or more of the simplification options.

There are seven simplified transfer pricing record-keeping options available:

- small taxpayers;
- distributors;
- low value adding intra-group services;
- low-level inbound loans;
- materiality;
- technical services; and
- low-level outbound loans.

A review of the simplified transfer pricing record-keeping options has been completed and the eligibility criteria for each option have been updated. The simplified transfer pricing record-keeping options contained in this version of the guideline are available for taxpayers to apply in relation to income years commencing on or after 1 July 2018 (or substituted accounting period).

In order to ensure that these changes do not have a negative effect on taxpayers who have already arranged their affairs to take advantage of the options as they existed in the previous version of the guideline, taxpayers are able to apply the options as they existed in that previous version for their first income year commencing on or after 1 July 2018 (or substituted accounting period) only.

Some points to note are:

- the options in the guideline are available to companies, trusts and partnerships where they meet the eligibility criteria; and
- where an entity chooses to use a simplified record-keeping option, it needs to inform the ATO of its election, either through a disclosure in its international dealings schedule or in its country-by-country statements, if applicable.

7. GST territorial nexus: intangibles

The Commissioner has released a draft ruling which considers when a supply of anything other than goods or real property (an intangible) is connected with the indirect tax zone under s 9-25(5)(a), (b) and (c) and Div 85 of the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (GSTA) (GSTR 2019/D2).

For a supplier to be liable for GST on a taxable supply, one of the requirements is that the supply be connected with the "indirect tax zone" (effectively Australia).

The draft ruling also explains exclusions to the "connected with Australia" rules, where some supplies of intangibles made by non-residents are treated as being not connected with Australia.

The draft ruling considers these concepts:

- when a supply is made through an enterprise carried on in Australia;
- when a "thing is done" in Australia;
- subcontracted services;
- provision of advice or information;
- the creation, grant, transfer, assignment or surrender of a right;
- entry into, or release from, an obligation; and
- digital supplies.

Recent case decisions

8. Disclosure of protected information

The Federal Court (White J) has held that the disclosure to the Commissioner of Taxation (or to his legal advisers or a court) by a tax officer of otherwise protected information relating to the affairs of a taxpayer who had brought defamation proceedings against the Commissioner was not prohibited (*Jordan, Commissioner of Taxation v Second Commissioner of Taxation*[1]).

The plaintiff in the defamation proceedings was a Mr Vanda Gould whose activities were relevant to the Hua Wang Bank taxation litigation which culminated in the decision of the High

Court in *Bywater Investments Ltd; Hua Wang Bank Berhad v FCT*.[2] The alleged defamatory statements were made by the Commissioner in answer to a question by a journalist after the Commissioner had finished a speech to the National Press Club on 8 July 2017. The plaintiff alleged that listeners would have understood the Commissioner's reference to "the principal of that scheme" to be a reference to himself and would have understood the Commissioner's words to convey the following defamatory meanings:

– [he] had engaged in the worst kind of money laundering;
– [he] had engaged in the worst kind of insider trading; and
– [he] had engaged in the worst kind of tax fraud.

The defamation proceedings had in fact been stayed pursuant to a succession of orders made with the consent of both parties. That was because the plaintiff in the proceedings was facing criminal charges and the parties appreciated that there may be a significant overlap between the issues and evidence in the criminal proceedings, and those in the defamation proceedings. For this reason, the Commissioner had not yet filed a defence to the defamation proceedings.

However, in order to prepare his defence, the Commissioner wished to have access to material held by the ATO concerning Mr Gould. It was common ground that the ATO held a considerable volume of material, and that this material included "protected information".

White J said that he considered that a disclosure of the protected information relating to the affairs of Mr Gould in the circumstances proposed by the Second Commissioner would be within the non-disclosure exception provided for in item 3 of the table in s 355-50(2) of Sch 1 to the *Taxation Administration Act 1953* (Cth). Under that provision, records or disclosures made in performing duties as a taxation officer include disclosure to any entity, court or tribunal for the purpose of criminal, civil or administrative proceedings (including merits review or judicial review) that are related to a taxation law.

His Honour was of the view that the terminology in the relevant provisions pointed against item 3 of the table in s 355-50(2) being concerned only with the vindication of a taxation law or with proceedings which have a direct connection with such a vindication.

It was the fact that Mr Gould's allegations in the defamation proceedings concerned statements made by the Commissioner, and did not concern assessments made by the ATO of the taxation liabilities of Mr Gould or of the companies which he controlled or managed. That provided some "separation" between the proceedings and the taxation laws. However, it was reasonable to suppose at this stage that there was a real prospect that the context in which the statements were made would be important in understanding what they conveyed to the ordinary and reasonable listener. That being so, there was, at the least, a reasonable prospect that the Commissioner may wish to refer to the Hua Wang Bank litigation and what was publicly known concerning that litigation at the time of his speech to the National Press Club. Therein would lie a relationship with the taxation laws. White J said that he did not consider that such a relationship should, in the present circumstances, be regarded as so tenuous or indirect as not to be encompassed by item 3 of the table in s 355-50(2).

TaxCounsel Pty Ltd
ACN 117 651 420

References

1 [2019] FCA 1602.

2 [2016] HCA 45.

Tax Tips

by TaxCounsel Pty Ltd

Testamentary trusts and minors

Draft amending legislation to make changes to the special regime that applies in relation to the unearned income of minors has been released.

Background

The unearned income of minors rules in Div 6AA of the *Income Tax Assessment Act 1936* (Cth) (ITAA36) have been a feature of the income tax landscape for almost 40 years, having been originally enacted by the *Income Tax Laws Amendment Act 1980* (Cth).

In the case of an individual taxpayer who is a "prescribed person", the effect of the provisions of the Division (in combination with the *Income Tax Rates Act 1986* (Cth)) is that, subject to some shading in, tax at the maximum personal rate of tax is imposed on what is called the "eligible taxable income" of the taxpayer. The rationale of the provisions is that they are an integrity measure to deny most minors a tax advantage from receiving income that might flow from income-splitting arrangements.

There is a special provision (s 102AG ITAA36) which deals with how Div 6AA operates in the case of trust income. It is this provision which is to be amended and is of particular relevance to this article.

The scheme of Div 6AA

As indicated, for the provisions of Div 6AA to apply, the individual must be a "prescribed person", that is, the individual must be under 18 years of age on the last day of the income year and also not fall within any category of excepted person.

The provisions apply in relation to an individual's "eligible taxable income", which is so much of the individual's assessable income for the income year as is not excepted assessable income (for example, is not employment income or business income), reduced by relevant allowable deductions (ss 102AD and 102AE ITAA36).

Trust estates

In the case of a trust estate, for the provisions of Div 6AA to apply in relation to a beneficiary, the beneficiary must be a prescribed person in relation to the particular income year, and the provisions of Div 6AA apply to so much of the share of the beneficiary of the net income of the trust estate of the income year as, in the Commissioner's opinion, is attributable to assessable income of the trust estate that is not, in relation to that beneficiary, excepted trust income (s 102AG(1)). The kinds of assessable income of a trust estate that will qualify as excepted trust income are defined in s 102AG(2).

It may be noted that it is specifically provided (in s 102AG(8)) that where any property is transferred to the trustee of a discretionary trust, the property is to be taken to have been transferred to the trustee for the benefit of each of the beneficiaries who can potentially benefit under the trust.

The existing category of excepted trust income that is presently relevant is defined as an amount included in the assessable income of a trust estate in relation to a beneficiary of the trust estate to the extent to which the amount is assessable income of a trust estate (often called a testamentary trust) that resulted from:

- a will, codicil or an order of a court that varied or modified the provisions of a will or codicil; or
- an intestacy or an order of a court that varied or modified the operation of the intestacy provisions (s 102AG(2)(a)).

Further, income from property that, in the opinion of the Commissioner, represents accumulations of excepted trust income in relation to the beneficiary can also be excepted trust income (s 102AG(2)(e)). Income on unpaid entitlements, that in relation to the beneficiary were excepted trust income, may also be excepted trust income.

Significantly, there are some existing anti-avoidance type provisions that can apply for the purposes of s 102AG as presently enacted. Under one of these provisions, an amount of assessable income will not be excepted trust income if it is derived by the trustee directly or indirectly under, or as a result of, an agreement (broadly defined) that was entered into, or carried out by, any person for the purpose, or for purposes that included the purpose, of securing that that assessable income would be excepted trust income (s 102AG(4)). A merely incidental purpose is, however, disregarded (s 102AG(5)).

Budget change

It was announced in the 2018-19 Budget that, from 1 July 2019, the concessional tax rates available for minors receiving income from testamentary trusts would be limited to income derived from assets that are transferred from the deceased estate or the proceeds of the disposal or investment of those assets. It was explained that:

> "Currently, income received by minors from testamentary trusts is taxed at normal adult rates rather than the higher tax rates that generally apply to minors. However, some taxpayers are able to inappropriately obtain the benefit of this lower tax rate by injecting assets unrelated to the deceased estate into the testamentary trust. This measure will clarify that minors will be taxed at adult marginal tax rates only in respect of income a testamentary trust generates from assets of the deceased estate (or the proceeds of the disposal or investment of these assets)."

It was indicated that the measure was estimated to have "a small unquantifiable gain to revenue over the forward estimates".

Exposure draft amendments

An exposure draft of the amendments (and explanatory materials) that are intended to give effect to the

Budget announcement were released by Treasury on 3 October 2019.

The broad effect of the proposed amendments is to specifically confine the operation of s 102AG(2)(a) to assessable income of a kind covered by a proposed new subs (2AA).

Incorporating the proposed amendments into s 102AG as italics, the relevant provisions of s 102AG would read as follows:

> "**102AG Trust income to which Division applies**
>
> (1) Where a beneficiary of a trust estate is a prescribed person in relation to a year of income, this Division applies to so much of the share of the beneficiary of the net income of the trust estate of the year of income as, in the opinion of the Commissioner, is attributable to assessable income of the trust estate that is not, in relation to that beneficiary, excepted trust income.
>
> (2) Subject to this section, an amount included in the assessable income of a trust estate is excepted trust income in relation to a beneficiary of the trust estate to the extent to which the amount:
>
> (a) is assessable income, *of a kind covered by subsection (2AA)*, of a trust estate that resulted from:
>
> (i) a will, codicil or an order of a court that varied or modified the provisions of a will or codicil; or
>
> (ii) an intestacy or an order of a court that varied or modified the application, in relation to the estate of a deceased person, of the provisions of the law relating to the distribution of the estates of persons who die intestate;
>
> (b) is employment income;
>
> …
>
> *(2AA) For the purposes of paragraph (2)(a), assessable income of a trust estate is of a kind covered by this subsection if:*
>
> *(a) the assessable income is derived by the trustee of the trust estate from property; and*
>
> *(b) the property satisfies any of the following requirements:*
>
> *(i) the property was transferred to the trustee of the trust estate to benefit the beneficiary from the estate of the deceased person concerned, as a result of the will, codicil, intestacy or order of a court mentioned in paragraph (2)(a);*
>
> *(ii) the property, in the opinion of the Commissioner, represents accumulations of income or capital from property that satisfies the requirement in subparagraph (i);*
>
> *(iii) the property, in the opinion of the Commissioner, represents accumulations of income or capital from property that satisfies the requirement in subparagraph (ii), or (because of a previous operation of this subparagraph) the requirement in this subparagraph."*

There are a number of points discussed below that may be made in relation to the proposed subs (2AA).

"Assessable income from property"

It is a basic precondition for the proposed provisions of subs (2AA) to be met that the assessable income be derived by the trustee of the trust estate from property (see proposed subs (2AA)(a)).

"Property" is already defined for the purposes of Div 6AA as property, whether real or personal, and to include money (s 102AA(1) ITAA36).

Assessable income would, of course, include ordinary income (for example, rent), as well as statutory income (for example, a net capital gain) (see s 995-1 of the *Income Tax Act Assessment Act 1997* (Cth) (ITAA97)).

There is a question as to the circumstances in which the happening of a CGT event that gives rise to a capital gain for a trust could give rise to assessable income derived from property. The position is clear in relation to the happening of CGT event A1 (disposal of a CGT asset). But the position is not so clear in relation to some CGT events, for example, CGT event D1 (creating contractual or other rights). The issue would be the nexus conveyed by "from" in the expression "assessable income is derived … from property". The reference to "property" would presumably be to existing property, but if CGT event D1 happens, there will be the *creation* of a contractual or other right. It is arguable, however, that if, for example, CGT event D1 were to happen as a result of the grant of an easement over land, it could be said that a capital gain that arises from the happening of CGT event D1 was derived from property, that is, the land.

Where a trust estate has more than one capital gain for an income year and one or more, but not all, of the capital gains would fall within the concept of excepted trust income in s 102AG, and also has a capital loss or a carried forward net capital loss, the way that the net capital gain method statement in s 102-5 ITAA97 is applied will become significant. In essence, any capital loss or net capital loss should be applied first against any capital gain or gains that would not be potentially excluded from the operation of Div 6AA.

It may be noted that the expression "income from property" is defined in s 6(1) ITAA36 but that definition may not be relevant to the construction of the expression "assessable income derived from property". The expression "income from property" is, however, used in Div 6AA in s 102AA(4), which is referred to below. That introduces some degree of uncertainty as it is a standing difficulty whether a reference to "income" in the ITAA36 extends beyond the concept of income according to ordinary concepts.

The requirements of proposed subs (2AA)(b)

As to the three alternative requirements of proposed subs (2AA)(b), the explanatory materials for the exposure draft amendments point out that these will ensure that there is a connection between the property from which excepted trust income is derived and the deceased estate that gave rise to the testamentary trust.

The first alternative requirement (that the property was transferred to the trustee of the trust estate to benefit the beneficiary from the estate of the deceased person concerned, as a result of the will, codicil, intestacy or order of a court mentioned in s 102AG(2)(a)) will ensure that:

- income from property that is unrelated to the deceased estate is not treated as excepted trust income for the purposes of Div 6AA; and

– only beneficiaries included in the class of beneficiaries by the deceased, rather than an entity which was later added to the class of beneficiaries, can have excepted trust income under proposed s 102AG(2)(a).

The second alternative requirement in proposed subs (2AA)(b) (that the property, in the opinion of the Commissioner, represents accumulations of income or capital from property that satisfies the first requirement) will ensure that further income from property that represents undistributed trust income or capital from such assets in a testamentary trust can be excepted trust income for the purposes of Div 6AA.

The third alternative requirement is that the property, in the opinion of the Commissioner, represents accumulations of income or capital from:

– property that satisfies the second requirement; or

– property that has already satisfied this requirement.

This requirement ensures that further income on accumulations of income or capital from property that satisfies the second requirement, and such further accumulations (and so on) in a testamentary trust can be excepted trust income for the purposes of Div 6AA.

It should be noted that the concept of income derived from property is defined in existing s 102AA(4) to include income derived from property that, in the opinion of the Commissioner, represents that property. This would allow property that satisfies any of the three requirements of proposed s 102AG(2AA)(b) to be converted from one asset type to another, without losing the ability for income that is derived by the converted asset to be excepted trust income under s 102AG(2)(a). The use in s 102AA(4) of the word "income" (and not the expression "assessable income") is noted above.

It should also be noted that, in some circumstances, the streaming provisions may need to be utilised to achieve an optimum result from the operation of Div 6AA. It is not possible to stream other than for capital gains and franked dividends (*FCT v Greenhatch*[1]).

Examples

The explanatory materials give the following two examples to illustrate the operation of the proposed amendments.

Example 1: Injected asset

On 1 July 2019, testamentary trust ABC is established under a will of which a minor is a beneficiary. Pursuant to the will, $100,000 is transferred to the trustee from the estate of the deceased. Shortly after the testamentary trust is established, a related family trust makes a capital distribution of $1,000,000 to the testamentary trust. The resulting $1,100,000 is invested in ASX-listed shares on the same day. Dividend income of $110,000 is derived for the 2019-20 income year. The net income of the trust is $110,000 and the minor is presently entitled to 50% of the amount of net income.

The minor's share of the net income of the trust is $55,000. $50,000 is attributable to assets unrelated to the deceased estate and not excepted trust income. $5,000 is excepted trust income on the basis that it is assessable income of the trust estate that resulted from a testamentary trust, derived from property transferred from the deceased estate.

Example 2: Income from retained excepted trust income

Following on from example 1, the minor's share of the net income of the trust (being $55,000, comprising $5,000 excepted trust income and $50,000 not excepted trust income) is not paid to the minor by the trustee, but is invested for their benefit in ASX-listed shares shortly after the commencement of the 2020-21 income year. For the 2020-21 income year, that investment derives income of $5,500, and the minor is presently entitled to the entire amount.

$5,000 is attributable to assets unrelated to the deceased estate and not excepted trust income. $500 is excepted trust income on the basis that it is assessable income of the trust estate that resulted from a testamentary trust, derived from income that was previously excepted trust income.

The existing anti-avoidance provision

As noted above, there are anti-avoidance type provisions in s 102AG(4) as presently enacted. It is not clear why the Commissioner could not have sought to apply s 102AG(4) in the kind of case to which the proposed amendments are directed.

It may be noted that for other categories of income that fall outside the testamentary trust exclusion but are excepted trust income, the Commissioner would have to seek to rely on the existing Div 6AA anti-avoidance provision in appropriate cases.

Application and transitional

The proposed amendments to Div 6AA are to apply in relation to assets acquired by or transferred to the trustee of a testamentary trust estate on or after 1 July 2019.

The explanatory materials state that income from assets and accumulations held in a testamentary trust prior to 1 July 2019 can continue to be excepted trust income under s 102AG.

TaxCounsel Pty Ltd

Reference

1 [2012] FCAFC 84.

Mid Market Focus

by Peter Bembrick, CTA, HLB Mann Judd Sydney

Think you're selling shares in a small business? Guess again

The small business CGT concessions offer valuable tax savings, but major changes to the rules for selling shares have added extra tests that will be difficult to satisfy.

Introduction

There are significant tax savings to be made when selling a business, or selling your ownership interest in an entity carrying on a business, where the small business capital gains tax (CGT) concessions in Div 152 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) can be applied.

Be very wary, however, of the massive changes to this landscape for sales of interests in business entities *on or after 8 February 2018* — the bottom line being that meeting the tests to apply the concessions has now become more challenging, with new twists and turns that will often be extremely difficult or impossible to navigate.

What was the problem with the old rules?

To overcome the perceived abuse of the old rules dealing with selling shares and units in business entities,[1] the government has added an expanded series of tests to the basic conditions for applying the CGT concessions.

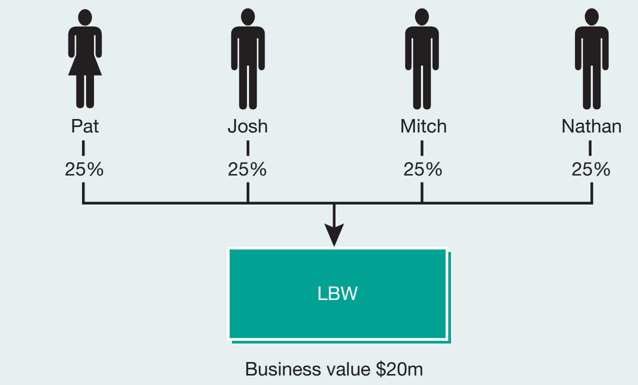
The problems identified with the previous rules were that they potentially allowed:

1. a shareholder/unitholder to own between 20% and 40% of one or more large business entities and to apply the CGT concessions to a sale of their shares:

Example 1: Multiple stakeholders in a large business entity

Pat, Josh, Mitch and Nathan each owned 25% of Last Blast World Pty Ltd (LBW) which carried on a sporting merchandise business. They were able to sell their shares in LBW to IPL Holdings for $20m in total but, as none of them were treated as controlling LBW, they would each have to count only the value of their 25% stake ($5m) when applying the $6m net asset value test, giving them a reasonable chance of applying the concessions.

Example 1 (cont)



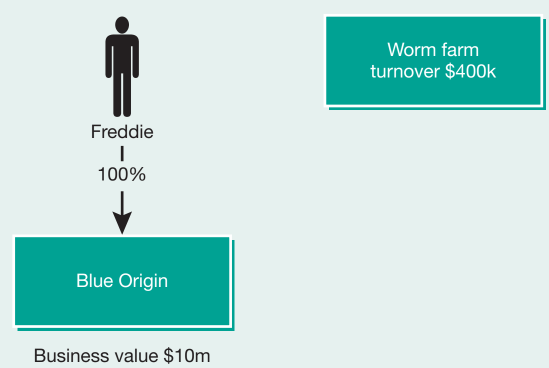
As will be seen below, the situation under the new rules would be vastly different; and

2. an individual to start up or acquire a small business to satisfy in their own right the $2m "small business entity" turnover test, where it is clear that they will fail the $6m net asset value test:

Example 2: Buying a small business when selling out of a larger business

Freddie owned 100% of Blue Origin Pty Ltd which carried on a business of corporate wellness coaching. He sold all of his shares to Todd for $10m. In the year of the sale, Freddie acquired a worm farm which supplied local anglers with bait and had an annual turnover of $400,000. Under the old rules, Freddie could potentially rely on the newly acquired business to classify himself as a "small business entity", and therefore apply the CGT concessions to the sale of his Blue Origin shares.

Again, as will be discussed below, the new rules apply more complex tests and would produce a different outcome.



What has changed?

There are three additional basic conditions that will have to be met going forward whenever shares or units in business entities are sold.

Condition 1. Modified active asset test

The modified active asset test applies only to multi-layer structures and changes the way in which the active asset test[2] applies to selling the interests in one entity (the "object entity") that in turn holds an interest in another entity (the "later entity") carrying on a business, ie selling at the "top" of the structure.

The active asset test requires the market value of active assets held by entities in which interests are sold to be at least equal to 80% of the total market value of assets for a period equal to the lesser of 7.5 years or one-half of the period during which the shares or units were held.

The modified active asset test applies by looking at the total market value of the object entity, disregarding any shares in companies or interests in trusts, instead looking through to the proportionate interests owned in the total market value of assets held by any later entities in which the object entity has an interest.

When applying this test, a later entity's assets cannot be treated as active assets unless the entity either qualifies as a CGT small business entity (ie meets the $2m aggregated turnover test), or satisfies the $6m net asset value test, in both cases using a modified control test that looks at turnover or assets of the object entity, its affiliates, and any entity "controlled" by the object entity where an interest of 20% or more is enough to establish control.

The taxpayer must also be a "CGT concession stakeholder" in the later entity, ie they or their spouse holds an interest of at least 20%.

Due to the complexity of this test, it is best understood using an example:

Example 3. Selling shares under a multi-layer structure

Roland owns 60% of the shares in Tet Corporation which has as its only assets a 50% interest in Tower Enterprises Pty Ltd (which runs a travel agency business valued at $4m, with an annual turnover of $1.5m) and a 30% interest in Mejis Pty Ltd (which operates a horse stud valued at $3m, with an annual turnover of $1m).

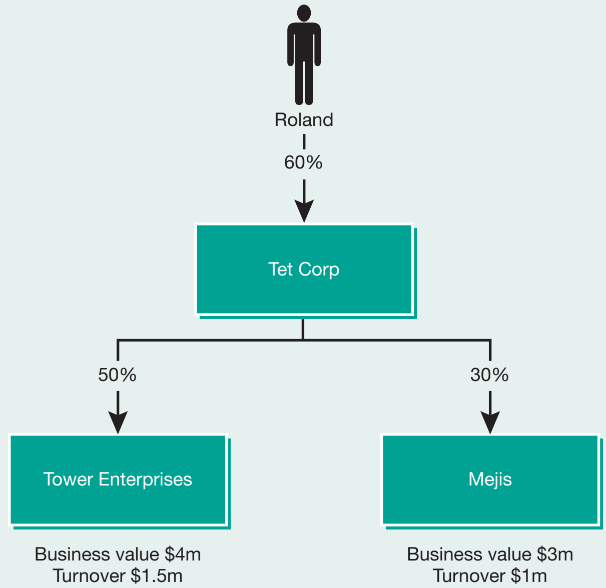
The steps to be followed when applying this condition are:

1. identify which entities are aggregated under the modified control test, which in this case is all three companies, as Tet Corporation has an interest of > 20% in both later entities;
2. calculate Roland's indirect interests in each of the later entities, being 30% for Tower Enterprises (ie 60% × 50%) and 18% for Mejis (ie 60% × 30%);
3. determine whether shares in Tet Corporation satisfy the modified active asset test, being $1.2m for Tower Enterprises (ie $4m × 30%) and $540,000 for Mejis (ie $3m × 18%); and
4. calculate the active asset percentage based on the fact that the indirect interests in the assets of Mejis are not treated as active as Roland's indirect ownership is less than 20% and he is therefore not a CGT concession stakeholder of Mejis. As the only active asset to be counted is the indirect interest of $1.2m in Tower Enterprises, and the total aggregated asset value is $1.74m, the active asset percentage is 69%.

Example 3 (cont)

Assuming that this is representative of the percentages that applied during the time that the structure was in place, Roland's shares in Tet Corporation would not satisfy the modified active asset test, and the CGT concessions in Div 152 would not be available to him.

For completeness, it is worth noting that, even if the 80% requirement was satisfied, the $6m net asset value threshold would in any case have been breached because both Tower Enterprises and Mejis are "controlled" by Tet Corporation, and the aggregated net asset value would be $7m. Similarly, neither company qualifies as a CGT small business entity as, while individually they have a turnover of less than $2m, the aggregated turnover is $2.5m.



Condition 2. Carrying on a business prior to the CGT event

The second new condition represents a significantly more prescriptive approach to applying the $2m turnover test when shares or units are sold, and it becomes relevant only where the $6m net asset value test cannot be satisfied.

There are two key parts to this condition that, when combined, make it much more difficult than under the old rules to fall back on the $2m turnover test in order to claim the concessions:

1. the taxpayer must have carried on a business *just prior* to the CGT event happening. This means that it is not sufficient to acquire or commence a small business after selling out of the existing business, and if there is any chance of satisfying this condition, careful analysis of the taxpayer's existing situation is advisable before committing to the sale; and
2. the object entity must itself have been a CGT small business entity for the income year, which requires analysis of the object entity's turnover, as well as that of any connected entities and affiliates, to ensure that aggregated turnover did not exceed $2m.

Returning to example 2 above, if Blue Origin had a turnover at all times exceeding $2m, it would have been impossible for Freddie to apply the CGT concessions to the sale of his shares.

If, however, Blue Origin had an annual turnover of $1.5m, and the new worm farming business with a turnover of $400,000 was acquired prior to the share sale, Freddie may have just scraped in under the $2m aggregated turnover threshold, and it may have been possible to apply the CGT concessions.

Condition 3. Object entity must satisfy $2m turnover test or $6m net asset value test

The third new condition is a very important one as it requires the object entity to satisfy either the $2m aggregated turnover test (ie to be a CGT small business entity) or the $6m net asset value test, in each case, if there is a multi-layer structure, applying the modified control percentage of 20% (discussed above). This is all aimed at preventing taxpayers from using the CGT concessions when selling shares or units in one or more large business entities.

While there are a variety of complex situations to which this new condition could apply, its effect can be illustrated by returning to example 1. It is clear that LBW would fail the $6m net asset value test, meaning that the only possible exception might be if the company's aggregated turnover did not exceed $2m, and also that the individuals satisfied the "carrying on a business" requirement discussed above. Each of them would apply this test to their own situation.

As LBW's turnover was $4m, and as none of the individual shareholders were carrying on a business, the effect of the new rules is that they would be unable to apply the CGT concessions.

Conclusion

The recent changes to the small business CGT concessions represent a whole new ball game when selling shares or units in business entities, and they are intended to close off many opportunities that might previously have existed. It is important to understand the impact of the changes, undertake the appropriate planning ahead of a proposed transaction, and identify the best outcome for each of the exiting shareholders.

Bearing in mind the associated commercial discussions with the purchaser, if the tax advantages of a share sale are not available to the extent that they may have been previously, and the transaction is driven back towards the sale of business assets out of a business entity, the desire for transferring funds to the shareholders, both from the sale proceeds and from the retained earnings/reserves all the way through to the eventual winding-up of the business entity, opens up another avenue of careful discussion and planning.

Peter Bembrick, CTA
Tax Partner
HLB Mann Judd Sydney

References

1 S 152-10(2) ITAA97.

2 S 152-35 ITAA97.

Tax Education

CTA Program: advance your knowledge

The Tax Institute is proud to profile a number of our duces from recent study periods.

Gabriele Lanzara, Senior Tax Analyst, BGC (Australia) Pty Ltd

Can you provide a brief background of your career in tax?

I started my career in 2014 working for a small boutique tax firm while in the final year of my law and commerce degrees at the University of Western Australia. I always had an interest in accounting and taxation matters and focused on these areas while studying. I then accepted a graduate position with Deloitte in the private clients' tax team. At Deloitte, I was involved in the provision of accounting and taxation compliance and advisory services to private family groups and high net worth individuals. After completing the Chartered Accountants Program in 2017, I moved into a corporate tax role with BGC, a large vertically integrated group of manufacturing, building and construction companies. My current role is quite diverse and challenging, with a good blend of compliance and advisory work.

What is the most valuable aspect of studying with the Institute?

I found that the topics covered in the CTA2B course were directly relevant to my current role. At BGC, I am required to advise on a range of different taxes, including income tax, GST and FBT, and to consider how the technical outcomes could be applied practically within the business. The materials are well written and a great resource as they collate the relevant taxation law (scattered across various legislation, cases and rulings), and explain how the law works in a clear and concise way. In addition, I found that the examples used in the case studies and activities were very practical and related to issues which arise regularly in practice.

What are your areas of new confidence?

Before enrolling in this course, I felt that GST and corporate tax were my weakest areas. However, I feel that I could advise on these areas more confidently now. Many of the topics within these modules were not covered in my previous studies, so it was good to get the technical background I required.

What was the reason for undertaking study with the Institute?

After completing the Chartered Accountants Program, I wanted to look into studying a pure tax course, consistent with the direction I want to further my career in. The CTA2B Advanced course appeared to cover the topics which were most relevant to my current role and I felt that taking this subject would develop my technical knowledge in those areas.

Where to now for you when it comes to continuing tax education?

I intend to complete the CTA2A course before moving on to CTA3 in order to become a Chartered Tax Adviser, as well as to obtain my tax agent registration.

What are the challenges of juggling study and work?

I'm sure most of us would agree that finding the time to study while meeting the demands of a full-time professional job is challenging. If you find it too difficult to study during the week, set aside time on the weekend to get through the work. I also feel that work–life balance is extremely important, and I make it a priority to fit in some exercise every day.

What advice do you have for other tax professionals considering the the CTA Program?

Keep up with the required reading in the study materials and regularly consult the program timetable to ensure that you are on track. Complete the quizzes as you finish each topic. This course, in particular, contained a lot of required reading and I found that making my own condensed summaries of the required cases and ATO rulings was helpful in picking up the most important points.

Hannah Edwards, Tax and Audit Manager, HQB Chartered Accountants

Can you provide a brief background of your career in tax?

With over 10 years' experience in audit, I moved from the city to a regional town to work for a firm that required a much wider knowledge of both audit and tax. Over two years ago, I started doing the tax agent courses with The Tax Institute to try and bring my knowledge up to speed as quickly as possible.

What is the most valuable aspect of studying with the Institute?

Commercial Law 2 furthered my understanding of bankruptcy and insolvency law which I had a bit of knowledge around prior to studying. Now this knowledge has increased considerably, and in the current climate, this is very important to assist struggling clients.

I learned a lot more about insurance law in Commercial Law 3, which I knew relatively little about beforehand. It is important when assisting clients to make decisions about the best way to protect their assets and businesses.

What was the reason for undertaking study with the Institute?

Prior to my current job, I had limited knowledge of Australian tax as I am from the United Kingdom. As such, I started the Tax Agent Program, which includes the above two subjects, so that I can become a qualified tax agent next year.

Where to now for you when it comes to continuing tax education?

My tax education will continue through the regular updates that I receive from The Tax Institute, attending courses and webinars. Tax laws and legislation are constantly changing which means that my education will never stop and the challenge of keeping up to date and always learning is one of the aspects that I really enjoy about my job.

What are some challenges of juggling study and work?

Studying can be hard when you have various tax and other deadlines that need to be met at work. I would suggest doing as much study upfront as you can in order to have the time to continue to meet work obligations during busy periods, without worrying that you are getting behind in your studies.

What advice do you have for other tax professionals considering the Tax Agent Program?

I think the Tax Agent Program is a great program to undertake in terms of the course materials and information that you learn; it is also very applicable to real-life situations.

Daniel Vucetic, Principal Director, Owbiz Corporate Pty Ltd

Can you please provide a brief background of your career in tax?

In my 23 years of experience, I have held several commercial roles in emerging medium-sized enterprises, where structuring and taxation matters were regular agenda items. With shareholders, local and abroad, my engagement with the top tier accounting firms granted me the opportunity to grasp a fundamental understanding and interest in taxation law. Several years later, I had a yearning to assist emerging SMEs to achieve optimal results. Hence, with the exposure gained through past experiences, I embarked on a mission to support people in business who embrace entrepreneurial flair in a rapidly changing world.

What are your areas of new confidence?

I have gained new confidence in contracts in commercial law, consumer protection and intellectual property.

What was the reason for undertaking study with the Institute?

The diversity and growth of our client portfolio has confirmed the need to maintain a fundamental understanding of the core elements offered studying these two subjects. They certainly provide a greater level of confidence in key areas.

Where to now for you when it comes to continuing tax education?

I am eager to achieve a greater understanding in the areas of self-managed superannuation funds and international tax due to client demand and demographics.

What are some challenges of juggling study and work?

This is always a difficult question to answer as we all are at different stages in our lives, hold different responsibilities, aspire to different goals, and yearn for that utopia of work–life balance. How you structure your week will essentially dictate your success in life holistically. I espouse and strongly hold the opinion that adequate sleep (not excessive) and being an early riser with prearranged time to achieve your various objectives for the week are essential. However, it is just as important to be flexible and reprioritise on the go, as well as maintaining a positive and healthy mind, since life is often busy and demanding.

What advice do you have for other tax professionals considering the Tax Agent Program?

It is empowering when you are "equipped with the skills to make your mark" through the delivery of relevant and appropriate outcomes for your client, whoever they may be. Absorb yourself in the course and utilise all of the resources available as they collectively provide a wholesome educational experience.

Member Profile

This month's column features Rhys Cormick, CTA, from Deloitte, Canberra.

Member since

2017

Areas of specialty

Employment taxes, government taxes and expatriate taxes.

Why are you a member of The Tax Institute?

Being a member of The Tax Institute provides access to unparalleled thought leadership and events that are specific to the tax profession. Comprising a diverse membership base, the Institute provides a forum for a variety of ideas to connect with a collective group that cares about continuously improving the tax profession in Australia.

How is your membership beneficial to your practice and clients?

Technical updates and member articles have been a great way for me to keep abreast of tax technical issues, both within my area of subject matter expertise and across the broader spectrum of tax issues that impact my clients. Contributing articles myself has been rewarding as it allows me to hone my research and writing skills.

How did you end up in tax?

My interest in tax started when a great university lecturer with a passion for tax first introduced me to The Tax Institute. I have stayed in touch with this lecturer over the years and we have been lucky enough to write a number of joint publications together across a broad range of topics. We have also presented together in China and at the Tax and Transfer Policy Institute of Australia in Canberra. While the original attraction to tax came from the intellectual challenge and complexity of the law, as I have progressed through my career, I have enjoyed the softer skills of leading teams, collaboration and strategic thinking — there is never a dull moment!

What are the challenges for tax practitioners this year?

A continuous challenge for tax practitioners this year and over the coming years is how to increasingly add value to end-users. Key drivers are the changing role of the regulator, the race to digitisation, and the changing expectations of clients and society. These challenges bring about opportunities to learn and encourage the tax profession to provide value to clients and the community not previously attained.

For practitioners in industry, the challenge of adding value comes as digitisation impacts the compliance role. Being able to elevate a tax function to provide broader insights through data science and industry-specific knowledge is increasingly important. Across the profession, the challenge of attracting, developing and retaining talent is always important as the skillset required of tax professionals increases.

Most memorable career moment to date

Deloitte has given me the opportunity to work with amazing clients and inspiring people across the globe. Starting with Deloitte in Brisbane, I moved back to my home town of Canberra in 2017 and I have been fortunate to develop skills in managing tax functions and in leading teams.

The most memorable moments for me have been when my team and I are working collaboratively and in sync to solve difficult problems together.

How do you relax?

Spending time with family and friends, as well as hunting for the best whisky in town.

Advice to those entering the profession

Absorb as much information as you can and invest in developing both technical skills and soft skills. Particularly in larger companies and government, it is important to learn how to navigate in your chosen company and market. The tax profession is facing a time of disruption and change. Embracing disruptive technologies and broadening your commercial awareness will help you to be at the forefront of that change.

Payroll tax game changer? Optical Superstore decision

by Matthew McKee, FTI, Partner, Gillian Tam, FTI, Associate, and Rose McEvoy, Lawyer, Brown Wright Stein Lawyers

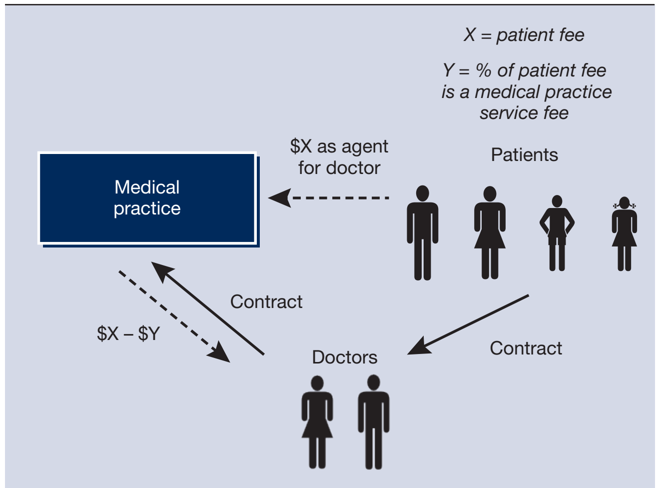
The Commissioner of State Revenue Victoria has been successful in the recent decision by the Court of Appeal of Victoria in *Commissioner of State Revenue v The Optical Superstore Pty Ltd*, where it was found that the transfer of funds from an optical store to optometrists engaged by the optical store under a "facilities use and trust" model were deemed taxable wages and subject to payroll tax obligations. The decision is likely to have far-reaching payroll tax implications for operators of medical, dental and allied health practices. While the wider implications of the decision are not yet clear, there may also be implications for businesses outside of the medical, dental and allied healthcare industries which operate under a similar model, where a person collects money on behalf of a service provider.

A decision by the Court of Appeal of Victoria is likely to have far-reaching implications for the payroll tax obligations of operators of medical, dental and allied health practices. All medical and allied health practices should review their payment arrangements to ensure that they comply with their payroll tax obligations.

It is a common practice for medical, dental and allied health practices to operate under a "tenancy and agency" model, under which a healthcare provider (eg a doctor or dentist) engages a practice to provide facilities and administration services to the healthcare provider for a service fee (see Diagram 1).

These arrangements are intended to operate so that the healthcare provider is conducting their own business and performing work for the patients, with the support of the practice. As part of these arrangements, the practice collects the patient fees from patients on behalf of the healthcare provider and, after deducting a service fee, pays the balance of the patient fees to the healthcare provider.

Diagram 1. Typical medical practice arrangements



It has long been thought that the payments by the practice to the healthcare provider under these arrangements are not subject to payroll tax, as the money being paid to the healthcare provider already belongs to the healthcare provider, and is only being held by the practice on trust for the healthcare provider. It was thought that the distributions of the money to the practitioner were not an amount that was paid or payable for work performed by the healthcare provider to the practice and, therefore, were not deemed to be taxable wages under the "relevant contract" provisions in the payroll tax law.

This traditional understanding has now been turned on its head following the decision in *Commissioner of State Revenue v The Optical Superstore Pty Ltd (Optical Superstore)*.[1]

To understand the implications of the decision, it is necessary to understand the particular arrangement used in *Optical Superstore* and the history of the litigation.

Facts in Optical Superstore

The Optical Superstore Pty Ltd was the trustee of four related trusts that together carried on an optical dispensary business known as The Optical Superstore.[2]

The arrangement used by The Optical Superstore was as follows.

The optometrists would direct Medicare and private patients to pay the consultation fees to the store owner, to be held on trust for the optometrist or its nominee.[3] The store would then deduct the occupancy fees due and pay the net amount to the optometrist or their nominee.[3]

Where the consultation fees derived by the optometrists were less than the amount that they would be entitled to, based on their hourly rate and time spent in the store, the store would treat the amount paid as a "location attendance premium" to the optometrists.[4] Goods and services tax would be paid on the location attendance premium and a recipient created tax invoice issued.[4]

The consultation fees were paid into the store owner's trading account.[5] The deposits named the relevant optometrists.[6]

The moneys were not held in separate sub-accounts for each optometrist.[5] After submitting the number of hours worked in a given store, the hours were signed off by the relevant store manager.[7]

A monthly payment would be made to the optometrist of the amount of the consultation fee it was due after deduction of the occupancy fee. No invoice was raised by the optometrist for this amount as it was considered to be a return of moneys belonging to the optometrist.[7] Diagram 2 sets out The Optical Superstore arrangement.

There are a number of particular features of The Optical Superstore model that are often not seen in medical practice arrangements (collectively called the "special features"), including:

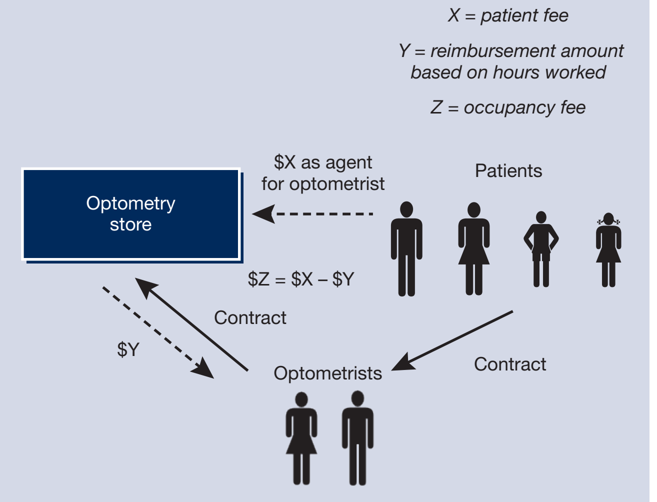
– the percentage that the optometrist received was calculated by reference to the hours that the optometrist worked;[7]
– if the deduction of the occupancy fee resulted in a negative amount, the payment would be treated as a "location attendance premium";[4]
– the hours worked by the optometrist were submitted to, and signed off by, the relevant store manager;[7] and
– the stores were selling products in conjunction with the services provided by the optometrist.[8]

The statutory provisions

The relevant statutory provisions in this case were ss 32(1)[9] and 35(1) of the *Payroll Tax Act 2007* (Vic) (PTA), which provide as follows:

> "32(1) In this Division, a ***relevant contract*** in relation to a financial year is a contract under which a person (the ***designated person***) during that financial year, in the course of a business carried on by the designated person —
>
> (a) supplies to another person services for or in relation to the performance of work; or
>
> (b) has supplied to the designated person the services of persons for or in relation to the performance of work; or
>
> (c) gives out goods to natural persons for work to be performed by those persons in respect of those goods and for re-supply of the goods to the designated person or, where the designated person is a member of a group, to another member of that group."
>
> "35(1) For the purposes of this Act, amounts paid or payable by an employer during a financial year for or in relation to the performance of work relating to a relevant contract or the re-supply of goods by an employee under a relevant contract are taken to be wages paid or payable during that financial year."

Diagram 2. The Optical Superstore arrangement



Note: If X was less than Y, the difference was treated as a "location attendance premium" payable to optometrist (GST would be paid and a recipient created tax invoice issued).

During the investigation by the Commissioner and in the objection decision, the Commissioner concluded that, under the arrangements, the optometrists provided services to the stores owners and patients and customers of the business of the store owners such that the agreements between the stores and the optometrists were "relevant contracts" under s 32.[10]

The Commissioner considered that, even if the consultation fees were held on trust for the optometrists, the distribution to them was still taxable wages in accordance with the decision of White J in *Freelance Global Ltd v Chief Commissioner of State Revenue*.[11,12]

The Optical Superstore appealed the objection decision to the Victorian Civil and Administrative Tribunal (VCAT).

VCAT decision

At first instance, Member Tang of the VCAT[13] considered that arrangements were put in place to benefit the stores because the provision of optometry services on site would lead to increased sales of optometry products.[14] Therefore, the services of the optometrists were being provided to the store owner as well as to the patients and, as such, the contracts were "relevant contracts".[15]

Member Tang held that the "location attendance premiums" paid to optometrists were "for or in relation to the performance of work".[16] However, Member Tang accepted that the consultation amounts were held for the optometrists on express trust and, as a result of which, the payments to the optometrists (or their nominees) were simply a return of money belonging to them and could not be viewed as a payment for, or in relation to, the services provided to the store owners.[17]

Supreme Court decision

Croft J in the Supreme Court of Victoria did not accept that the payments were not "for or in relation to the performance of work".[18] His Honour accepted the Commissioner's submission that the words "for or in relation to" are broad and, as the optometrists received the payments from performing work for patients and the stores, they were "for or in relation to the performance of work".[18] His Honour stated as follows:[19]

> "What is critical in determining whether the distributions were for or in relation to the performance of work is the breadth of the phrase 'in relation to' both generally and in the context of the PTA. Once that is accepted, it is plain that in circumstances where the distributions were — in substance — made as a result of the provision of

> optometry services by the Optometrist Entities, those distributions were for or in relation to the performance of work. Indeed the moneys which were distributed were earned through the relevant work, being the provision of optometry services to the public. *Though it is true that the bulk of the work was done for patients, rather than the Trustee, as the Tribunal found, services were also provided to the Trustee*." (emphasis added)

However, Croft J did not consider that the amounts were "paid or payable" to the optometrists within the meaning of s 35.[20] Croft J considered that the meaning of "payment" under the PTA does not extend to a return of money by "one person to another person where the money already belongs to the second person".[20] His Honour stated as follows:[20]

> "The relevant contract provisions impose payroll tax on amounts that are 'paid or payable by an employer ... for or in relation to the performance of work'. In this way, the PTA requires that amounts that can be characterised as 'payments' by the employer to the employee be identified. The meaning of 'payments' within the PTA does not extend to a return of money by one person to another in circumstances where the second person earned that money from providing services to a third party and directed the money be deposited in the bank account of the first person and held in trust. The amounts returned to the Optometrist Entities were not 'paid or payable for or in relation to the performance of work' within the meaning of s 35(1) of the PTA with the effect that payroll tax cannot be collected in respect of those amounts. Accordingly, the appeal must fail."

Court of Appeal decision

On 12 September 2019, the Victorian Court of Appeal allowed the Commissioner's appeal.

Importantly, The Optical Superstore did not appeal the finding of Croft J that, if the payment of the amounts were "paid or payable", they were "for or in relation to the performance of work".[21] The only issue the Court of Appeal needed to decide was whether the amounts were "paid or payable" within the meaning of s 35.[22]

The Court of Appeal considered that the amounts paid to the optometrist were "paid or payable" within the meaning of s 35, stating that "[t]he ordinary meaning of 'payment' readily embraces a payment of money to a person beneficially entitled to that money".[23]

Concluding observations

An unresolved question is whether Croft J was correct in his conclusion that the payments were "for or in relation to the performance of work". As the taxpayer did not appeal this conclusion, the Court of Appeal did not consider or resolve the question.[21]

The special features meant that the arrangements considered in *Optical Superstore* had an "employment-like" quality about them. In that sense, the arrangement was one for which, some may argue, payroll tax should have been payable. Many medical practice arrangements do not have such a quality. However, there is nothing in the decision of Croft J as to the construction of "for or in relation to the performance of work", or the Court of Appeal as to the construction of "paid or payable" that suggests the outcome is limited to arrangements with the special features. Croft J adopted a broad view of "for or in relation to the performance of work" and the Court of Appeal adopted a similarly broad view of "paid or payable".[21]

It may be that the special features impacted on the decision of Member Tang in the VCAT that the contracts were "relevant contracts", a decision which was not appealed by the taxpayer and, therefore, not considered by Croft J or the Court of Appeal.[24] Member Tang made the following comments in making his decision on this issue:[25]

> "In my view, the essential arrangement between the Trustee (and the trustees of the BAT and IOBT) and Optometrist Entities was that the Optometrist Entities would ensure the attendance of optometrists (including but not limited to the optometrist associated with the entity) at locations and times to be agreed, in order that those optometrists would provide optometry services to actual or anticipated customers of the Trustee.
>
> The arrangements were put in place to benefit the Trustee (and the trustees of the BAT and IOBT) because the provision of optometry services on site would lead to increased sales of frames, lenses and other optometry products.[92] The provisions of, and the language used in, the Optom Agreements are consistent with attempts to secure those benefits. Given the breadth of the terms used in the payroll tax legislation, there is no incongruity in finding that the services of the optometrists were provided to the Trustee as well as to the patients."

It is possible that, under arrangements where the medical or health practice does not sell products to the patients in conjunction with the services provided by the practitioner, the contracts will not be "relevant contracts". While it seems to be sufficient that the practitioners are providing services to the patients for the payments to them to be "for or in relation to the performance of work" under s 35, for the contract to be a relevant contract, the practitioner must be "supplying services" to the practice. If the only benefit for the practice is the occupancy and/or administration fees, are the practitioners supplying services to the practice?

The position will be uncertain until such time as the revenue offices clarify their positions. Until such time, there would be considerable risk in adopting a position that payments from a medical practice to practitioners under a "tenancy and agency" model are not taxable wages.

There is also a question as to what the decision means for arrangements outside of the medical and health industries where money is collected on behalf of a service provider. It is not clear where the dividing line will be for billing and collection arrangements.

Key takeaways

The key takeaways are as follows:

- medical practices that use a tenancy and agency model may now need to include payments made to the practitioners in their taxable wages for payroll tax;
- this is so, notwithstanding that the practitioners may be operating an independent business from the premises;
- it seems unlikely that it will be possible to confine the conclusion reached to the special features of The Optical Superstore arrangement, although there is some argument that the special features were what caused the contracts to be "relevant contracts" in the first place;

- medical practices using these arrangements should urgently review their arrangements; and
- the implications of the decision are unlikely to be limited to health industries, and could extend to other arrangements where a person collects money on behalf of a service provider.

Matthew McKee, FTI
Partner
Brown Wright Stein Lawyers

Gillian Tam, FTI
Associate
Brown Wright Stein Lawyers

Rose McEvoy
Lawyer
Brown Wright Stein Lawyers

References

1 [2019] VSCA 197.
2 *The Optical Superstore Pty Ltd v Commissioner of State Revenue (Review and Regulation)* [2018] VCAT 169 at [1].
3 [2018] VCAT 169 at [62].
4 [2018] VCAT 169 at [71].
5 [2018] VCAT 169 at [67].
6 [2018] VCAT 169 at [66].
7 [2018] VCAT 169 at [69].
8 [2018] VCAT 169 at [58].
9 None of the exceptions to a relevant contract in s 32(2) PTA applied in this case.
10 [2018] VCAT 169 at [44].
11 [2014] NSWSC 127.
12 [2018] VCAT 169 at [105].
13 *The Optical Superstore Pty Ltd v Commissioner of State Revenue (Review and Regulation)* [2018] VCAT 169.
14 [2018] VCAT 169 at [84].
15 [2018] VCAT 169 at [85].
16 [2018] VCAT 169 at [118].
17 [2018] VCAT 169 at [110].
18 *Commissioner of State Revenue v The Optical Superstore Pty Ltd* [2018] VSC 524 at [55].
19 [2018] VSC 524 at [54].
20 [2018] VSC 524 at [46].
21 *Commissioner of State Revenue v The Optical Superstore Pty Ltd* [2019] VSCA 197 at [88].
22 [2019] VSCA 197 at [33].
23 [2019] VSCA 197 at [67].
24 [2018] VSC 524 at [54].
25 [2018] VCAT 169 at [84] and [85].

Assessing market value ratios for roll-over relief provision

by Hung Chu, Director, Lonergan Edwards & Associates

The application of the CGT roll-over relief under s 615-20(2) of the *Income Tax Assessment Act 1997* (Cth) depends on the comparison of two market value ratios. The first market value ratio involves exchanging shareholders' shares in the interposed entity, and the second market value ratio involves exchanging shareholder's shares in the original entity. Assessing whether the two ratios are equal is complicated if the original entity has different classes of shares with different rights. The outcome of the comparison is very fact-specific, depending on whether or not a market value discount should be applied to shares subject to certain shareholder right restrictions, which in turn depends on, inter alia, the certainty of the proposed exchange of shares to proceed and the time frame for the completion of the proposed exchange of shares.

Introduction

It is quite common for a controlling shareholder of a private company to hold ordinary shares with full voting rights, whereas the other shareholders hold different classes of shares subject to no or limited voting rights and other restrictions. However, various commercial situations arise that require simplification of such structures to a single share class. A simple example is a public listing where shareholders (exchanging shareholders) dispose of all of their shares in the original company to a newly established company (the interposed company) in exchange for shares in the interposed company.

Under s 615-20(2) of the *Income Tax Assessment Act 1997* (Cth),[1] for CGT roll-over relief to apply, the following ratios must be equal:

- the ratio of:
  - the market value of each exchanging shareholder's share in the interposed company; to
  - the market value of the shares in the interposed company issued to all exchanging shareholders (worked out immediately after the completion time) (post-exchange market value ratio); and
- the ratio of:
  - the market value of that shareholder's shares in the original company that were disposed of under the scheme; to
  - the market value of all the shares in the original company that were disposed of under the scheme (worked out immediately before the disposal) (pre-exchange market value ratio).

The valuation complication

"Market value" is generally defined as the price that would be negotiated in an open and unrestricted market between a knowledgeable, willing but not anxious buyer (WBNAB) and a knowledgeable, willing but not anxious seller (WBNAS) acting at arm's length within a reasonable time frame. This is consistent with the definition of "market value" recognised in *Spencer v Commonwealth*.[2]

When assessing the above market value ratios for the application of roll-over relief, a valuation complication arises from the presence of multiple classes of shares with differing rights in the original company.

While the facts of each case are different, for ease of exposition and illustration of the key valuation principles, let us consider a simplified example where:

- the original company has dual classes of shares (ordinary shares and restricted shares which are subject to voting restrictions). The interposed company only has one class of shares (ie ordinary shares); and
- each exchanging shareholder's shares in the original company is exchanged for the same number of ordinary shares in the interposed company, regardless of whether that shareholder's shares in the original company are ordinary shares or restricted shares. That is, if the proposed scheme and one-for-one exchange of shares proceeds, each restricted shareholder's restricted shares in the original company would be exchanged for the same number of ordinary shares in the interposed company.[3]

Whether or not the above two market value ratios are equal depends on whether or not any market value discount should be applied to the restricted shares relative to the ordinary shares in the original company, based on the different rights of each share class immediately before the completion time.

Should a market value discount be applied?

Whether a market value discount should be applied depends on the certainty (immediately before the completion time) with which the proposed one-for-one exchange of shares would proceed. This certainty depends on, inter alia:

- the conditions precedent for the proposed exchange of shares;
- the commercial motivations and contractual commitments for the satisfaction of the conditions precedent; and
- the regulatory motivations for the proposed exchange of shares to proceed. For example, the presence of the non-voting class of shares makes it difficult for the initial public offering of the original company to be completed

due, for example, to the restriction on voting shares in the listing rules of the Australian Securities Exchange. The effect of the proposed one-for-one exchange of shares is to eliminate the non-voting shares and address the regulatory restriction.

The assessment of this certainty (or lack thereof) will determine whether the market value of the restricted shares is driven by the existing restrictions on the shares immediately before the completion time or the market value of the ordinary shares in the interposed company for which the restricted shares are proposed to be exchanged at the completion time.

For example, if it is reasonable to expect that a WBNAB and a WBNAS would, having considered the commercial context of the proposed exchange, agree that immediately before the completion time, the proposed one-for-one exchange of each shareholder's restricted shares in the original company for ordinary shares in the interposed company is certain to proceed at the completion time practically only seconds later, no market value discount should be applied to the market value of each shareholder's restricted shares for the voting restrictions (or other differential rights) associated with those shares.

This is because, as the exchange of each shareholder's restricted shares/non-voting shares for ordinary/voting shares in the interposed company is both imminent and certain, the market value of each shareholder's restricted shares immediately before the completion time is unaffected by voting rights and other shareholder class differences which were about to be eliminated.

In simple terms, if the proposed exchange of shares is certain to proceed, practically only seconds later at the completion time, the market value of each shareholder's restricted shares immediately before the completion time is the same as if that shareholder held ordinary shares in the original company.

This is consistent with the fundamental valuation principles that:

– market value is a forward-looking concept; and
– value is the present value (ie today's value) of future economic benefits (received only a fraction in time later).

In this regard, assuming that the ex-ante certainty of the proposed exchange of shares is to proceed practically only seconds later, focusing only on the existing non-voting characteristic and other differential rights of each shareholder's restricted shares when assessing the market value of that shareholder's restricted shares immediately before the completion time is also inconsistent with *FCT v Miley*.[4]

Mr Miley was one of three equal shareholders in a company (AJM). The three shareholders sold their shares in the company to a single purchaser for $17.7m under an arm's length transaction.

The Administrative Appeals Tribunal held that a minority interest discount of 20% should apply to Mr Miley's pro-rata share of the sale price of $17.7m when assessing the market value of his minority shareholding just before the sale.

On appeal, Wigney J held that:[5]

> "The approach taken by the Tribunal was erroneous. In short, the Tribunal misdirected itself in relation to the decision in Pioneer Concrete. That misdirection led the Tribunal to ignore a relevant consideration, that consideration being that just before the sale, there was a buyer in the market who was ready and willing to purchase all the shares in AJM, including Mr Miley's shares, for $17.7 million, and that Mr Miley and the other shareholders were ready and willing to sell all the shares at that price."

From a valuation perspective, the presence of a willing buyer and a willing seller(s) for all of the shares in AJM immediately before the sale of Mr Miley's minority shareholding justifies, as the court held, applying no minority interest discount when assessing the market value of Mr Miley's minority shareholding in AJM immediately before the sale. In principle, this is no different from the ex-ante certainty of the imminent elimination of the voting and other differential rights of the restricted shares justifying the application of no market value discount to the restricted shares for those restrictions immediately before the completion time.

Obviously, in cases where the commercial context indicates that there are uncertainties as to whether the proposed exchange of shares would proceed and/or there would be a significant delay in the completion of the proposed exchange of shares, a market value discount may be applied to the restricted shares.

Conclusion

Assessing the equality of the two market value ratios for the application of roll-over relief under s 615-20(2) is complicated if the original entity has different classes of shares with different rights.

Whether or not the pre-exchange market value ratio is equal to the post-exchange market value ratio is very fact specific, depending on, inter alia, the certainty of the proposed exchange of shares to proceed, the terms of the proposed exchange of shares, the time frame for the proposed exchange, and whether or not a market value discount should be applied to shares subject to certain shareholder right restrictions.

These valuation issues need to be addressed in the commercial context in which the valuation exercise is to be undertaken.

Hung Chu
Director
Lonergan Edwards & Associates

References

1 This division also applies to a scheme for reorganising the affairs of a unit trust. However, for ease of exposition, this article only refers to a company when discussing this scheme.

2 [1907] HCA 82.

3 Because roll-over relief only applies if the above ratios are (exactly) equal and not, for example, "similar in all material respects", the numerical equivalence of share numbers is critically important.

4 [2017] FCA 1396.

5 Ibid at [75].

SA land tax developments: aggregation avalanche

by Peter Slegers, CTA, Partner,
Joshua Pascale, Associate, and
Daniel Marateo, Associate, Cowell Clarke

The South Australian Marshall Government has committed itself to a significant, and what has proved to be controversial, reform of the state's land tax regime. Proposed to commence from 1 July 2020, the new measures will, if passed by the South Australian Parliament, introduce sweeping aggregation changes that seek to group related companies for land tax purposes and aggregate based on each owner's fractional interests in land. There will also be a shift towards imposing a surcharge on trust landowners in certain circumstances in common with some other states. This article considers the mechanics and planning issues associated with the proposed measures. It will be of relevance to advisers acting for landowners in South Australia and groups considering acquiring land in South Australia.

Reform agenda

The Marshall Government has committed itself to a significant reform of South Australia's land tax regime.

Following the unexpected Treasury announcement on the Budget night of 18 June 2019, the government moved swiftly to release an exposure draft of the proposed Bill to amend the land tax legislation, which had a minimal consultation period of one month.

If all goes to plan for the South Australian Government, the measures set out in the Land Tax (Miscellaneous) Amendment Bill 2019 (LTMAB) will have been introduced to parliament in the October 2019 sittings. At the time of writing, the LTMAB had not yet been introduced to parliament, and so this article is based on the LTMAB as released for consultation.[1]

This article considers the basic mechanics and planning issues associated with the LTMAB measures. It will be of relevance to advisers acting for landowners in South Australia and groups considering acquiring land in South Australia.

Existing land tax regime

Before considering the precise LTMAB measures, it is worthwhile revisiting the mechanics of the *Land Tax Act 1936* (SA) (LTA) in its current form.

Under the LTA, tax is assessed on an owner of land[2] in South Australia.[3] The tax is calculated on the site value in force at midnight on 30 June immediately preceding the commencement of each financial year (and on other circumstances that exist at midnight on 30 June).[4] However, the liability to land tax arises on 1 July of the following financial year.[5]

The basic workings of the LTA might be broadly summarised as follows:

– except as provided for explicitly in the legislation, land tax is calculated on the total or aggregated taxable value of all land (or interests in land) owned by the same taxpayer;[6]

– the taxable value of land is determined by its site value and is subject to progressive or marginal rates of tax, with the tax-free threshold currently being $391,000 and the highest threshold being $1,302,000 (see the table in the Appendix);

– grouping of commonly owned or controlled companies, trusts and other entities does not occur under the LTA except for some relatively limited provisions concerning land owned by a trustee of one or more trusts with the same beneficiary. In other words, each company and the trustee of each trust is treated as a separate person and a separate taxpayer;

– where two or more persons are the owners of land, the same amount of land tax is payable in respect of that land as if only one person were the owner,[7] however, each group of owners is treated as a separate taxpayer from any other owners of land which are comprised of some, but not all, of the same owners;[8]

– the Commissioner of State Taxation is empowered to disregard a "minor interest" for the purposes of determining the landowner and the person subject to tax. This will automatically apply where a person has an interest of 5% or less in land unless (in the unlikely event) the Commissioner is satisfied that there is no doubt that the interest was created solely for a purpose, or entirely for purposes, unrelated to reducing the amount of land tax payable;[9]

– the Commissioner may also disregard a minor interest where a person's interest in the land is greater than 5% but less than 50% and the Commissioner forms the opinion that the purpose, or one of the purposes, for the creation of the interest was to reduce the amount of land tax payable;[10] and

– in respect of trusts, there are a variety of existing (but relatively narrow) provisions that may group the trustees of trusts. Perhaps the most important is the provision that stipulates that where land is held on trust and the trustee is the taxpayer for the land, the taxable value of the land will not be aggregated with the taxable value of other land owned by the same taxpayer unless the land is held in trust for the same beneficiary.[11]

The last-mentioned rule has been subject to a controversial change in its administration by the Commissioner who has sought to use it as a basis for treating two or more discretionary trusts with the same trustee as grouped where the trusts have the same potential objects.

In the authors' view, this interpretation is unsupported by the existing law. It relies on treating the reference to a "beneficiary" as the same as a mere object or potential beneficiary of a discretionary trust, and there is considerable doubt as to whether a court would take this approach if the matter needed to be decided. Nonetheless, on the basis that the LTMAB is enacted, these issues are likely to be academic (see further below).

As with all state and territory land tax regimes, there are a variety of exemptions contained in the LTA. These fall into two major categories. First, outright exemptions from land tax.[12] Second, numerous exemptions (either in full or in part) which require proper grounds to exist and for such exemptions to be granted by the Commissioner and remain in force at the time of any land tax liability arising.[13]

The first category includes a long list of various exemptions, including primary production land situated outside a defined rural area. The second category of exemptions includes primary production land that is situated within a defined rural area (typically, land that is closer to metropolitan areas of South Australia). This exemption requires a number of additional criteria to be satisfied before the primary production exemption can be granted.[14]

Another common exemption is for land that is owned by a natural person which constitutes that person's principal place of residence. This exemption also requires that the buildings on the land have a predominantly residential character and that no part of the land is used for a business or commercial purpose (other than the business of primary production), or the part of the land so used is less than 25% of the total floor area of all buildings on the land. It should be noted that the natural person who owns land and uses it as his or her principal place of residence does not need to be the sole owner of the land.[15]

Aggregation or aggravation?

The South Australian Government originally announced incremental decreases to the land tax rates together with aggregation measures. These rate decreases have now been substantially brought forward by further Treasury announcements, which are to be effected by the LTMAB (see proposed rates for 2020-21 in the Appendix). This is seemingly in light of the Marshall Government remaining firmly committed to pursuing its aggregation agenda.

Importantly, the existing LTA not only uses the term "aggregation" several times in its provisions but, in fact, also defines the "aggregation principle". This is stated to mean "the principle under which the taxable value of all land owned by the same taxpayer is aggregated for the calculation of land tax".[16]

Interestingly, the now popular and commercial usage of the term "aggregation" appears to refer to any aspect of the legislation that groups two or more persons for the purposes of the group's overall land tax assessment. This shifting meaning of "aggregation" is significant given that there have been strong allegations from sectors of the media that the new measures are "fixing a loophole".

The existing provisions of the LTA suggest that, for a long period of time, aggregation has been a design feature of the legislation and the legislation only intended it to apply to one legal person (or group of legal persons where land is co-owned), except in very limited circumstances. In reality, what is occurring is a significant broadening of the concept of "aggregation" for the purposes of increasing the land tax liability of certain commonly controlled groups.

> *"What is occurring is a significant broadening of the concept of 'aggregation' for the purposes of increasing the land tax liability."*

LTMAB measures: overview

It is proposed that significant changes will be effected to the existing South Australian land tax regime with effect from 1 July 2020. The proposed changes are largely based on the Victorian and New South Wales land tax legislation.

Perhaps the most controversial change is to group "related corporations" for the purposes of aggregating land interests. Whether corporations are related will turn on, among other considerations, whether the same person has, or the same group of persons acting together have, a controlling interest in both corporations. This, in turn, depends on whether the same person, or group of persons acting together:

– hold more than 50% of the issued share capital of each company;
– are able to cast, or control the casting of, more than 50% of the votes at a general meeting of each company; or
– are able to control the composition of the board of each company.[17]

The notion of a group of persons "acting together" is not defined. This gives rise to some obvious conceptual challenges. For instance, if A and B together hold more than 50% of the share capital of Company 1 and A, B and C together (but not A and B together) hold more than 50% of the share capital of Company 2, will this be viewed as the same group of persons "acting together" to therefore have a controlling interest in both companies?

Significantly, while the above measures are proposed to apply to companies, the LTMAB measures do not aggregate land held by commonly owned or controlled trustees of trusts. Instead, the measures seek to apply surcharge rates on trusts (with some relief for unit trusts and fixed trusts — see below) and a "one-off" grandfathering measure for discretionary trusts.

The LTMAB deals with four major types of trusts, namely: unit trusts, fixed trusts, discretionary trusts and excluded trusts.[18] Excluded trusts include, among others, charitable trusts, public and listed unit trusts and complying superannuation funds. Excluded trusts are not affected by the new trust surcharge measures but continue to be subject to land tax at standard rates. "Administration trusts" are also excepted from the surcharge measures. Curiously, testamentary trusts do not appear to fall within the definition of an "administration trust".[19]

For land owned in unit trusts, it is proposed that:

- trustees are subject to surcharge rates of land tax unless the Commissioner is notified of the unitholders, in which case the trustee will be assessed at standard rates on the whole of the taxable land subject to the trust;
- where the Commissioner has been notified of the unitholders, each unitholder will be assessed (in addition to the trustee) on their proportionate interest in the land held by the unit trust. This interest is then aggregated with all interests of the unitholder in other taxable land; and
- in this latter case, the unitholder will be subject to a reduction in its land tax liability on account of the land tax assessed to the trustee (so as to avoid double taxation). If this deduction would result in a negative amount payable, the unitholder does *not* receive a credit for that amount.[20]

Provisions mirroring the above also apply for fixed trusts.[21]

Land held by trustees of discretionary trusts will be subject to land tax at surcharge rates. This is subject to the ability of a trustee of a discretionary trust to nominate a beneficiary as the "owner" of existing land held in the trust for land tax purposes.

Significantly, the nomination must be made by no later than 30 June 2020 and can only be made in respect of "pre-existing trust land", being land already held by the trust on the day the LTMAB is introduced to the House of Assembly. Where such a nomination is made, surcharge rates will not apply to the land owned by the trust and the land will instead be taken to be owned by the nominated beneficiary. All subsequent land acquired in discretionary trusts will be subject to the surcharge rates.

Other aspects of the proposed measures include:

- taxing co-owned land at the co-owner level (as a single taxpayer) and also taxing each individual co-owner on their fractional interests in all co-owned land (aggregated with any other interests in land held by that co-owner), with a credit available at the individual co-owner level to avoid double taxation;[22]
- the abandonment of the "disregarded minor interest" provisions for aggregation purposes (they will no longer be necessary given the above shift to taxing fractional interests) but for their application for the purposes of granting a whole or partial main residence exemption;[23] and
- extensive obligations on trust taxpayers to notify the Commissioner of changes in circumstances (including the acquisition and disposal of all land held on trust).

Multiple landowners and crediting system

As noted already, where two or more persons own land, they will initially be assessed as if they were one taxpayer. Each person is then also assessed on their fractional interest in the land (which is aggregated with any other land that person owns), but with that person then receiving a credit for the initial tax assessed on their behalf. As already highlighted, a similar crediting system will also apply to unit trusts and fixed trusts.

The stated purpose of the crediting system is to avoid double taxation. However, it expressly does not allow for any amount to be refunded to the taxpayer where the credit exceeds the tax payable.[24]

The following is a worked example of how the crediting system may work:

- A and B each own a 50% interest in land (jointly held) with a site value of $600,000, giving rise to land tax of $750;
- A and B are therefore assessed jointly on the $750;
- A is then assessed on his fractional interest in the land giving rise to a separate assessment to A, which will include not only assessing A on his fractional interest in the jointly held land, but also on any other land owned by A. On the basis that A owns no other land, he will be assessed on land with a notional site value of $300,000 (being 50% of $600,000). Although A receives a credit of $375 for the tax already assessed to A and B jointly, this cannot be refunded to A. A will simply not be liable for any further land tax; and
- assuming now that A did own other land with a site value of $450,000, the combination of that land and the jointly owned land would give rise to an assessment based on a notional site value of $750,000 (being 50% of $600,000 plus $450,000), resulting in land tax of $1,500. A would then be able to apply the $375 credit from the jointly held land against A's $1,500 liability, resulting in $1,125 of land tax (in addition to A's joint liability for the $750 on the jointly held land).

On the basis that these processes mirror the Victorian land tax regime (which appears to be the case), all of these assessments are expected to take place simultaneously. That is to say, there will be no delay in paying tax upfront on one assessment before a credit can be received on another assessment. Instead, it is expected that the annual assessments imposed on landholders will be issued with credits immediately applying.

An issue arises where one of the parties is the trustee of a trust and the other is an individual. Should the surcharge rates apply to the joint assessment or only the trust's fractional interest assessment? This appears to be addressed by a provision in the LTMAB that states that if an owner of land is a trustee of a trust, no regard is to be had to the existence of the trust in relation to the joint assessment.[25] The same provision makes it clear that regard is to be had to the trust in relation to the separate assessment. In other words, when determining the trust's separate assessment on its fractional interest in the land, surcharge rates are to apply.

Unit trust scenarios

A unit trust scheme is defined under the LTMAB to mean "an arrangement made for the purpose, or having the effect, of providing facilities for participation by a person, as a beneficiary under a trust, in any profit or income arising from the acquisition, holding, management or disposal of property under the trust".[26] Broadly, a unit in a unit trust scheme gives its owner a right or interest that entitles the beneficiary to participate proportionately with other unitholders in a distribution of property of the trust.[26]

As noted already, the trustee of a unit trust will be assessed at surcharge rates unless it gives notification of the unitholders to the Commissioner. The effect of the notification is that the trustee of the unit trust is no longer assessed at surcharge rates, however, the unitholders are then assessed on their fractional interest in the underlying unit trust land (in proportion to their unitholdings in the unit trust). The unitholders will receive a credit for the amount of land tax paid by the trustee on their behalf.

It is worthwhile contemplating how these basic scenarios might work in practice.

Example 1

Two discretionary trusts (DT1 and DT2) each hold 50% of the units in a unit trust (UT). UT owns land with a site value of $700,000.

DT1 and DT2 do not own any land in their own right, nor do they have any other interests in land.

The trustee of UT is assessed at surcharge rates on the land giving rise to an assessment of $4,750. No land tax payable arises to DT1 and DT2 on the basis that DT1 and DT2 do not own land.

Example 2

Assume that, on the same facts, UT makes a notification. This would mean UT pays tax at standard rates, giving rise to an assessment of $1,250, but now DT1 and DT2 are assessed on their fractional interest in the land owned by the UT (ie $350,000 per discretionary trust). Importantly, because they are the trustees of trusts (and as discretionary trusts, they cannot make a notification), DT1 and DT2 should be subject to land tax at surcharge rates.[27] Therefore, $1,750 of land tax arises per trust.

That said, each discretionary trust receives a credit of $625 for the tax already assessed to UT (proportionate to their interests).[28] Therefore, DT1 and DT2's respective land tax liabilities are reduced to $1,125.

Example 3

Assume that DT1 happens to own land in its own right with a site value of $500,000.

This would mean that the land owned by DT is now aggregated with the fractional interest in the UT land assessed to it — all at surcharge rates. This would result in DT1 being assessed on the land held in its own right ($500,000) plus DT1's fractional interest in the underlying UT land ($350,000). This gives rise to a total land tax liability for DT1 of $7,342.50. Again, DT1 would be entitled to offset the $625 credit (arising from its proportionate share of the UT assessment) against

Example 3 (cont)

the $7,342.50 amount. This would result in land tax of $6,717.50 being assessed to DT1.

Therefore, in this scenario, UT is liable for $1,250, DT1 for $6,717.50 and DT2 $1,750.

Example 4

Now assume that all units in UT are instead held by two self-managed superannuation funds (SMSF1 and SMSF2) in the same proportions as DT1 and DT2 previously. Also assume that the site value of the UT land remains at $700,000 and SMSF1 owns land with a site value of $500,000. SMSF2 owns no land.

If UT gives notification, UT will be assessed at standard rates and a land tax liability of $1,250 would arise. Importantly, as both SMSF1 and SMSF2 are excluded trusts, they are assessed at standard rates.

Therefore, SMSF1 is assessed on its total land interests, being $850,000 (ie $500,000 in its own right plus the fractional interest of $350,000). Land tax of $3,092.50 arises, however, this is reduced to $2,467.50 after the application of its credit received from UT.

SMSF2 is assessed on $350,000 of land, giving rise to a nil land tax liability at standard rates. Importantly, SMSF2 cannot apply its credit to create a land tax refund.

It should be noted that, if SMSF2 was a company or an individual rather than an SMSF, it would obtain the same result since companies and individuals are not subject to the surcharge.

Given these relatively basic examples, one can readily see some complex issues and significant planning opportunities arising in practice. In particular, decisions on whether the trustee of a unit trust makes the notification are likely to be affected by:

- the difference in outcomes for surcharge and standard rates for the trustee of the unit trust;
- whether the unitholders themselves own land (which will be aggregated with their fractional assessments); and
- the tax profile of unitholders (whether they are subject to surcharge rates or not).

Discretionary trusts and pre-existing trust land

Like unit trusts and fixed trusts, discretionary trusts will also have an ability to overcome the surcharge rates. However, this will be restricted to "pre-existing trust land".

In particular, the trustee of a discretionary trust will have the ability to nominate one beneficiary as the owner of all of the trust's land. As a result:

- the trustee will no longer be assessed at surcharge land tax rates;
- the beneficiary will include the whole of the trust land in its own assessment (and will need to aggregate this land with any other land owned by the beneficiary); and

– the beneficiary will receive a credit for the tax assessed to the trustee which will be deducted from the beneficiary's total land tax liability.[29]

Significantly, this nomination will be a "one-off" opportunity for trustees as the nomination must be made on or before 30 June 2020.[30] Importantly, where the designated beneficiary dies or becomes incapacitated, the trustee is able to nominate another beneficiary of the trust to become the designated beneficiary in the first beneficiary's place.[31] The nomination will then continue to prevent the trustee from being assessed at surcharge rates on pre-existing land.[32]

It should be noted that a "beneficiary" for the purposes of the nomination effectively refers to any potential object of a trust that can receive a capital distribution and who is 18 years of age or above. The beneficiary must sign a statutory declaration accepting their nomination.

It is worth noting that a nomination can be withdrawn after it is made. However, if this occurs, the trustee can never lodge another nomination and the trust will always be subject to land tax at the surcharge rates. An important decision therefore looms for trustees of discretionary trusts — the nomination can be revoked, but it can never be made if the 30 June 2020 deadline is missed.[33]

Advisers should be aware that if a discretionary trust owns pre-existing land for which a trust nomination is in force and then acquires further land after the LTMAB has been introduced to parliament (subsequent trust land), a formula applies in calculating the tax at the trustee level. This formula has the effect of apportioning the standard rates against the value of the pre-existing trust land and the surcharge rates against the value of the subsequent trust land.

Example 1

Assume that a discretionary trust (DT) owns land with a site value of $1,000,000 that was acquired before the LTMAB was introduced to parliament. Such land is therefore pre-existing trust land.

DT chooses not to make a nomination on or before 30 June 2020.

DT is assessed on the land at surcharge land tax rates, giving rise to a liability of $10,567.50 for the 2021 income year (which is $5,000 higher than the standard rates). DT will be assessed at surcharge rates for all future years.

Example 2

Instead, assume that, on or before 30 June 2020, DT nominates an individual, A, who is a potential beneficiary of DT as to capital. A is now the designated beneficiary of DT.

DT is assessed on the land at standard rates, giving rise to a liability of $5,567.50 for the 2021 income year. DT will be assessed at standard rates for all future years while the nomination remains in force.

A does not have any other interests in land (except an interest in a main residence) but is now assessed on the

Example 2 (cont)

land owned by DT for the 2021 income year. This gives rise to approximately $5,567.50 of land tax.

A obtains a credit for the tax paid by DT which can now be applied against A's liability. As a result, A will have no additional tax to pay.

Example 3

Assume that A dies in the 2022 year.

Also assume that DT makes a new nomination of A's surviving spouse, B, who is a potential beneficiary of DT. B is now the designated beneficiary of DT.

Also assume that DT acquired another property on 30 June 2021, with a site value of $600,000.

The trust now has pre-existing trust land and subsequent trust land, with a total site value of $1.6m. Applying the formula contained in proposed s 13A(7)(d) LTA, land tax is assessed to DT and a liability of approximately $21,291.25 arises.

B owns no other land (except the main residence) and is therefore assessed on the pre-existing trust land owned by DT for the 2022 year, giving rise to approximately $5,567.50 of land tax.

B obtains a credit for the land tax paid by the trustee of $21,291.25, which can now be applied against B's liability.[34] However, B cannot obtain a refund for the additional $15,723.75 paid by DT.

Example 4

Assume the same facts as example 3 but the property DT bought on 30 June 2021 was in fact purchased in B's name.

If all other facts remain the same, DT will still be assessed on its pre-existing trust land giving rise to a liability of $5,567.50 at standard rates.

When B is assessed, B will need to aggregate the property B owns personally with the property DT owns that is assessed to B. B will be assessed at standard rates giving rise to a liability of $19,232.50.

B will then be able to deduct the $5,567.50 assessed to DT from the $19,232.50 assessed to B, giving rise to a liability for B of $13,665.

It can be seen that in the lead up to 30 June 2020, the trustees of discretionary trusts will need to carefully consider whether to simply bear the surcharge or make a nomination of a designated beneficiary.

It should be noted that because the standard and the surcharge rates each have the same top threshold, the impact of surcharge rates is limited where each parcel of land with high values is held in separate trusts. In other words, the surcharge effectively "caps out" at site values equivalent to the highest threshold. Therefore, some groups holding separate parcels of high value land in each trust may be better off simply paying the surcharge rates in each trust. Groups of this kind will still have the benefit of non-aggregation since each trust will be a separate taxpayer for land tax purposes.

This can be seen in the following case study.

A family group owns five properties in separate discretionary trusts, each with a site value of $1m. If the group does not make beneficiary nominations for any of the discretionary trusts, each trust will be taxed at surcharge rates giving rise to a collective land tax liability of $52,837 (see table below).

However, a collective land tax liability of $27,837.50 can be achieved in the unlikely scenario where each trust has the ability to nominate a different beneficiary. A more realistic option is reflected in scenario D where, for example, Mum is nominated for one discretionary trust, Dad another, and then the three remaining trusts are left to incur the surcharge. Table 1 outlines five scenarios available to the group and the resulting tax liability for each scenario.

As always, it will be important to check the relevant trust deeds and, in particular, the capital beneficiary clauses to ensure the desired nominees are able to be nominated.

Other issues impacting on whether or not to make a nomination include:

– how many family members might be appropriate to nominate against a group of trusts since each trust can only nominate one designated beneficiary;
– whether a nomination is necessary in circumstances where the trust has a main residence; and
– the long-term consequences of nominating given that it will allow for a succession of new nominations as each designated beneficiary dies or becomes incapacitated.

Corporate groups

As noted already, unlike trusts, corporate groups may be subject to aggregation and assessed as a single corporation where the companies are "related corporations".

In addition to being assessed to land tax on an aggregated basis, related corporations that own land will also be jointly and severally liable for the land tax payable in respect of the group.[35]

The following basic examples highlight some observations regarding the potential application of the company grouping provisions in the LTMAB.

Example 1

Assume that Husband holds 100% of the share capital in Company 1 and his spouse, Wife, holds 100% of the share capital in Company 2.

Unlike other tax and revenue legislation, the LTMAB does not appear to automatically group associates (such as spouses) for the purposes of determining whether the same person, or group of persons, has a controlling interest in more than one company.

As such, it might be expected that Company 1 and Company 2 are not grouped in this scenario on the basis that the same person or persons do not have a controlling interest in each corporation.

If, however, Husband and Wife each held 50% of the share capital in Company 1 and 50% of the share capital in Company 2, the outcome would likely be different. Although neither Husband nor Wife holds or controls the rights associated with *more* than 50% of the shares in each company, in this latter example, it could be said that the same persons have a "controlling interest" in each of the corporations when acting together, resulting in Company 1 and Company 2 being aggregated.[36]

Example 2

Building on example 1, assume that:

– Husband and Wife each hold 50% of the issued share capital in Company 1; and
– Husband, Wife, Daughter and Son each hold 25% of the issued share capital in Company 2.

In this case, Companies 1 and 2 are unlikely to be grouped under the LTMAB on the basis that Husband and Wife acting together do not hold *more* than 50% of the issued share capital in Company 2. The mere fact that all four individuals have a familial relationship should not result in Companies 1 and 2 being grouped.

Of course, it is important in this circumstance to ensure the governing documentation for Company 2 does not confer any special rights or powers on Husband or Wife. For example, if the constitution of Company 2 allowed

Table 1. Discretionary trust nomination permutations

Scenario	Nomination/s	Trust tax	Top-up beneficiary tax	Total
A	Nil — all trusts incur surcharge rates	$52,837	–	**$52,837**
B	Nominate same beneficiary for five trusts	$27,837	$72,995	**$100,833**
C	Nominate one beneficiary for three trusts Nominate another beneficiary for two trusts	$27,837	$53,828	**$81,655**
D	Nominate one beneficiary for one trust Nominate another beneficiary for one trust Three trusts incur surcharge rates	$42,837	–	**$42,837**
E	Nominate different beneficiary for each trust	$27,837	–	**$27,837**

Example 2 (cont)

Husband and Wife to appoint or remove directors, this may be sufficient to make the companies "related corporations".[37]

Example 3

Assume the same facts as in example 2, however, that the shareholding in Company 2 is instead as follows:

- Husband, Wife and Daughter as to 1,000 A class shares each (ie 25% each of the total issued share capital); and
- Son as to 1,000 Z class shares (ie 25% of the total issued share capital).

The A class shares confer usual voting, dividend and capital rights, while the Z class shares confer on the holder a right to a fixed dividend and also preferred capital rights on a winding-up (ie preference shares).

On its face, Husband and Wife hold only 50% of the issued share capital in Company 2 and therefore it might be suggested that, as this is not more than 50%, Company 1 and Company 2 are not grouped.

However, the LTMAB provides that a reference to the issued share capital of a corporation does not include a reference to any part of it that carries no right to participate beyond a specified amount in a distribution of either profits or capital.[38] The Z class shares, carrying fixed dividend rights, appear to fall within this category.

As such, it is likely that Company 1 and Company 2 will be grouped in this scenario on the basis that the Z class shares held by Son will be disregarded when determining whether Husband and Wife together have a controlling interest in both companies (ie Husband and Wife's shareholding in Company 2 will be 66% rather than 50%).

Example 4

Husband and Wife still each hold 50% of the issued share capital in Company 1, however, assume now that the shareholding in Company 2 is as follows:

- Husband and Wife as to 20% each; and
- Trustee Pty Ltd (TrusteeCo) as trustee for a discretionary trust (DT) as to 60%.

Husband and Wife are also the directors and equal shareholders of TrusteeCo.

There is considerable uncertainty as to how the controlling interest provisions are intended to operate in this situation. While on its face, Husband and Wife might be seen as having a controlling interest in Company 2 by virtue of being able to control TrusteeCo's voting rights in Company 2, the position may be impacted by proposed s 13J(1)(c) LTA.

Proposed s 13J(1)(c) provides that any shares held or power exercisable by a person or corporation as a trustee or nominee for another corporation:

Example 4 (cont)

- are to be treated as exercisable by that other person or corporation, if the trust is a fixed trust or a unit trust; and
- are to be treated as not held or exercisable by the trustee or nominee (whether or not the trust is a fixed trust or a unit trust).

This provision appears to suggest that where shares in a company are owned by the trustee of a discretionary trust, the trustee of that trust cannot be treated as holding the shares or exercising any powers. If this is the case, arguably, no persons have a controlling interest in Company 2 because Husband and Wife could only be taken to control the rights associated with more than 50% of the issued share capital in Company 2 if TrusteeCo did in fact hold shares for the purposes of the test.[39]

The authors have sought clarification on this issue from Treasury and RevenueSA.

The path ahead …

Once the LTMAB is introduced to the South Australian Parliament, the Marshall Government will most likely need the support of the State Labor Opposition to see it passed into law.

At the time of preparation of this article, the Labor Opposition has not publicly committed itself to a position on the new measures. With significant lobbying against the aggregation measures by the Property Council of Australia and Business SA, at the time of writing, the LTMAB still has a way to go before it can be guaranteed a safe passage through parliament.

There will be a need to carefully monitor the position as the situation progresses.

Peter Slegers, CTA
Partner
Cowell Clarke

Joshua Pascale
Associate
Cowell Clarke

Daniel Marateo
Associate
Cowell Clarke

Acknowledgment

The authors would like to acknowledge and thank Lachlan Prider and Jackson Jury, law clerks with Cowell Clarke, for their assistance in the preparation of this article.

References

1 Further, the figures used in this article are based on the thresholds and rates in the LTMAB released for consultation, together with RevenueSA's projections for indexation of the land tax thresholds for the 2020-21 financial year.

2 S 14 of the *Land Tax Act 1936* (SA) (LTA).

Appendix

SA land tax rates 2019-20

Total taxable site value	Amount of tax
Does not exceed $391,000	Nil
Exceeds $391,000 but not $716,000	$0.50 for every $100 or part of $100 above $391,000
Exceeds $716,000 but not $1,042,000	$1,625.00 plus $1.65 for every $100 or part of $100 above $716,000
Exceeds $1,042,000 but not $1,302,000	$7,004.00 plus $2.40 for every $100 or part of $100 above $1,042,000
Exceeds $1,302,000	$13,244.00 plus $3.70 for every $100 or part of $100 above $1,302,000

SA land tax rates for 2020-21 as proposed in SA state Budget 2019-20

Total taxable site value	Amount of tax
Does not exceed $450 000	Nil
Exceeds $450,000 but not $755,000	$0.50 for every $100 or part of $100 above $450,000
Exceeds $755,000 but not $1,098,000	$1,525.00 plus $1.65 for every $100 or part of $100 above $755,000
Exceeds $1,098,000 but not $1,372,000	$7,184.50 plus $2.40 for every $100 or part of $100 above $1,098,000
Exceeds $1,372,000 but not $5,000,000	$13,760.50 plus $2.90 for every $100 or part of $100 above $1,372,000
Exceeds $5,000,000	$118,972.50 plus $3.60 for every $100 or part of $100 above $5,000,000

Reduction in highest rate as proposed in SA state Budget 2019-20

2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
3.7%	3.6%	3.5%	3.4%	3.3%	3.2%	3.1%	3.0%	2.9%

Land tax bracket for 2020-21 as amended by LTMAB (standard rates)

Total taxable site value	Amount of tax
Does not exceed $450,000	Nil
Exceeds $450,000 but not $755,000	$0.50 for every $100 or part of $100 above $450,000
Exceeds $755,000 but not $1,098,000	$1,525.00 plus $1.65 for every $100 or part of $100 above $755,000
Exceeds $1,098,000	$7,184.50 plus $2.40 for every $100 or part of $100 above $1,098,000

SA land tax bracket for 2020-21 as amended by LTMAB (trust surcharge rates)

Total taxable site value	Amount of tax
Does not exceed $25,000	Nil
Exceeds $25,000 but not $450,000	$125 plus $0.50 for every $100 or part of $100 above $25,000
Exceeds $450,000 but not $755,000	$2,250.00 plus $1.00 for every $100 or part of $100 above $450,000
Exceeds $755,000 but not $1,098,000	$5,300.00 plus $2.15 for every $100 or part of $100 above $755,000
Exceeds $1,098,000	$12,674.50 plus $2.40 for every $100 or part of $100 above $1,098,000

3 S 4(1) LTA.

4 Ss 4(3) and 7(2) LTA.

5 S 4(2) LTA.

6 "Taxpayer" is each person liable to pay tax under the LTA: s 2(1) LTA.

7 S 12(1) LTA. Note that s 12(2) does not affect the operation of other provisions of the legislation under which the value of land is aggregated for the purposes of a land tax assessment.

8 S 13(3)(a) LTA.

9 S 13A(2) LTA.

10 S 13A(3) LTA.

11 S 13(3)(b) LTA.

12 S 4(1) LTA.

13 S 5 LTA.

14 S 5(10)(g) LTA.

15 S 5(10)(a) LTA.

16 S 2(1) LTA.

17 Proposed ss 13H and 13I LTA (as amended by the LTMAB).

18 All defined in proposed s 2(1) LTA except unit trusts that are defined by reference to a unit trust scheme.

19 This is on the basis that an administration trust will exist where the assets of a deceased are held by a personal representative only until the completion of the administration of the estate or the third anniversary of the death of the deceased (whichever is earlier): proposed s 2(1) LTA.

20 Proposed s 13 LTA generally.

21 Proposed s 12 LTA.

22 Proposed s 9 LTA.

23 Proposed s 5AA LTA.

24 Proposed s 9(6) LTA.

25 Proposed s 9(7) LTA.

26 Proposed s 2(1) LTA.

27 There is some ambiguity as to whether discretionary trusts will pay land tax at standard or surcharge rates on land imputed to the trust pursuant to a unit trust notification. In the authors' view, based on the current draft LTMAB, the discretionary trust would pay surcharge rates.

28 Applying the formula in proposed s 13(6) LTA.

29 Proposed s 13A(9) LTA.

30 Proposed s 13A(1) LTA.

31 Proposed s 13A(3) LTA.

32 Proposed s 13A(7)(c)(ii) LTA.

33 Proposed s 13A(6) LTA.

34 Pursuant to proposed s 13A(9), it seems that the credit received by the nominated beneficiary is equal to the *whole* of the amount of tax assessed to the DT trustee (as opposed to the amount of land tax assessed to the trustee on pre-existing land only). This appears to be an anomalous result and has been ignored for the purpose of these calculations.

35 Proposed s 13K(2) LTA.

36 Proposed s 13I LTA.

37 The tests relating to controlling the composition of the board, controlling the casting of more than 50% of the votes and holding more than 50% of the issued share capital are alternative tests and therefore satisfying only one of those in respect of Company 2 would be sufficient to group Company 1 and Company 2 in the example given.

38 Proposed s 13J(1)(b) LTA.

39 This interpretation is broadly consistent with the interpretation adopted by the Chief Commissioner of State Revenue in NSW, which has an identical deeming provision to proposed s 13J(1)(c)(ii): para 15 of Revenue Ruling LT 003v2 (NSW).

A Matter of Trusts

by Will Monotti, Sladen Legal

The appointor: common problems

Careful consideration of the identity of the appointor of a trust, and the scope of their powers, is essential in succession planning.

Most modern discretionary trusts, whether established via a will or as an inter vivos "family" trust, will have an appointor. The appointor's powers are subject to the wording of the will or trust deed under which they are appointed.

The power that is common to almost every appointor of a discretionary trust is the power to appoint additional trustees, or to remove a trustee and appoint a new trustee or trustees in their place. It is for this reason that the appointor is often referred to as the ultimate controlling position of the trust. However, this power is sometimes considered to be fiduciary in nature,[1] meaning that the holder of the power is required to exercise it honestly and in good faith, with the best interests of the beneficiaries in mind and for a proper purpose; while it may be an ultimate power, it is not unfettered.

Some trusts will also appoint a guardian (sometimes also known as a principal), and for trusts with guardians and appointors, the roles are often distinct, notwithstanding that the same persons may be appointed. The guardian is usually required to consent to the trustee exercising certain powers (often characterised as "reserved" and/or "restricted" powers), which may include the power to amend the trust deed, exclude beneficiaries or make a distribution of trust capital.

Other trusts will only have an appointor, and in such instances, the positions of appointor and guardian may be conflated. The question of whether or not these reserved or restricted powers are fiduciary or personal in nature is not settled and becomes particularly thorny when the trustee and guardian or appointor are the same person or company. The wording of the trust deed may provide guidance in this regard.

Prohibitive variation powers

If, as is the case with many older trusts, there is no or an inadequate provision for an additional, substitute or successor appointor made in the trust deed, the trustees may look to amend the deed to provide for this addition, substitution or succession. The possibility of the trustees effecting such an amendment will depend on the wording of the deed's variation power.

In *Mercanti v Mercanti*, the Supreme Court of Western Australia held that the scope of a trustee's power of amendment is contingent on the power's "express terms, or on what may properly be implied", by a "reasonable person", having considered the power within the broader context of the deed.[2] The court held that an amendment power which allowed only for the variation of "trusts" did not allow the trustee to change the appointor. This deed used words and phrases such as "trusts", "this trust" and "trusts, terms and provisions" variously throughout the deed, which the court held was indicative of a deliberate attempt to distinguish between "trust" powers and "terms and provisions".

Having had regard to the trust deed in its entirety, it was determined that matters relating to the appointor were part of the "terms and provisions" of the deed, rather than being "trust" powers. The deed's amendment power was therefore sufficiently restrictive to prohibit any change to the appointor or terms and provisions pertaining to the appointor.

This poses problems for trustees of trusts with such amendment powers. There will be no one simple solution to these problems. The trustee could seek an order from the court to vary the trust, though there is no guarantee that such an application would succeed. If the appointor clause cannot be changed and there is only one appointor named in the deed, with no successor, the trustees may need to consider the practical implications for the trust on the death of the appointor, and the consequences of vesting the trust early from the perspectives of tax and asset protection.

If the trustee of the trust is a corporate entity, in lieu of using the position of appointor to provide for trustee succession, the trustee could consider the structure of ownership of shares in the company and plan for those shares to be gifted or transferred, either by will or other document, on particular trigger events, such as the death or incapacity of the shareholder(s). Succession issues can also be mitigated through the use of a corporate appointor, with shareholder(s) to bequeath their shares to their desired successors.

It is also important to remember that, if there is consistent language throughout the deed to indicate that matters relating to the appointor are "trusts", a variation power that refers only to "trusts" need not necessarily prevent amendment to the appointor clauses. The overarching lesson from *Mercanti* is that the deed will govern the way the trustee approaches these matters, and that before making any changes to the deed, both the amendment power and the deed as a whole should be carefully reviewed.

Can the appointor appoint themselves or a related company as trustee?

Appointors of discretionary trusts should be aware that there is common law support for the characterisation of the power to appoint trustees as fiduciary in nature. This dates back to a 19th century decision of Kay J, in which it was emphasised that the power to select a trustee should not be made by that person in a manner which resulted in the individual benefiting.[3]

The validity of this characterisation was considered in the recent case of *Baba v Sheehan* by the Supreme Court of

New South Wales, where it was alleged that the appointment by an appointor of an entity as trustee constituted a fraud on a power.[4] The appointor had appointed not himself as trustee, but instead a company that he controlled. Parker J expressed doubt that an appointor should be prohibited from appointing themselves as trustee, and that in this case, the fact that the newly appointed trustee was a separate legal entity would, in any event, preclude it from being considered under any such rubric of prohibition.[5]

The decision suggests that there is ambiguity as to whether Kay J's view should be adopted as a definitive approach. Nonetheless, it was emphasised that, while the power itself may not be fiduciary, it may still be used in a manner tantamount to a fraud on a power if the use of the power could be deemed improper or self-serving in a way that disregards the interests of, or disenfranchises, the other beneficiaries of the trust. The facts of the case did not merit further interrogation of this question by Parker J but, should it arise elsewhere, the appointor could record in the deed of appointment or accompanying resolution confirmation of their concerns as to the conduct of the trustee if that were the basis for their decision to remove that trustee.

Joint appointors: can the power be unwittingly extinguished?

Another potential trap that may arise is in the event of the death of an appointor or a guardian appointed jointly with another appointor or guardian. Old case law indicates that, if a bare power, such as an appointor or guardian power, is given jointly, then, on the death of one of the joint recipients of the power, that power is altogether extinguished — it is intended that the power be granted to, and exercised by, those individuals together and only together.[6] If this power therefore does not automatically vest in the survivor, it is possible, should no successor have been nominated, that a trust will be without an appointor or guardian after the death of one of them. Again, this will depend on the wording of the deed.

If there are multiple appointors appointed without specification as to whether the appointment is "joint" or simply a collective appointment, without any other provision to the contrary, it may be assumed that the appointment is collective and thus is not extinguished on the death of one of the appointors. It is recommended, when establishing new trusts, to include a clause in the deed to specify what is to occur on the death or incapacity of an appointor (or guardian) and, similarly, to carefully consider whether the appointment should be specified as joint in the deed's schedule.

Conclusion

The appointor has significant powers (which arguably can be categorised as fiduciary) and so, when establishing a trust, the decision as to who is appointed as appointor is as important, if not more so, than the selection of a trustee. Poor succession planning in relation to the position or an exercise of the power in an inept manner may present further problems to trusts and their beneficiaries. Meticulous drafting of the trust deed or any deeds to vary or rectify an original deed will, in such scenarios, prove critical.

Will Monotti
Associate
Sladen Legal

References

1 See, for instance, *Re Skeats' Settlement* (1889) 42 Ch D 522; *Montevento Holdings Pty Ltd v Scaffidi* [2012] HCA 48; and *Scaffidi v Montevento Holdings Pty Ltd* [2011] WASCA 146 at 147-150.

2 *Mercanti v Mercanti* [2015] WASC 297 at [78].

3 *Re Skeats' Settlement* (1889) 42 Ch D 522.

4 [2019] NSWSC 1281 at 42.

5 Ibid at 67.

6 See, for instance, *Mansell v Mansell* [1732] EngR 187; *Brassey v Chalmers* [1852] EngR 995; *Montifiore v Browne* [1858] EngR 1053.

Superannuation

by Daniel Butler, CTA, and Bryce Figot, CTA, DBA Lawyers

SMSF investment strategies: are they a financial product?

While some argue that an investment strategy is not a financial product, advisers not covered by a licence are at substantial legal risk when providing such a strategy.

Many advisers do not foresee the potential flow-on legal consequences from merely providing an investment strategy template to a self-managed superannuation fund (SMSF) client. Indeed, many believe they are merely assisting their client, particularly to ensure that the SMSF will have the necessary paperwork to survive an audit and not receive an auditor contravention report.

This article therefore focuses on whether an unlicensed adviser who merely provides an investment strategy to an SMSF trustee is providing a financial product or financial service that is covered by the *Corporations Act 2001* (Cth). It also briefly examines potential related legal risks.

Australian financial services licence regime

Accountants and other SMSF advisers who are not covered by an Australian financial services licence (AFSL) are not permitted to provide financial product (FP) advice or related financial services under the *Corporations Act 2001*.

While some commentators argue that the preparation of an investment strategy is not an FP requiring a licensed adviser, an adviser who is not covered by a licence would be placing themselves at substantial legal risk of contravening the *Corporations Act 2001* and potential exposure to damages and other claims by simply providing an investment strategy, especially if this proved unsatisfactory.

For example, a non-licensed adviser supplying an investment strategy covering investments that lost substantial value may be at risk in relation to an SMSF trustee that suffers any loss and damages from the fund's poor investment performance. While the adviser may argue that the investment strategy template was merely provided to satisfy the *Superannuation Industry (Supervision) Act 1993* (Cth) (SISA) and the *Superannuation Industry (Supervision) Regulations 1994* (Cth) (SISR) criteria and was not intended to be relied on as a *real* investment strategy, that adviser will be tested to the level of care and skill that a reasonably competent licensed professional providing investment strategies would prepare (especially after appropriate fact finding and disclosures of the service offering etc).

A licensed (AFSL) adviser should typically run through the following steps in relation to preparing an investment strategy for a client:

- agree their relevant terms of engagement and scope, and provide their financial services guide;
- undertake an extensive fact-finding exercise;
- undertake risk profiling of the client based on their goals and level of risks etc;
- provide a statement of advice;
- provide an investment strategy based on the above; and
- ensure that each step above is appropriately documented/recorded.

A non-licensed adviser who merely provides an investment strategy template without going through the above process, in addition to contravening the *Corporations Act 2001* and not being covered by their professional indemnity insurance, would be measured to the standard of a reasonably competent professional adviser with an appropriate licence under the *Corporations Act 2001*.

Also, the recent SMSF auditor negligence case, *Ryan Wealth Holdings Pty Ltd v Baumgartner*,[1] highlights how advisers can readily be liable for any shortcomings in an SMSF's investment strategy.

Broadly, in this case, the SMSF auditor had an *indirect* responsibility for checking the SMSF investment strategy for SISA/SISR and financial statement purposes, and the auditor was held primarily liable for the investment losses suffered.

Similarly, as noted in the above example, a non-licensed adviser simply providing an investment strategy template where the SMSF trustee suffers a material loss could potentially be liable for any consequential loss or damages suffered. Moreover, as lawyers often point out, there is always the risk of a vexatious litigant!

An issue with insurance

Assume that the template investment strategy also covered the requirement regarding the consideration of insurance in reg 4.09(2)(e) SISR and that the non-licensed adviser wanted the client to also be covered from a SISA/SISR viewpoint. Thus, the template investment strategy may include wording such as:

> … the trustees have considered insurance cover on each member and have resolved not to implement any cover.

Now assume that one of the members, who happens to be the main "breadwinner" of the family, dies without any insurance. The non-licensed adviser could be liable for substantial damages on the basis that such an investment strategy was a recommendation not to implement insurance when that recommendation has subsequently proved to be inappropriate due to the death of the SMSF member.

This is where the investment strategy involves FP advice under the *Corporations Act 2001*. Such an adviser may be potentially liable in, among other things, negligence to the SMSF member or anyone else who may suffer due to no, or inappropriate, insurance in place.

An adviser must generally be licensed to provide a recommendation in relation to insurance. A non-licensed adviser can provide limited factual advice on the general types of insurance available to manage risk without making any recommendation, where a recommendation can include seeking to influence a decision in relation to a financial product.

What is FP advice?

A person provides a financial service under s 766A(1) of the *Corporations Act 2001* if they:

- provide FP advice (s 766B of the *Corporations Act 2001*); or
- deal in an FP (s 766C of the *Corporations Act 2001*).

An FP under s 763A(1) of the *Corporations Act 2001* is broadly a facility through which a person does one or more of the following:

- makes a financial investment (s 763B of the *Corporations Act 2001*); or
- manages financial risk (s 763C of the *Corporations Act 2001*).

Financial product advice, under s 766B(1), means a recommendation or a statement of opinion that:

- is intended to influence a person in making a decision in relation to a particular FP or class of FPs; or
- could reasonably be regarded as intended to have such an influence.

Thus, while strictly speaking, an investment strategy template is not an FP, by itself (as some commentators have suggested), the provision of an investment strategy template can readily constitute a financial service.

As you may appreciate from the above, without the right context, the claim that an investment strategy template is not an FP is, by itself, misleading.

What should advisers do?

As many advisers would be aware in practice, if an investment strategy template is provided to a client with the recommendation that they complete it themselves or engage an expert licensed adviser to do so, many clients will want to come back and ask the adviser supplying that template what to do next. While it may be tempting to say, "just complete it this or that way with these words or ranges" etc, a non-licensed adviser should simply state that they are precluded under the *Corporations Act 2001* from assisting any further in this regard and should insist on the client seeking assistance from an adviser with an appropriate licence.

Thus, non-licensed advisers should not prepare SMSF investment strategies for their clients. Non-licensed advisers can, however, refer their clients to appropriate resources or to an adviser who is covered by an AFSL in relation to assisting an SMSF with its investment strategy obligations.

Another alternative is for a non-licensed adviser to refer their SMSF client to a supplier that provides documentation that can assist SMSF trustees to prepare their own investment strategy.

Where a non-licensed adviser provides an investment strategy template or refers their client on to a licensed adviser, they should also issue an appropriate letter of execution that clearly covers them in the event their client ever alleges that they provided any FP advice or related financial service.

Conclusion

If a non-licensed adviser wishes to supply an investment strategy template to a client (which is not recommended), they should at least provide a comprehensive disclaimer letter stating, among other things, that they cannot provide FP advice as they are not covered by an AFSL and that the client should seek FP advice from a licensed adviser with an appropriate AFSL to complete the template.

For the reasons outlined above, it is generally suggested that non-licensed advisers recommend their SMSF clients seek advice from a licensed adviser or, if the SMSF trustee does not wish to obtain such advice, to refer their client to resources where the SMSF trustee can prepare their own investment strategy. Naturally, an appropriate comprehensive disclaimer letter should also be issued under this option.

Advisers must be aware of what advice and services they can offer in relation to assisting SMSF trustees and members on their investment strategies, especially if they do not have an AFSL. Otherwise, advisers may be exposed to potential legal risks.

Daniel Butler, CTA
Director
DBA Lawyers

Bryce Figot, CTA
Special Counsel
DBA Lawyers

Reference

1 [2018] NSWSC 1502.

Tax Cases

by Michael Norbury, CTA, Norbury Lawyers

The case of the knight's advocate

When might a tax agent represent a client at a hearing in the Federal Court? Is there another basis on which a tax agent might assist his client in a Federal Court hearing?

Background

Sir Yii Ann Hii, the taxpayer, had been knighted in Papua New Guinea, but was in debt to the Australian Commissioner of Taxation for many millions of dollars. The origins of the debt arose when assessing conclusions by the Commissioner that the taxpayer was, for the purposes of Australian taxation law, a resident of Australia for several years earlier this century.[1]

The taxpayer had conducted multiple pieces of litigation against the Commissioner, including a proceeding in the High Court in its original jurisdiction,[2] and the Supreme Court of Queensland, as well as other proceedings in the Federal Court.[3]

This proceeding

This proceeding involved an interlocutory application made by the taxpayer for the following orders:[4]

"1. That the Court permits the Australian registered tax agent of the [taxpayer], Ms Moira Helen Clay ('**Ms Clay**'), to assist the [taxpayer] as a 'McKenzie friend':
   a. in the application for relief under section 398 of the *Judiciary Act* 1903
   b. in this interlocutory application and/or
   c. in any directions or other hearings in the applications.
2. That the Court permits Ms Clay as a 'McKenzie friend' to represent, speak in support of and/or act on behalf of the [taxpayer]:
   a. for the purposes of this interlocutory application
   b. in the application for relief under section 398 of the *Judiciary Act* 1903 and/or
   c. in any directions or other hearings in the applications

   as necessary for the proper conduct of these applications, including appearing on behalf of the [taxpayer], preparing written submissions, and making oral submissions in the applications if required.
3. Alternatively, if:
   a. the court does not permit Ms Clay to represent, speak in support of and act on behalf of the [taxpayer] in either or both of applications as requested at order 2, and/or
   b. if the [taxpayer] is required for some other reason to appear in the matter,

   that the [taxpayer] be permitted to appear before the Court by telephone, or alternatively by audio or video link or other appropriate means, for the proposes of:
   i. this interlocutory application
   ii. the application for relief under s 398 of the *Judiciary Act* 1903 and/or
   iii. for any directions or other hearings in the applications

   in accordance with s 478 of the Federal Court Act 1976.
4. That pursuant to Rule 30.23(g) of the Federal Court Rules 2011 and if the Court considers it appropriate, any hearing be by written submissions and the requirement for oral submissions be dispensed with.
5. That the [taxpayer] pays the cost of any audio or video link as permitted by the Court.
6. That the costs of this interlocutory applicant be reserved.
7. Any other order the court considers appropriate."

The interlocutory application was part of a wider application in which the taxpayer was seeking to have the court issue writs of certiorari and mandamus against the Commissioner in relation to the audit decision and the objection decision. The taxpayer was seeking that the audit decision and objection decision of the Commissioner were effectively no decision and had no legal effect.[5]

McKenzie friend

The court explained that the term "McKenzie friend" employed by the taxpayer in his interlocutory application referred to a form of assistance to a litigant in person recognised by the Court of Appeal for England and Wales in the case which had come to lend its name to such an assistant, *McKenzie v McKenzie.*[6] In that case, the court referred to a feature of permissible assistance to a litigant in person described long beforehand in this way by Lord Tenterden CJ[7] in *Collier v Hicks*:[8]

> "[a]ny person, whether he be a professional man or not, may attend as a friend of either party, may take notes, may quietly make suggestions, and give advice"

The court observed that it was immediately apparent from this description and from the interlocutory orders sought by the taxpayer that he was applying for permission that Ms Clay undertake a wider role in the proceedings than that of a "McKenzie friend". The taxpayer sought that she be permitted to undertake an advocacy role for him. Such permission from the court was necessary because Ms Clay was not a legal practitioner. She was a registered tax agent who had undertaken some post-graduate study in taxation and business law (her tertiary qualifications were a Bachelor of Business (Accounting) from RMIT and a Masters of Commerce (Taxation and Business Law) from QUT). In relation to her practising as a registered tax agent, Ms Clay carried professional indemnity insurance. Whether that extended to her undertaking advocacy work was not clear but the court was prepared to assume in her favour that it did.[9]

The court acknowledged the Judicial Committee of the Privy Council in *O'Toole v Scott*,[10] which held that *Collier v Hicks* also stood for a wider proposition, which was that, subject to any statutory provision to the contrary, both judges and magistrates, as an incident of the power to regulate the judicial proceedings of the court which they are constituting, have a discretion to allow any person to act as an advocate in those proceedings. In relation to the Federal Court, the court held that, were there any doubt in relation to the power to grant such leave as an incident of the exercise of judicial power, and it was not suggested that there was, that power would be supplied in any event by s 23 of the *Federal Court of Australia Act 1976* (Cth), such is the breadth of power conferred by that section.[11]

The court found that the authorities demonstrated the correctness of the position jointly adopted by the taxpayer and the Commissioner, which was that the court had power not only to permit Ms Clay to assist the taxpayer as a "McKenzie friend", but also, by leave, to permit her to undertake an advocacy role for the taxpayer in the proceedings. The Commissioner did not contest that Ms Clay could be permitted to act as a McKenzie friend, although some practical difficulties which might attend her so acting in the peculiar circumstances of this case. The Commissioner was, however, adamantly opposed to the granting of leave for Ms Clay to act as an advocate for the taxpayer.[12]

In relation to the practical difficulties, the court noted that the taxpayer had an absolute right to be present at, and to appear on his own behalf in, these proceedings. That right was qualified only by an obligation not to behave in such a way as to disrupt the orderly conduct of the proceedings.[13]

Case management hearings in these proceedings and the hearing of the present interlocutory application had, in relation to participation by the taxpayer, been conducted by telephone. The taxpayer lived in Singapore. He did not wish to come to Australia in order to appear in person in the proceedings. That was because he apprehended that there was a high likelihood that the Commissioner would make a departure prohibition order under the *Taxation Administration Act 1953* (Cth) (TAA), based on his taxation liability were he to enter Australia. The court was persuaded by the course of litigation between the taxpayer and the Commissioner and the large outstanding taxation debt that the apprehension was not misplaced.[14]

The court held that the choice of not being present in Australia at a hearing of an application would be one for the taxpayer made for his own reasons. Should the taxpayer choose yet again to appear by video or telephone link, the practical difficulty in relation to Ms Clay's acting just as a McKenzie friend would again be that she would be based in Australia. To act as a McKenzie friend, Ms Clay needed to be able to sit adjacent to the taxpayer.[15]

The court considered that an alternative way in which Ms Clay might act as a McKenzie friend for the taxpayer would be for her to go to Singapore and to sit next to him during a video or telephone link during the hearing of the application.[16]

Finally, the court proposed to make some directions which might allow Ms Clay remotely to undertake a McKenzie friend role as described without undue disruption of the hearing of the application. Ms Clay and the taxpayer might, as between themselves, establish a reliable electronic link. Ms Clay might then sit at the Bar table and send to the taxpayer by email any particular suggestions which might commend themselves to her in the course of the hearing of the application.[17]

Should Ms Cray be permitted to act as an advocate?

The court relied on the summary of considerations which emerged from relevant authorities, offered by Stein JA (Mason P and Sheller JA agreeing) in *Damjanovic v Maley*,[18] which were relevant to the exercise of the discretion to grant or refuse leave to an unqualified person to appear on behalf of an unrepresented litigant:[19]

"**(a) The complexity of the case**

[70] Whether the case is one of complexity or minor or straightforward has often been seen as a discretionary factor ...

(b) Genuine difficulties of the unrepresented party

[72] These include matters such as unexpected language difficulties and emergencies. An example of the latter was the absence of legal aid in a criminal appeal ...

(c) The unavailability of disciplinary measures and a duty to the court by lay advocates

[74] Almost every case mentioned these matters as protection for a client when a qualified lawyer represented a party but were protections which were not available where an unqualified lay advocate appears …

[75] In appropriate cases a legal practitioner may be ordered to pay costs. The position is far from clear in relation to a non-party lay advocate. There may be extreme circumstances where the conduct of a lay advocate could attract an adverse costs order.

[76] In my opinion, the overall duty of a barrister or solicitor to the court is an important consideration. It is a duty of candour and a practitioner must not knowingly mislead the court. The court is entitled to place reliance on that duty and expect it to be met. The disciplinary codes of the legal profession back up the overriding duty of a practitioner to the court ...

[77] Training, qualifications and experience are also important. This is not to say that there are not incompetent lawyers, including some who seek to practice advocacy. For the most part, the market and the disciplinary codes account for them. But with unqualified and uninsured lay advocates, the court loses the benefit of the overriding duty and clients are at a distinct disadvantage. Apart from endeavouring to ensure that a lay person granted leave to appear obeys the rules, there is little a court can do except, in an appropriate case, withdraw the leave to appear.

[78] … However, the absence of a disciplinary code and duty to the court underlines the inappropriateness of permitting unqualified persons to appear apart from an exceptional case.

(d) Protection of the client and the opponent

[79] Lay advocates are unqualified, unaccredited and uninsured. This places a client at considerable risk ... A lay advocate does not owe the same duty to his client as does a lawyer.

[80] One should also not lose sight of a lawyer's duty to his/her opponent ... None of these protections for the system of justice exist with an unqualified lay advocate ...

(e) Lay advocates in inferior courts and tribunals

[81] There are indications in some of the cases that Local Courts, given their jurisdiction and large numbers of unrepresented litigants, may be more likely to grant leave to unqualified persons. This is, one assumes, in straightforward uncomplicated matters where the party is under some disability in presenting his/her own case. This may also be the case with some specialist jurisdictions and tribunals.

[82] The authorities however suggest that higher courts should be very chary at giving leave ...

> **(f) The interests of justice**
>
> [83] What runs through all of the authorities as the guiding principle in the exercise of the discretion is the public interest in the attainment of the ends of justice. The public has an interest in the effective, efficient and expeditious disposal of litigation in the courts. As a general rule this can best be achieved by parties employing qualified lawyers."

The court noted that, in relation to the granting of leave, there was a discretion to exercise, in the circumstances of a particular case for which the overarching touchstone was what best serves the interests of justice, the principles to which Stein JA adverted were neither exhaustive nor to be applied uncritically as if they were some sort of checklist.[20]

In relation to the proceedings to date, the court noted that the taxpayer spoke good, although strongly accented, English. He had no need for an interpreter.[21]

His written submission in respect of his present interlocutory application was, the court found, also articulate. It displayed the fruits of quite extensive legal research. Inferentially from her references in her affidavits to legal research which she had conducted, Ms Clay had input into the preparation of this written submission. Whether others had was not apparent either expressly or inferentially on the evidence.[22]

The court expressed the view in relation to the present application, even that role being opposed by the Commissioner, that assistance as Ms Clay might provide in the interests of justice had already been provided by her input to the written submission in relation to authorities touching on leave for a layperson to appear as an advocate, and that the interests of justice did not require that she additionally be permitted to appear as an advocate.

However, while viewed in isolation, such helpful apparent input from Ms Clay was a factor tending in favour of granting her leave to undertake an advocacy role on the hearing of the application, there were many countervailing factors.[23]

The written submissions anticipated that "the [taxpayer] will raise issues of ... res judicata, issue estoppel or Anshun estoppel". Assuming that Ms Clay had input into the written submission, the court found that other features of that submission did not give any confidence that the interests of justice, which included but were not confined to those of the taxpayer as a party, would be assisted by permitting Ms Clay to act as an advocate. More particularly, the submission did not give the court any confidence at all in relation to Ms Clay's understanding of the processes, found in Pt IVC TAA, for the challenging on the merits of assessments based on conclusions reached by the Commissioner about the residence of a taxpayer, the ramifications of finality in relation to the invocation of those processes and their dismissal, the limited basis on which the legality of an assessment might be challenged on judicial review, and the ramifications of finality in relation to earlier such unsuccessful challenges. In the proceedings in the High Court, Ms Clay made an affidavit which was read in support of the application brought by the taxpayer in which he sought the same relief by way of declaration, writ of certiorari and mandamus and other relief as in the present case. In her affidavit evidence in the present case, Ms Clay acknowledged that a similar application was earlier brought in the High Court, but she erroneously characterised the basis on which those proceedings were dismissed as being because they were "premature". That was not so.[24]

Ms Clay had only limited experience of court matters and a post-graduate qualification which focused on taxation and business law, rather than this in the context of other areas of law and practice. To the extent that she had input into the written submission, that limited experience and singularity of educational focus was manifest. Familiarity with background facts and revenue law cases concerned with residency was one thing, ability to transcend focus on these and to understand and offer relevant oral submissions in relation to "res judicata, issue estoppel or Anshun estoppel" was another.[25]

The court was not persuaded that either the taxpayer, the court or the Commissioner would be assisted by permitting Ms Clay to make oral submissions on the taxpayer's behalf. The court concluded that permitting Ms Clay to make oral submissions may elongate the hearing.[26]

Conclusion and comment

The court's decision highlights that, in court proceedings involving tax cases, a knowledge not only of tax law, but also a knowledge of other areas of substantive law and court procedure are required. Ms Clay did not have these.

Also, lawyers are subject to discipline by the courts in a way that others are not.

It will always be difficult for any non-lawyer to represent another in the higher courts.

Michael Norbury, CTA
Principal
Norbury Lawyers

References

1 *Hii v FCT* [2019] FCA 1589 (*Hii*) at [1].
2 *Hii v FCT* [2019] HCATrans 97.
3 *Hii* at [3].
4 *Hii* at [4].
5 *Hii* at [6].
6 [1971] P 33 at 38 and 41.
7 [1831] EngR 686.
8 *Hii* at [9].
9 *Hii* at [10].
10 [1965] AC 939 at 952.
11 *Hii* at [11].
12 *Hii* at [13].
13 *Hii* at [14].
14 *Hii* at [15].
15 *Hii* at [21].
16 *Hii* at [22].
17 [*Hii* at [24].
18 [2002] NSWCA 230.
19 *Hii* at [26].
20 *Hii* at [27].
21 *Hii* at [31].
22 *Hii* at [32].
23 *Hii* at [34].
24 *Hii* at [35].
25 *Hii* at [36].
26 *Hii* at [40].

Successful Succession

by Lachlan Einsiedel, Hartwell Legal

Walls close in on trustee discretion

Since time immemorial, discretionary trusts have heralded the mostly unreviewable discretion of trustees. The recent flurry of cases show that the days of limitless trustee powers are over.

The goalposts continue to shift on the obligations imposed on trustees acting under discretionary trust powers. The traditional view among legal, accounting, wealth and financial advisers is that as long as decisions made under a trust are not ultra vires*,* the exercise of trustee powers will not be subject to judicial review. This view is a gross misinterpretation of the law, and the limits on trustee decision-making go further than this. The mid-80s decision of *Karger v Paul* shone a light on trustee decision-making limitations requiring a trustee to exercise their discretionary powers in a manner that gives "real and genuine consideration [to] their decision-making, and to act in good faith and for the proper purposes".[1]

The difficulties in mounting such cases have caused advisers to fable that discretionary trust powers remain unlimited. The difficulty in mounting a case under the rule in *Karger v Paul* is twofold. First, the onus rests on the aggrieved beneficiary (or some other person with appropriate standing) to show that in exercising the power that the beneficiary seeks to quash, the trustee acted without "real and genuine consideration in their decision making, or acted in bad faith, or without proper purpose". Second, beneficiaries have no legal entitlement to access deliberative trust documents, or anything else that shows the trustee reasons for making decisions (eg board minutes etc).[2] Combined, these two difficulties have made it quite problematic and near impossible for trustee decisions to be impeached.

Trustees being entitled to indemnity (until denied by the court) for their legal costs from trust funds may also be a deterrent to beneficiaries who hope to receive a future distribution. As such, the myth was likely further perpetuated by the extremely few cases being brought to court impeaching trustee discretion[3].

Nevertheless, courts continue to remind practitioners that trustees need to be careful in exercising their discretion, as the courts will not hesitate to exercise their powers to supervise trusts where trustees apply their power improperly. The power is not infinite and our role as advisers is to alert our trustee clients to the boundaries.

Failing good advice, we will continue to see clients in the destructive circumstances that Mr Clacher and his family found themselves in September before the Queensland Supreme Court.

Setting the scene

The facts are plentiful and, for the most part, unnecessarily long. They involve Thomas Clacher, his three children (Suzanne Campbell, Wendy Hook and Janine Blumke) and each of their respective family units.

The fable starts off like many families with amassed wealth — Thomas being the sole director and shareholder of TL Clacher No. 2 Pty Ltd, the trustee of the Clacher Family Trust.

The income beneficiaries of the trust included:[4]

- Thomas;
- Suzanne;
- Wendy;
- Janine;
- the spouse and children of Suzanne, Wendy and Janine ("the family unit"); and
- any person or corporation nominated in writing to be a beneficiary by the trustee.

The trust's multiple investment properties, cash, shareholdings and other securities were accumulated by Thomas and his wife, Pauline (the girls' mother), in his younger years through his optometry practice.

The Clachers were an unusually close-knit family until the middle of 2014.

The turbulence

In the middle of 2014, Suzanne, her husband, Jon Campbell, Wendy and her husband, Mac, met with Chris Burrell (Thomas' stockbroker) to discuss restructuring the family trust.

Following these discussions, things became sour between Thomas, Suzanne and Wendy.

On 26 July 2014, Thomas made the first move by signing a written record of instruction to Glenn Blumke, the husband of Janine.[5] He stated that he was unhappy that Jon Campbell had been given information about his tax records, properties and rental income statements. The document expressed that he no longer wanted Wendy or Mac to be involved in his personal tax, company, or family trust matters, effectively severing them from the family trust.

On 27 July 2014, Thomas, as sole director of the corporate trustee, executed a deed of variation allowing the trustee to declare and exclude any beneficiary from the trust, following which Thomas made a resolution with the effect of excluding Wendy, Suzanne, their respective partners and their children, and other remote issue from the Clacher Family Trust.[5]

On 9 October 2014, Thomas made a further set of resolutions. He confirmed that Wendy and Suzanne were not beneficiaries of the Clacher Family Trust.[6]

On 12 October 2014, Thomas resolved to vary the trust deed appointing his legal personal representative, and daughter, Janine as the trustee in the event of his incapacity or death.[6]

On 4 December 2014, Thomas made a number of resolutions to:

- vary the Clacher Family Trust to distribute the assets in the trust within six months of his date of death in equal shares between Wendy, Suzanne and Janine with their children taking a share should any of them predecease him; and
- appoint Flowon 241 Pty Ltd, a company of which Janine and Glenn Blumke were directors, as appointer on Thomas' death.[7]

These resolutions were made with his lawyers in the absence of Janine and Glenn.

On 12 December 2014, a further set of resolutions were made with the effect of reversing the 4 December resolutions.[8]

On 17 December 2014, Thomas instructed his solicitor, Luke Comino, to transfer multiple properties and other assets, to the Blumke Family Trust, and on 22 December 2014, Thomas resolved that the Clacher Family Trust make allocations to himself and the Blumke Family Trust. No legal advice was obtained in respect of the resolutions.[9]

Thomas' vulnerabilities

In mounting a claim that Thomas was subject to undue influence or unconscionably causing him to act without real and genuine consideration in his decision-making, acting in bad faith or for improper purpose, the applicants noted the following vulnerabilities:[10]

- that he was 88 years of age, recently widowed and acutely grieving;
- that he suffered from beliefs that he had formed without rational basis perpetuated by Janine and Glenn Blumke;
- that he was declining capacity through age-related medical conditions;
- that he lived with and was reliant on Janine and Glenn Blumke; and
- that he terminated the services of his longstanding stockbroker and accountant.

The evidence

Wendy and Suzanne, Janine and Glenn and Thomas each provided disparate and unreconcilable evidence about the reason for which Thomas made the resolutions.

His Honour refused to accept much of the evidence given by Thomas, Janine and Glenn, preferring the accounts of Wendy and Suzanne. He deemed that the evidence provided by Thomas and Janine was inconsistent with objective evidence.[11]

The factual circumstances between Thomas and his children are copious. In the interests of brevity, only the salient evidentiary points have been summarised to illustrate the general gist of the saga between the Clacher clan.

Thomas' evidence about severing Wendy

Thomas led evidence by affidavit about why he had ousted Wendy as a beneficiary of the trust, noting:

- he had received little assistance from Wendy and her family;
- Wendy had been disrespectful towards him on several occasions; and
- Wendy was too involved in his financial affairs and upset with him about not accepting advice about making a distribution of $450,000 to each of his children.[12]

When Thomas later provided evidence orally at hearing, he was visibly cognitively impaired and argumentative, and unable to coherently express his reasons. He was confused about documents which had his signature on the grounds that he did not believe it to be his signature.[13] He also was unable to comprehend the 27 June and 9 October resolutions, or provide justification for him doing so. His Honour was unable to accept Thomas' affidavit evidence and reasons for removing Wendy due to the large inconsistencies between Thomas' evidence given by affidavit and orally. The applicants' evidence was accepted by his Honour which was inconsistent with Thomas' desire to disown Wendy and Suzanne.

It wasn't until late October that Thomas had ceased contacting Wendy. He had made several allegations against Wendy, including that she had commenced a legal matter against him (which had not in fact happened by this point) and that she was trying to transfer him into an aged care home.[14] These allegations led him to irrationally sever his relationship with her, despite having an extremely close relationship with her and her family for Wendy's entire life.

Evidence about severing Suzanne

In June 2014, Jon Campbell had liaised with Chris Burrell and Greg Roberts (the long-term accountant) to obtain a report in relation to Thomas' financial affairs (which Thomas had authorised). Thomas had seemingly forgotten that he had authorised this, and in early September, he confronted Suzanne, noting that he was unhappy with Jon liaising with his accountants. Thomas was under the impression that Jon was deceitfully trying to work out how much money he and Suzanne would inherit after he passed away.[15]

The relationship between Thomas and Suzanne fragmented. In September 2014, he ceased contact with Suzanne and Jon on the advice of Janine, who Thomas believed was protecting him. Again, the court accepted that Thomas and Suzanne enjoyed a very close relationship throughout the years and this severance of ties was entirely irrational.

In November 2014, in a telephone call with Suzanne, Thomas made allegations that Suzanne and Wendy were taking him to court (which was not true at that point in time), that Suzanne was trying to have him classed as insane, and that he had been told not to speak to Wendy or Suzanne.[16]

The intended end result of the steps taken by Thomas was to divert all the benefit of his significant wealth (both personal and of the trust) to Janine and her family, to the exclusion of his other two daughters and their families.

The legal principles

To impeach the resolutions and dispositions of property made by Thomas, the applicants contended that the reasons given by Thomas were matters of which the trustee should not have acted on, given that they were delusional and likely brought about in circumstances of undue influence or unconscionable conduct on the part of Janine and Glenn.

His Honour conveniently summarised the obligations on a trustee in exercising discretionary powers:[17]

> "… in exercising such a power the trustee is under a duty to act responsibly and in good faith, including that the trustee may not exercise it 'irresponsibly, capriciously or wantonly'. In this context, capriciousness may be equated to irrationality, but irrationality is to be distinguished from unreasonableness or unfairness, which are not enough."

His Honour, further, considered the inquiries that ought to be undertaken when considering the exercise of a discretionary power (such as exclusion of beneficiaries or distribution of assets):[18]

> "As part of the process of, and solely for the purpose of, ascertaining whether there has been any such failure, it is relevant to look at evidence of the inquiries which were made by the trustees, the information they had and the reasons for, and manner of, their exercising their discretion. However, it is not open to the Court to look at those things for the independent purpose of impugning the exercise of discretion on the grounds that their inquiries, information or reasons or the manner of exercise of the discretion, fell short of what was appropriate and sufficient."

His Honour had difficulty in being able to ascertain Thomas' reasons for making the resolutions and transfer of properties. The waters were so muddied by the conflicting evidence that he could only infer reasons based on the surrounding facts.

His Honour accepted that Thomas had formed, and was likely encouraged, by Janine and Glenn to form delusional beliefs that Wendy and Suzanne were trying to move him into an aged care home against his will, that they had mounted a legal matter against him, and that the way to protect himself was to transfer property out of the family trust.[19]

The court found it clear from the circumstances, oral evidence from Wendy and Suzanne, and transcripts of conversations with Thomas that no consideration was given to the content of the resolutions as they had been made on delusions which were irrational. Thomas, as the mastermind behind the trustee company, had an obligation to act responsibly and in good faith, not capriciously. Acting delusionally and irrationally was in breach of obligations. The circumstances that gave rise to this finding are:

– his resolutions made on 4 December 2014 without the assistance of Janine and Glenn contradicted the other resolutions made insofar as they divided the property between Suzanne and Wendy, who he had previously resolved to disown;
– he never informed his lawyers or accountants of the resolutions;
– in his evidence, he showed no appreciation of the true circumstances of his family, instead only considering the delusions causing him to pass the resolutions; and
– the resolutions were drafted by Glenn, a family member and beneficiary, and without the benefit of legal advice.

It was accepted that Thomas' lack of appreciation of the circumstances was sufficient to establish that he did not give real and genuine consideration prior to making the resolutions, and that such resolutions were made without a rational basis.

The court said that:[20]

> "[Thomas'] actions were brought on by what appears to have been a combination of paranoia and anger based on false allegations that Wendy or Suzanne or Jon Campbell or some combination of them was attempting to take advantage of or pressure him in some unfair way. In this, I have concluded that Janine and Glenn Blumke were both prepared to encourage [Thomas] and to take advantage of his irrational fears."

The court accepted that Thomas had been subjected to influence by Janine and Glenn which was undue, this meant that the decisions he had made were made without real and genuine consideration. On that basis, the court set aside the resolutions and property transfers made by Thomas. The court further found that Thomas' decisions were invalid and in breach of trust by reason of unconscionable conduct by Janine and Glenn towards Thomas. In addition, the court appointed an independent trustee to replace the existing trustee and to give effect to these orders, and for the account to be taken and passed in the court in relation to any dealings with assets by Thomas (in his capacity as director of the trustee company).[21]

What can we learn as practitioners?

As practitioners, the learnings from this case are plentiful. The most obvious is that the courts are cracking down on discretionary powers and practitioners need to stop preaching the narrative that discretionary powers are unlimited and unfettered.

Trustees of discretionary trusts still must act in accordance with their fiduciary duties to act in good faith and with proper purposes.

Poisoning of a mind or "calumny" against someone is not a cause of action to set aside or invalidate a dealing in Australia. In this case, calumny amounted to undue influence and unconscionable conduct sufficient to set aside the dealings with significant assets. This may be opening the way to an extension of the principles of calumny which do exist in other common law jurisdictions, like England.

The case makes it clear that financial and wealth advisers, accountants and legal practitioners need to be careful when obtaining instructions from clients. The case shows the importance of canvassing client instructions to ensure that:

– they have genuine reasons for exercising trust powers;
– the reasons for exercising powers are logical and well considered, even if not necessarily commercially sound;
– clients are acting of their freewill and not subject to pressure induced by family members;
– when acting for multiple members of the family, afford the client the option to seek independent legal and financial advice;
– when in doubt, make further inquiries to verify client instructions, circumstances to assess the rationality of client decisions (eg obtain a medical report from their longstanding general practitioner or a capacity report from a specialist);

- it is clear why clients may be making substantial changes to their affairs, and whether there is a severing of existing family or professional relationships; and
- the reasons for, and veracity of, the client's claims have been tested.

After all, our job is not only to maximise and protect our client's wealth, but also to prevent the destructiveness of family trust disputes.

Lachlan Einsiedel
Incapacity, Wills and Estates Lawyer
Hartwell Legal

References

1 *Karger v Paul* [1984] VR 161 at 164.

2 *Re Londonderry's Settlement* [1965] Ch 918.

3 *Mercanti v Mercanti* [2016] WASCA 206; *Trani v Trani* [2018] VSC 274; *Re Marsella* [2019] VSC 65.

4 *Campbell v TL Clacher No. 2 Pty Ltd* [2019] QSC 218 (*Campbell*) at [45].

5 *Campbell* at [82].

6 *Campbell* at [83].

7 *Campbell* at [85].

8 *Campbell* at [84].

9 *Campbell* at [282].

10 *Campbell* at [279].

11 *Campbell* at [5].

12 *Campbell* at [104].

13 *Campbell* at [105].

14 See, generally, *Campbell* from [137].

15 *Campbell* at [203].

16 *Campbell* at [235].

17 *Campbell* at [60].

18 *Campbell* at [64].

19 *Campbell* at [243].

20 *Campbell* at [55].

21 *Campbell* at [376].

Events Calendar

November 2019

STATE / EVENT	DATE	CPD
National		
Monthly Tax Update	27/11/19	1
Women in Tax National Congress 2019	29/11/19	7
New South Wales		
Morning Tax Club – Sydney	6/11/19	1.5
Morning Tax Club – Parramatta	7/11/19	1.5
NSW Trusts Conference	7/11/19	7
Queensland		
Noosa Tax Intensive	21/11/19	13.5
South Australia		
SA Tax Roundtable	12/11/19	2
SA Tax Institute Leadership Seminar | Customer FIRST: 2019 & Beyond	21/11/19	3
SA Trusts Day	22/11/19	6.25
SA Tax Briefing	26/11/19	1.5
Victoria		
R&D Masterclass	12/11/19	3.75
Breakfast Club – Melbourne	21/11/19	1.5
Breakfast Club – Geelong	22/11/19	1.5
Victorian Trusts Conference	28/11/19	6
Young Tax Professionals	29/11/19	1
Western Australia		
Corporate Tax Series 4	6/11/19	1
Navigating your career path – Young Tax Practitioners Breakfast	8/11/19	1
Young Tax Professionals	13/11/19	1.5
In Division 7A, We Trust	13/11/19	12
Women in Tax High Tea	20/11/19	1
Retirement & Aged Care – Advising Your Clients	27/11/19	6.5
Young Tax Professionals	28/11/19	1.5

For information on upcoming events, visit **taxinstitute.com.au/cpd**.

Cumulative Index

The following cumulative index is for volume 54, issues (1) to (5). Listed below are the pages for each issue:

Vol 54(1): pages 1 to 52
Vol 54(2): pages 53 to 104
Vol 54(3): pages 105 to 160
Vol 54(4): pages 161 to 228
Vol 54(5): pages 229 to 284

Legislation

Rulings and other materials

Cases

Authors

Giving back to the profession

The Tax Institute would like to thank the following presenters from our October CPD sessions. All of our presenters are volunteers, and we recognise the time that they have taken to prepare for the paper and/or presentation, and greatly appreciate their contribution to educating tax professionals around Australia.

Roy Abbas, CTA
Amber Agustin, FTI
Travis Anderson
Matthew Andruchowycz, CTA
Chris Ardagna, CTA
Aaron Ashboth
Melanie Baker, CTA
Jodylee Bartal
Gerard Basha
Kyle Beattie
Peter Bobbin, CTA
Phil Broderick, CTA
Neil Brydges, CTA
Daniel Burt, FTI
Tamara Cardan
Adrian Cartland
Daniel Chappel
Nicholas Clifton, ATI
Enzo Coia, CTA
Graeme Colley
Graeme Cooper, FTI
Kayla Costa
Emma Crause, FTI
Stuart Dall, ATI
The Hon. Justice Jennifer Davies
Greg Davies, QC, CTA
Fiona Dillon, CTA
James Donoghue
Tracey Dunn
David Earl, FTI
Bronwyn Eynon-Lewis
Ken Fehily, CTA
Chris Ferguson
Steve Grant, CTA
Carolyn Harvey
Denise Honey, CTA
Simon How, CTA
David Hughes, CTA
John Ioannou, CTA
Robyn Jacobson, CTA
Julianne Jaques, CTA
Michael Jenkins, CTA
Shivani Jethwa
Dayne Johnson, FTI
Ron Jorgensen, CTA
Cathy Joseph
Lee Jurga
Amanda Kazacos
Anthea Kennedy
Fiona Knight, CTA
Lynn Koh
David Lewis
Paul Liggins
Colin Little
Anna Longley
Ian Lug, AM
Raffael Maestri
Daniel Marateo
Julie McKay
Matthew McKee, FTI
Mark McKinley
Ilana Millar
Andrew Mills, CTA (Life)
Anthony Milton, CTA
Dominic Moon, ATI
Judy Morris
Sally Newman, CTA
Avril Nichols
Claire Nicholson, CTA
Mark Norris
Andrew O'Bryan, CTA
Frank O'Loughlin, QC, CTA
Neil Oakes, CTA
The Hon. Tony Pagone, QC
Michael Parker, CTA
Josh Pascale
Alex Patrick
Alec Pettigrew
Lachlan Prider
Virginia Rands
Gareth Redenbach, CTA
Aimee Riley, ATI
Heidi Rodgers
Craig Silverwood, FTI
Peter Slegers, CTA
Rebecca Smith
David Spurritt, CTA
James Strong
Helen Suke
Bruce Sullivan
Courtney Telega
Claire Thornett, CTA
Tim Tierney
Jessica Uchida
Emily Ulcoq
Julie Van der Velde, CTA
Chris Vittas
Scott Walker
Peter Walmsley
Simon Webster
Vicki Webster
Kimberley Wheller
James Whiley
Claire Williamson
Tony Windle, ATI
Ben Wood
Jonathan Woodger, ATI
David Xu
Nathan Yii, CTA
Rob Yunan, FTI
Aris Zafiriou
Abdulah Zobaer

TAXATION *in Australia*®
ISSN 0494-8343

Publishing House
The Tax Institute
ABN 45 008 392 372

50 Miller Street
North Sydney, NSW 2060

General Manager, Knowledge and Learning
Alexandra Wilson

Managing Editor
Deborah Powell

Content Consultant
Cheryl Goh

Graphic Designers
Mei Lam
Nicole Welch

Typesetter
Midland Typesetters, Australia

Advertising
Wayne Flekser 02 8223 0071

Contacts

National Council

President
Tim Neilson, CTA

Vice President
Peter Godber, CTA

Treasurer
Stuart Glasgow, CTA

National Councillors
Paul Banister, CTA
David Earl, FTI
Len Hertzman, CTA
Marg Marshall, CTA
Eddy Moussa, CTA
Tim Sandow, CTA
Jerome Tse, CTA
Todd Want, CTA

National Office

CEO: Giles Hurst
50 Miller Street
North Sydney, NSW 2060

Tel: 02 8223 0000
Email: ceo@taxinstitute.com.au

State Offices

New South Wales and ACT

Chair: Rae Ni Corraidh, CTA
Manager: Leanne Carter
50 Miller Street
North Sydney, NSW 2060

Tel: 02 8223 0031
Email: nsw@taxinstitute.com.au

Victoria

Chair: Leanne Connor, CTA
Manager: Brian Martin
Level 3, 530 Collins Street
Melbourne, VIC 3000

Tel: 03 9603 2000
Email: vic@taxinstitute.com.au

Queensland

Chair: John Ioannou, CTA
Manager: Paula Quirk Russo
Level 11, Emirates Building
167 Eagle Street
Brisbane, QLD 4000

Tel: 07 3225 5200
Email: qld@taxinstitute.com.au

Western Australia

Chair: Nick Heggart, CTA
Manager: Brian Martin
Level 10, Parmelia House
191 St Georges Terrace
Perth, WA 6000

Tel: 08 6165 6600
Email: wa@taxinstitute.com.au

South Australia and Northern Territory

Chair: Sean van der Linden, CTA
Manager: Craig Spurr
Ground Floor, 5-7 King William Road
Unley, SA 5061

Tel: 08 8463 9444
Email: sa@taxinstitute.com.au

Tasmania

Chair: Ian Heywood, CTA
Manager: Craig Spurr
Level 3, 530 Collins Street
Melbourne, VIC 3000

Tel: 1800 620 222
Email: tas@taxinstitute.com.au

THE TAX INSTITUTE

00016KNOW_10/19

taxinstitute.com.au