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Division 7A loan repayments: part 1

David Montani, CTA

Demerger relief rules: what constitutes a "restructuring"?

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Considerations from Greig v FCT

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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 publisher@taxinstitute.com.au.

Tax News – at a glance

by TaxCounsel Pty Ltd

September – what happened in tax?

The following points highlight important federal tax developments that occurred during September 2020. A selection of the developments is considered in more detail in the "Tax News – the details" column on page 162 (at the item number indicated).

SMSF member numbers

An amending Bill that was introduced into parliament on 2 September 2020 proposes amendments that will increase the maximum number of allowable members in self-managed superannuation funds from four to six. **See item 1.**

Thin capitalisation: the arm's length debt test

The Commissioner has released a final ruling that deals with the application of the arm's length debt test contained in the thin capitalisation rules (TR 2020/4). **See item 2.**

FBT: cars and COVID-19

The ATO has released a fact sheet that deals with determining how FBT obligations relating to work cars may be impacted by the COVID-19 pandemic, and how to calculate an FBT liability. **See item 3.**

Interest withholding tax: taxpayer alert

The Commissioner has issued a taxpayer alert in relation to arrangements which use offshore related entities to facilitate the avoidance of a withholding tax liability in relation to interest expenses deducted against Australian-sourced income and paid to non-residents (TA 2020/3). **See item 4.**

MEC groups and capital gains: taxpayer alert

The Commissioner has issued a taxpayer alert in relation to arrangements that appear to be designed to avoid the inclusion of capital gains in the assessable income of Australian-resident entities on the disposal of their assets (underlying assets) (TA 2020/4). **See item 5.**

Foreign income tax offset limit

The Commissioner has issued a final determination to the effect that capital gains are not included under s 770-75(4)(a)(ii) ITAA97 when calculating the foreign income tax offset limit (TD 2020/7). **See item 6.**

Scheme promoter regime

The Commissioner has succeeded in establishing that an individual (a Mr Paul Bogiatto) and two companies of his had engaged in conduct that resulted in each entity being a promoter of a tax exploitation scheme for the purposes of Div 290 of Sch 1 of the *Taxation Administration Act 1953* (*FCT v Bogiatto* [2020] FCA 1139). **See item 7.**

Personal services income: unrelated clients test

In a joint judgment, the Full Federal Court (McKerracher, Davies and Thawley JJ) has upheld the Commissioner's appeal from the decision of a single judge who had held (reversing a decision of the AAT) that the unrelated clients test contained in the personal services income provisions of the ITAA97 had been met (*FCT v Fortunatow* [2020] FCAFC 139). **See item 8.**

Discretionary non-resident beneficiary and CGT

The Federal Court (Steward J), consistently with a decision of Thawley J handed down earlier this year, has held that a non-resident beneficiary (or the trustee on the beneficiary's behalf) was assessable on distributions by a resident discretionary trust which were sourced from capital gains made by the trust from the disposal of shares which were not taxable Australian property (*N & M Martin Holdings Pty Ltd v FCT* [2020] FCA 1186). **See item 9.**

Backpacker tax appeal

The Full Federal Court has by majority (Derrington and Steward JJ, Davies J dissenting) upheld an appeal by the Commissioner from a decision of Logan J in the so-called backpacker tax case and, in doing so, held that the taxpayer was a resident, was not entitled to the benefit of the non-discrimination clause in the UK double tax agreement, and was taxable at the backpacker rates of tax (*FCT v Addy* [2020] FCAFC 135). **See item 10.**

No effective disclaimer by beneficiary

The AAT has rejected a taxpayer's contention that she had effectively disclaimed her entitlement to an income distribution of $80,000 from a discretionary trust for the 2014 income year (*The Beneficiary and FCT* [2020] AATA 3136). **See item 11.**

Work-related deductions

The AAT has allowed in part a taxpayer's objection against the Commissioner's treatment of certain work-related deductions that the taxpayer had claimed for the 2016 income year (*Bell and FCT* [2020] AATA 3194). **See item 12.**

President's Report

by Peter Godber, CTA

New delivery models for our trusted events

Innovation and resilience keep the Institute and its members moving forward.

It is that time of year when, with the brightness of spring, we look forward to some special state forums and popular intensive events in our CPD program before December comes around and the year closes in again.

I look at the programs for the Victorian and Tasmanian events and am so pleased that they come to us with the same high level of quality content and great speakers as in years gone by. Delivered to whatever extent possible face-to-face, but otherwise utilising online technology to ensure that our members continue to receive high-quality programs, our CPD program is proof that the old saying is true: the show must go on.

You will have no doubt been pleased to see the release of the program for the 28th Tax Intensive event at Noosa – and, this year, also at Terrigal. A truly exciting opportunity for immersive tax technical discussion, this event will be conducted simultaneously in November across two of our favourite destination venues! That is a wonderful example of the innovative spirit that our staff and event organisers have at present.

There is obviously a limit to the number of registrations available for face-to-face audiences, and all of these are delivered in accordance with a COVID-safe plan. But for those who commit to travelling to a venue, there will be a bit of that old feeling that we get from catching up with colleagues and enjoying a great retreat. This new model for event delivery, bringing together in-person and remote participation, makes a lot of sense and allows us to keep our vibrant community connected and informed.

For many more members, there are opportunities to register remotely for events and to benefit from the fabulous content and speakers that our events produce and attract. The National Infrastructure Conference and the International Tax Series are further examples of significant programs being delivered to members online at present.

You will now also no doubt be aware of The Tax Summit: Project Reform. This is an ambitious undertaking, combining a series of focus sessions, roundtables and keynote speakers into a program that culminates in a summit event in November. It is also a virtual event — which once again proves that, with our Institute and its volunteers and members at the helm, the shift to online events has not significantly hampered our excellent work.

The Institute's consultation and advocacy efforts continue in the background with a lot of energy. I recently attended an NTLG meeting that was both collaborative and productive. JobKeeper has been an ongoing topic for discussion in our consultation. However, we are starting to look beyond that a little, and making things more administratively easy for businesses and individuals is one broad common goal.

I also recently attended a Tax Practitioners Board Forum. We received a report on the strategic focus of the Board and its corporate plan for 2021. I note that the agenda for the TPB includes the expected review of 1,000 tax agents this coming year. A focus will be on misbehaviour concerning the government stimulus rollouts and unregistered agents.

We also noted that, at the time of the meeting, nearly 10 months had passed since the report to Treasury on the review of the TPB had been concluded, and still there has been no public disclosure of the recommendations, nor responses to it. We understand that there have been a lot of priority matters for Treasury this year, but the wait is now long. The findings of that review will give us more clarity on the regulation of the profession in future and help us all to plan better, so we will keep up the momentum to action its release.

On a positive note, the forum agenda also covered the consideration that the TPB is giving for COVID-related relief, and we had a genuine dialogue on how to better understand issues facing all tax professionals into the future.

As you know, the 2020–21 Federal Budget was announced last week. This year, our team of in-house experts produced our own Institute report, with analysis and insight into each measure affecting the tax profession. I myself was part of the effort on the night and I'm exceptionally proud of the final product produced. A big thank you to the team. I have no doubt this will be an invaluable resource for our members as they navigate the new tax measures.

And I once again thank Institute staff and our volunteers for their ongoing efforts. The pivoting we have done in this challenging year continues to impress us all.

Look out for our Tax Reform series of events that are coming on to the market now. The Tax Summit: Project Reform will give the Institute and its members a fantastic opportunity to learn and participate in work that will produce tangible recommendations for a better tax system.

And don't forget all of our trusted events, coming to you in new and exciting formats.

CEO's Report

by Giles Hurst

Charting a course to tax reform

At this critical time in history, repairing our tax system is vital.

If you repair a ship piece by piece, until every one of its components has been replaced, is it still the same ship? Or is it a fundamentally different object? In philosophy, this conundrum is known as Theseus' paradox.

You could ask the same of our tax system. How many components of our tax system must we repair or replace before it becomes a whole new beast?

This is a critical time in history. The COVID-19 pandemic has thrown immense challenges our way, thereby illuminating the cracks and imperfections in our current tax system. But by doing so, it has also opened the door for long-awaited and much needed change. Two significant events will soon have a major impact on the future of our tax system: the federal Budget and The Tax Summit: Project Reform.

The 2020–21 Federal Budget was announced on 6 October 2020 and included a number of measures relevant to our members and the tax profession as a whole. Our team of in-house experts worked tirelessly to bring you our first Institute 2020–21 Federal Budget Report, with key insights and analysis on these measures.

I'm happy to say that this Report is incredibly comprehensive, insightful and showcases the technical excellence of our tax team. Our President, Peter Godber, leant his leadership and insight alongside our Tax Policy and Advocacy team.

This was the Budget our economy needed right now, but it leaves ample space for further thought and action on the matter of tax reform. This is a space The Tax Institute will be operating and leading in during The Tax Summit: Project Reform.

Our current tax system is a pastiche of policy and provisions added to by successive governments over the years. Instead of being like Theseus' ship, which was repaired and improved bit by bit, the result might be regarded as something of a Frankenstein's monster — a lumbering giant not suited to the agile, online world in which our economy now operates.

Under the pressures of COVID-19, the imperfections in our tax system are starting to show. Rather than hide them away, it is our goal to take a closer look and then formulate a blueprint for replacing and repairing those broken pieces.

The people behind The Tax Summit: Project Reform

As we come ever closer to The Tax Summit: Project Reform event, I would be remiss not to mention the people making this monumental feat possible.

Andrew Mills, Director of Tax Policy and Technical, Robyn Jacobson, Senior Advocate, and our entire Tax Policy and Advocacy team have been instrumental in setting the agenda for this ambitious tax reform project. They will continue to be a driving force for positive change, not only at the event, but beyond it. The army of volunteers we so proudly mobilise in support also deserve recognition for all they have done to support this event, from those who are working behind the scenes to those who will attend as speakers, presenters and facilitators.

By now, I am sure you will have seen the roadmap to reform, mapping out the different focus sessions, roundtables and keynote speakers leading up to the summit event in November. It's exciting to see names like Peter Costello, Australia's longest serving Treasurer, Danielle Wood, CEO of the Grattan Institute, Rosheen Garnon, Board of Taxation Chair, and futurist, analyst, adviser and author, Bernard Salt, among the line-up of people lending their expertise.

Will we come away with a new ship, or simply a repaired and improved version of the current one? At the end of the day, perhaps that doesn't matter, as long as we come away with meaningful change for our members, our profession and, most importantly, our Australia.

This promises to be a world-class event series, and I am looking forward to connecting with many of you in the process of its delivery.

Tax Counsel's Report

by Julie Abdalla, FTI

Tax Summit: Project Reform

The Tax Institute's significant and ambitious endeavour, The Tax Summit: Project Reform is underway. This article explores the pillars of the project and the ways in which members can contribute to the tax reform process.

In the wake of the COVID-19 pandemic, we have had to adapt. This has meant drastic changes to the way we organise ourselves socially and the way we conduct business. Our tax system must similarly adapt to support Australians and our economic recovery. It is only through substantial tax reform that we can achieve this.

The Tax Summit: Project Reform is the platform for sophisticated tax discussion and debate, and a powerful endeavour towards major and structural reform. Building on the theme of The Tax Institute's pre-Budget 2020-21 submission, the project comprises a series of events including keynote and focus sessions with a spotlight on reforming the Australian tax system. It will culminate in a Virtual Summit in November which will showcase, challenge and refine the case for change, concluding with a submission to the Treasury.

The Tax Summit: Project Reform has been organised under four main pillars:

1. Retirement and Wealth;
2. Business Taxation;
3. Personal Tax and Transfer System; and
4. Indirect Taxation.

For decades, successive governments have taken a piecemeal approach to tax reform which has increased the complexity and inefficiency of our system. The reality is that each tax does not operate in isolation, and the entire tax system is inextricably intertwined with many aspects of daily life. Our goal is to holistically identify and address the real issues in our tax system. The pillar structure underpins this fundamental objective of redesigning the system at a macro level to achieve genuine tax reform. Naturally, there is some overlap between the themes addressed under particular pillars. This highlights the importance of taking an expansive approach to reform.

The pillars

Retirement and Wealth. Under the Retirement and Wealth pillar, we will discuss and debate superannuation topics, such as the superannuation guarantee regime, fund earnings, benefits and contributions. Importantly though, this pillar extends beyond superannuation and examines more broadly private wealth accumulation, retirement and death.

These topics affect all Australians, whether now or later. Moreover, the way in which these regimes are managed and administered significantly impacts the economy.

Business Taxation. The Business Taxation pillar is divided into two subcategories: Domestic and International. Within these subcategories, we will explore the spectrum of reform topics that relate to large businesses and small to medium-sized enterprises. Under the Domestic subcategory, we will delve into a range of corporate tax and financing matters, including the flow of capital and structuring, taxation of attribution managed investment trusts, consolidation regime, taxation of mergers and acquisitions, and taxation of financial arrangements regime. This is also an opportunity to debate the taxation of trusts, Div 7A, small business tax concessions, imputation, and measures to counteract the black economy. International topics for discussion include the taxation of the digital economy, transfer pricing rules, controlled foreign company regime, and thin capitalisation. We will also reassess and consider the redesign of employment taxes including FBT, the PAYG withholding rules, payroll tax, and the tax treatment of employee share and option plans.

Personal Tax and Transfer System. The personal tax and transfer system is a critical pillar which centres around those aspects of the tax system which most directly impact individuals. Focal points include marginal tax rates, work-related expenses, residency, social security and welfare matters, and personal exertion income.

Indirect Taxation. The Indirect Taxation pillar encompasses the multitude of indirect taxes ranging from GST to state transfer duties, property taxes, insurance duties, the petroleum resource rent tax and excises. We will engage on both domestic and international aspects of indirect taxation and identify opportunities to improve our economic position and competitiveness compared to our neighbours in the Asia-Pacific region and the OECD.

Opportunities to get involved

Throughout the event series, we will engage with the best and brightest tax minds to build the case for change. In addition to participating in The Tax Summit: Project Reform events, there are numerous channels through which members may contribute.

The Tax Institute has recently launched The Tax Institute Community, a forum bringing members together to discuss and debate current issues in tax. You can also contribute to the debate by reaching out to any of The Tax Institute's representative committees.

This is an opportunity for revolutionary, forward thinking on tax reform. Now is the time to reflect on the aspects of our current system that have and have not worked, to leverage these learnings, and to develop new and innovative solutions. We invite you to explore these avenues and contribute to a historical movement towards a simpler, fairer and more efficient tax system.

THE TAX INSTITUTE

AUGUST – NOVEMBER / ONLINE

A CASE FOR CHANGE

Help us build a case for change and join us at
The Tax Summit: Project Reform.

8 Focus Sessions | 6 Keynotes | 1 Virtual Summit | 30 CPD hours

Join us for a program bursting at the seams with insight,
innovation and the best thought leadership in the tax profession.

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Chris Richardson
Director of Deloitte Access Economics

The Hon. Peter Costello AC
Australia's longest-serving Treasurer

Danielle Wood
CEO
Grattan Institute

Rosheen Garnon
Chair
Board of Taxation

Bernard Salt AM
Futurist, analyst, adviser, commentator, author

Greg Smith
Former Head of the Treasury Budget and Revenue Group

Register now
thetaxsummit.com.au

Tax News – the details

by TaxCounsel Pty Ltd

September – what happened in tax?

The following points highlight important federal tax developments that occurred during September 2020.

Government initiatives

1. SMSF member numbers

An amending Bill that was introduced into parliament on 2 September 2020 proposes amendments that will increase the maximum number of allowable members in self-managed superannuation funds (SMSFs) from four to six.

In some instances, the number of individual trustees that a trust can have may be limited to less than five or six trustees by state legislation. Such rules could prevent some or all members of a fund with five or six members from being individual trustees. In such cases, the members of a fund can use a corporate trustee in order for the superannuation fund to meet, or continue to meet, the amended definition of an SMSF.

The proposed amendments will also update the sign-off requirements in the *Superannuation Industry (Supervision) Act 1993* (Cth) about the accounts and statements that the trustees of an SMSF must ensure are prepared for each income year. These changes will ensure that these requirements continue to apply correctly after the increase to the maximum number of members (and, therefore, to the maximum number of directors or trustees). Under the updated requirements, an SMSF with one or two directors or individual trustees will be required to have its accounts and statements signed by all of those directors or trustees. For all other SMSFs (that is, those with between three and six directors or trustees), the accounts and statements of the SMSF must be signed by at least half of the directors or individual trustees.

The amending Bill is the Treasury Laws Amendment (Self Managed Superannuation Funds) Bill 2020 and the amendments are to commence from the start of the first quarter (being the first 1 January, 1 April, 1 July or 1 October) that begins after the day the amending Act receives royal assent.

The Commissioner's perspective

2. Thin capitalisation: the arm's length debt test

The Commissioner has released a final ruling that deals with the application of the arm's length debt test contained in the thin capitalisation rules (TR 2020/4).

The thin capitalisation rules in Div 820 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) set a limit on the amount of debt that can be used to finance an entity's Australian operations. For entities that are not authorised deposit-taking institutions (non-ADIs), the arm's length debt amount for the year is one amount that can be used to determine an entity's maximum allowable debt. For tax purposes, an entity's debt deductions are reduced to the extent that its adjusted average debt exceeds its maximum allowable debt.

The ruling applies to an entity which seeks to apply the arm's length debt test contained in s 820-105 ITAA97 (for outward-investing entities (non-ADI)) and s 820-215 ITAA97 (for inward-investing entities (non-ADI)).

The purpose of the ruling is to provide interpretative guidance on key technical issues that may arise when determining an entity's arm's length debt amount. The ruling also provides interpretative guidance relating to the record-keeping requirements in s 820-980 ITAA97.

A practical compliance guideline (PCG 2020/7) has also been released to provide administrative guidance to taxpayers when applying the arm's length debt test.

TR 2020/4 replaces TR 2003/1 which has been withdrawn.

3. FBT: cars and COVID-19

The ATO has released a fact sheet that deals with determining how fringe benefits tax (FBT) obligations relating to work cars may be impacted by the COVID-19 pandemic, and how to calculate an FBT liability.

The key points in the fact sheet are:

- an employer's FBT obligations may be affected if employees have been garaging work cars at their homes due to the impacts of COVID-19;
- where a car is not being driven at all, or is only being driven for maintenance purposes, the ATO accepts that the employer is not holding the car for the purposes of providing fringe benefits. If the operating cost method is used and appropriate records are maintained, there may be no FBT liability for the car;
- certain kinds of cars may also be exempt from FBT even where they are garaged at employee homes;
- if an exemption does not apply and a work car is garaged at an employee's home, it will be deemed to be available for private use and there may be an FBT liability;
- the impact of COVID-19 on the business use of a car can be taken into account if it is being driven during the period it is garaged at home. This will require a logbook to be maintained (or to have been kept in any of the previous four years) which will enable the employer to calculate its FBT liability;
- logbook-keeping requirements will depend on whether an existing logbook is already being maintained for the year; and
- for any car fringe benefits calculated using the operating cost method, the business use estimates may be adjusted to reflect changes in an employee's driving patterns due to COVID-19.

4. Interest withholding tax: taxpayer alert

The Commissioner has issued a taxpayer alert in relation to arrangements which use offshore related entities to facilitate the avoidance of a withholding tax liability in relation to interest expenses deducted against Australian-sourced income and paid to non-residents (TA 2020/3).

The arrangements involve a non-resident deriving Australian-sourced income and incurring interest expenses (commonly from debt sourced from a related party) which are deductible against that income. Relevant arrangements typically display some or all of the following features:

- there is an Australian resident flow-through trust with one or more non-resident investors;
- the non-resident investor holds its interest in the resident trust through an interposed offshore entity (usually in a third jurisdiction which is a low or no tax jurisdiction and which is not part of the Australian tax treaty framework);
- the interposed beneficiary is financed in part or in whole by (usually, related-party) debt;
- the interest rate on the debt is at a significant premium to referrable third-party debt, or the lending entity's cost of funds (and the arrangement would usually fall outside the "green zone" referred to in PCG 2017/4);
- the resident trust derives Australian-sourced income and makes distributions to the interposed beneficiary; and/or
- the interposed beneficiary deducts the interest expense against the Australian income that it receives from the trust.

The ATO is not concerned with structures where deductible interest payments by a non-resident are merely incidental to what can be evidenced as ordinary and commercially appropriate business decisions.

The ATO believes that the arrangements may raise the following tax issues:

- the anti-avoidance provisions may apply in respect of structures if the particular facts and circumstances suggest that they were contrived to avoid payment of interest withholding tax or any Australian tax;
- related-party interest deductions may be reduced due to the operation of Australia's transfer pricing rules (Div 815 ITAA97);
- the thin capitalisation provisions (Div 820 ITAA97) may operate to deny interest deductions where the beneficiary is excessively leveraged; and
- the ultimate distributions made by the interposed beneficiary to its shareholders may be assessable income under s 44(1) of the *Income Tax Assessment Act 1936* (Cth) (ITAA36) in certain circumstances.

It is stated that arrangements may involve other features beyond those described in the taxpayer alert. For example, where, by reason of the interlinked rights and obligations in the related-party debt and other related schemes effecting what is economically similar to an equity interest, then, under certain circumstances, the related schemes provisions in Div 974 ITAA97 can operate so that related-party interest deductions may be denied.

5. MEC groups and capital gains: taxpayer alert

The Commissioner has issued a taxpayer alert in relation to arrangements that appear to be designed to avoid the inclusion of capital gains in the assessable income of Australian-resident entities on the disposal of their assets (underlying assets) (TA 2020/4).

The arrangements involve:

- an internal restructure within a multiple entry consolidated (MEC) group to enable the underlying assets to be disposed of by way of an eligible tier-1 (ET-1) company (directly or indirectly owning the underlying assets) leaving the MEC group; and
- circumstances where the disposal of the underlying assets might reasonably be expected to have been achieved in a more convenient or straightforward manner, resulting in the inclusion of a capital gain in the assessable income of the provisional head company of the MEC group.

On closer investigation, the stated justification for additional steps under the internal restructure lacks substance or real probative weight.

In relation to arrangements involving ET-1 companies, TA 2019/1 should also be considered. The ATO has issued the new alert (in addition to TA 2019/1) because further kinds of arrangements have subsequently been seen involving the uses of MEC groups to, in effect, reduce or avoid CGT. The ATO is particularly concerned that the reasons for some of the steps in the arrangements are not responsive to the objectively inferred commercial rationale of the taxpayer.

TA 2020/4 states that the general anti-avoidance provisions (Pt IVA ITAA36) may apply where taxpayers enter into arrangements of the kind described in the alert.

It is also stated that TA 2020/4 is not directed at arrangements which merely consist of a choice by two or more existing ET-1 companies of a top company to form an MEC group. However, such a choice may be an integrated or interdependent step in arrangements of the kind under review. The exception to the definition of "tax benefit" in s 177C(2) ITAA36 will not apply where the planning for, and implementation of, a scheme involves steps that commence before and continue after the making of the relevant choice or election. In such cases, the steps are not "merely contextual" but form part of a scheme consisting of more than the mere making of a choice or an election.

6. Foreign income tax offset limit

The Commissioner has issued a final determination to the effect that capital gains are not included under s 770-75(4)(a)(ii) ITAA97 when calculating the foreign income tax offset (FITO) limit (TD 2020/7).

The determination gives the following example.

Example

In an income year, an Australian taxpayer (the taxpayer) disposed of a number of CGT assets and recognised the following CGT events (assume that all capital assets have been held for less than 12 months):

Example (cont)

- – a foreign capital gain of $3,000 in respect of which $630 of foreign income tax was paid;
- – a foreign capital gain of $20,000 in respect of which no foreign income tax was paid;
- – an Australian capital gain of $10,000; and
- – a capital loss of $15,000.

When determining their net capital gain, the taxpayer applies the $15,000 capital loss against the $10,000 Australian capital gain and $5,000 of their foreign capital gain in respect of which no foreign income tax was paid.

The resulting net capital gain is $18,000 which includes a $15,000 foreign capital gain in respect of which no foreign income tax was paid and a $3,000 foreign capital gain in respect of which foreign income tax was paid. This net capital gain does not have a source.

The entire $3,000 foreign capital gain in respect of which foreign income tax was paid has been included in the taxpayer's assessable income. That $3,000 foreign capital gain will be disregarded under s 770-75(4)(a)(i) for the purposes of the FITO limit calculation in s 770-75.

The foreign capital gain amount of $15,000 in respect of which no foreign income tax was paid that was not absorbed by the capital loss cannot be included under s 770-75(4)(a)(ii) for the purposes of the FITO limit calculation in s 770-75, as it is neither an amount of ordinary income nor an amount of statutory income.

Recent case decisions

7. Scheme promoter regime

The Commissioner has succeeded in establishing that an individual (a Mr Paul Bogiatto) and two companies of his had engaged in conduct that resulted in each entity being a promoter of a tax exploitation scheme for the purposes of Div 290 of Sch 1 of the *Taxation Administration Act 1953* (Cth) (TAA53) (*FCT v Bogiatto*[1]).

The alleged tax exploitation schemes each involved claims under Div 355 ITAA97 in respect of purported R&D activities (R&D claims). The Commissioner alleged that it was not reasonably arguable that the scheme benefits resulting from the R&D claims were available at law. The allegations related to over 20 schemes involving 14 taxpayers in the 2012, 2013 and 2014 financial years.

The Federal Court (Thawley J) held that the Commissioner had established various contraventions with respect to tax exploitation schemes concerning 13 of the 14 taxpayers. Applications concerning some of the contraventions were, however, statute barred.

The conduct in relation to each of the alleged tax exploitation schemes was summarised by his Honour as follows:

1. the taxpayer would be contacted by telephone, either by Mr Bogiatto directly or by another person, for the purposes of arranging a meeting with Mr Bogiatto;
2. Mr Bogiatto would attend the prospective client's premises, promoting himself as an R&D specialist with considerable experience and expertise in assisting taxpayers with making R&D claims. Mr Bogiatto would discuss the possibility of the prospective client benefiting from R&D incentives, ask some questions about the operations of the business, advise that the taxpayer had a strong case for obtaining R&D incentives, and represent that he could assist;
3. Mr Bogiatto would send a letter of engagement, headed "Terms of engagement", to the prospective client. The terms of engagement included a fee calculated as a percentage of any R&D tax offset that the client might obtain, typically 30%;
4. Mr Bogiatto would then ask the client to send information about the operations and finances of the business, which he would use to prepare an "R&D tax incentive application" for submitting to AusIndustry for registration of the entity's R&D activities;
5. once registration with AusIndustry was confirmed, Mr Bogiatto would inform the client of this outcome and prepare an "R&D tax incentive schedule" containing figures that Mr Bogiatto instructed or advised the client to incorporate in its tax return or, if the client had already lodged a tax return for a given year, an amended tax return; and
6. by one of his companies, Mr Bogiatto would then send an invoice to the client and pursue payment.

During this process, if a client questioned Mr Bogiatto's calculations or asked for an explanation as to how the figures produced by Mr Bogiatto were derived, Mr Bogiatto would typically respond by asserting that he would not disclose his methodology because it was his intellectual property, asserting that he was the expert, and stating that the client should not question him. On occasion, he would provide some reason to reassure the client that the figures had a sound basis.

Where the tax exploitation schemes were implemented, the claims were grossly exaggerated or wholly unavailable. Also, each of the relevant implemented tax exploitation schemes involved tax evasion.

It may be noted that Thawley J was of the view that the better interpretation of s 290-50(1), Sch 1 TAA53 was that an associate, whose only involvement was to receive consideration, could be "[a]n entity [which has engaged] in conduct that results in … another entity being a promoter of a tax exploitation scheme".

It should also be noted that Thawley J rejected a submission of the Commissioner, made in relation to most of the schemes, that the R&D claims were not reasonably arguable at law because the "taxpayer did not have adequate or contemporaneous records to substantiate that the claimed R&D expenditure was incurred on R&D activities that had been registered with AusIndustry". His Honour said that, even where the Commissioner does establish an absence of adequate or contemporaneous records to substantiate the claimed R&D expenditure, it did not follow that the R&D claims were, for that reason, not reasonably arguable at law. The onus on the Commissioner in the present case was, among other things, to establish that it was not reasonably arguable that the scheme benefits were available

at law. Contrary to the Commissioner's submissions, this onus would not be discharged simply by establishing that inadequate records were kept. It would be discharged by establishing that the taxable facts were such that it was not reasonably arguable that the scheme benefits were available.

8. Personal services income: unrelated clients test

In a joint judgment, the Full Federal Court (McKerracher, Davies and Thawley JJ) has upheld the Commissioner's appeal from the decision of a single judge who had held (reversing a decision of the AAT) that the unrelated clients test contained in the personal services income provisions of the ITAA97 had been met (*FCT v Fortunatow*[2]).

The taxpayer was a business analyst and was at all relevant times the sole director of Fortunatow Pty Ltd (the company). Through contracts between the company and various recruitment or similar agencies, the taxpayer was engaged to provide services to organisations such as government departments, utilities, defence contractors, universities, banks, and large corporations. In the 2012 and 2013 income years, income of approximately $166,000 and $121,000, respectively, was returned in the company's income tax returns. The income related to the provision of the taxpayer's personal services to eight different end clients during those two income years. No remuneration was paid by the company to the taxpayer and he returned no income in his personal income tax returns for the relevant years.

The company transferred income generated by the taxpayer's personal services to the Fortunatow Family Trust (the family trust) which was characterised as "management fees" payable to the family trust. These fees were claimed as deductions and had the effect of reducing the company's taxable income to nil. The trust income was offset against the trust's rental losses. The Commissioner included the income of the company in the taxpayer's assessable income on the basis that the company's income was personal services income. There was no dispute that the income was personal services income, but the taxpayer contended that the company was conducting a personal services business within the meaning of s 86-15(3) ITAA97. Relevantly, the taxpayer relied on the "unrelated clients test" in s 87-20 ITAA97. The AAT rejected the taxpayer's contention and, on appeal at first instance, Griffiths J reversed the decision of the AAT. As indicated, the Commissioner's appeal from that decision has now been allowed by the Full Federal Court.

The taxpayer contended that he met the requirement in s 87-20(1)(b) ITAA97 (that the services were provided as a direct result of the individual or personal services entity making offers or invitations to the public at large or to a section of the public to provide the relevant services) because of his active profile on LinkedIn and his marketing by word of mouth at industry functions. He said that he kept his LinkedIn profile up to date and that he included a note that the company would be available for a new assignment on a certain date, namely, after completion of his current assignment. The taxpayer contended that his LinkedIn profile was a form of advertising.

Although the AAT accepted that the taxpayer's advertising on LinkedIn constituted the making of an offer or invitation to the public, it concluded that s 87-20(2) ITAA97 operated to deny the taxpayer's claim. That subsection provides that the individual or personal services entity is not treated, for the purposes of s 87-20(1)(b), as having made offers or invitations to provide services merely by being available to provide the services through an entity that conducts a business of arranging for persons to provide services directly for clients of the entity.

The Full Federal Court said that it was necessarily implicit in s 87-20(1)(b) that the client has made a decision to obtain the services. Without such a decision, the services could never have been provided. Accordingly, the inquiry as to whether the services were provided as a direct result of the making of offers or invitations invariably involved an inquiry about what caused the client's decision to obtain the services. If the client's decision to obtain the services was a direct result of the making of offers or invitations, the requirements of s 87-20(1)(b) would be met. A direct causal effect might be shown where it is established that an invitation or offer was comprehended by the client, in the sense of received and digested, and that it had at least some influence on the client's decision to obtain the services. The degree of influence required would depend on all of the circumstances.

If the requirements of s 87-20(1)(b) are satisfied with respect to two or more clients who were not associates of each other or associates of the individual or the personal services entity, s 87-20(1)(a) would be satisfied and the "unrelated clients test" would be met.

The Full Federal Court said that, as the Commissioner submitted, an offer or invitation which is only made to an intermediary, and is not passed on to and plays no part in, the client's decision to procure the relevant services, cannot be said to have directly resulted in the provision of the relevant services. This is because the offer or invitation loses its direct causal effect at the level of the intermediary, and the provision of the services can only be seen as the direct result of some other factor such as the intermediary's recommendation to the client.

On the facts as found by the AAT, none of the clients made their decisions to engage the services of the taxpayer as a direct result of any offer or invitation constituted by the taxpayer's LinkedIn profile.

The Full Federal Court also rejected an argument advanced by the taxpayer that the Commissioner's appeal was not competent.

9. Discretionary non-resident beneficiary and CGT

The Federal Court (Steward J), consistently with a decision of Thawley J handed down earlier this year, has held that a non-resident beneficiary (or the trustee on the beneficiary's behalf) was assessable on distributions by a resident discretionary trust which were sourced from capital gains made by the trust from the disposal of shares which were not taxable Australian property (*N & M Martin Holdings Pty Ltd v FCT*[3]).

In the 2013 and 2014 income years, N & M Martin Holdings Pty Ltd (Holdings) as trustee for the Martin Family Trust (the trust) sold shares in Altium Ltd. The trust was a resident discretionary family trust. Holdings, as trustee, resolved to distribute 99.27% and 100% of the capital gains made from

the sale of those shares in those income years (approximately $4m and $8.9m, respectively) to Mr Martin who was a discretionary object of the trust and was a non-resident for income tax purposes. The Altium shares were not "taxable Australian property" (TAP) for the purposes of Div 855 ITAA97.

The Commissioner issued assessments to Mr Martin on the basis that he had made capital gains in both years pursuant to s 115-215(3) ITAA97 and also assessed Holdings, as trustee, for the same gains pursuant to s 98 ITAA36 and s 115-220 ITAA97. Neither Holdings nor Mr Martin had paid the tax. The Commissioner acknowledged that, if Holdings paid the tax assessed to it, Mr Martin would be entitled to a deduction against his own tax liability that was equal to the amount of tax paid by Holdings in respect of Mr Martin's interest in the net income of the trust, and to a refund if that amount of tax paid by Holdings exceeded his tax liability as assessed.

Both Mr Martin and Holdings contended that the assessments were excessive because the capital gains assessed to Mr Martin should have been disregarded pursuant to s 855-10 ITAA97. That, it was contended, was because Mr Martin was a non-resident at the relevant times and the Altium shares were not TAP. It was not disputed that, if Mr Martin had held the Altium shares himself as opposed to being a discretionary object of a trust that held the shares, any capital gains made by him from the disposal of those shares in the 2013 and 2014 income years would have been disregarded, and Mr Martin would not have been liable to pay any Australian income tax on those gains.

Steward J said that the argument put on behalf of Mr Martin and Holdings had already been considered and rejected by Thawley J in *Peter Greensill Family Co Pty Ltd (trustee) v FCT*.[4] Even though Mr Martin and Holdings relied on new and additional contentions in support of a different conclusion concerning the application of s 855-10 and Subdiv 115-C ITAA97, Steward J said that it was accepted that he should follow the decision of Thawley J unless he were to be satisfied that the decision in *Peter Greensill* was wrong. Steward J was not satisfied that the decision in *Peter Greensill* was wrong; on the contrary, he was inclined to the view that it was correctly decided.

The decision of Thawley J in the *Peter Greensill* case was considered in the Tax Tips column of the June issue of the journal at page 607. An appeal to the Full Federal Court has been lodged from that decision. Presumably, an appeal will also be lodged against the decision of Steward J.

10. Backpacker tax appeal

The Full Federal Court has by majority (Derrington and Steward JJ, Davies J dissenting) upheld an appeal by the Commissioner from a decision of Logan J in the so-called backpacker tax case and, in doing so, held that the taxpayer was a resident, was not entitled to the benefit of the non-discrimination clause in the United Kingdom double tax agreement, and was taxable at the backpacker rates of tax (*FCT v Addy*[5]).

The taxpayer was a UK citizen who lived in Australia from 20 August 2015 to 1 May 2017, apart from a two-month period in early 2016 when she toured South-East Asia. She arrived in Australia on a 12-month working holiday visa but obtained a second 12-month visa before the first one expired (she qualified by working on a farm).

At first instance, Logan J held that the taxpayer was a resident of Australia during the 2017 income year (both according to the ordinary meaning of that term and under the 183-day test) and that the non-discrimination article in the Australia–UK double tax agreement (art 25) had the effect that the taxpayer was to be taxed under the normal individual rates of tax that applied to residents and not at the backpacker rates (which impose a rate of 15% on the first $37,000 of taxable income and apply to taxable income derived from 1 January 2017).

The Full Federal Court was unanimous that the taxpayer was not a resident of Australia for tax purposes during the 2017 income year according to the ordinary concept of residence.

However, the Full Court upheld Logan J's decision that the taxpayer was a tax resident of Australia under the 183-day test. Under that test, an individual is a tax resident if they have actually been in Australia, continuously or intermittently, during more than one-half of the income year (which the taxpayer had), unless the Commissioner "is satisfied that the person's usual place of abode is outside Australia and that the person does not intend to take up residence in Australia".

Essentially, the Full Federal Court held that the Commissioner could not have been satisfied that the taxpayer's usual place of abode was outside Australia and that she did not intend to take up residence here because the Commissioner had failed to consider those questions. In this regard, the Full Court disagreed with Logan J's reasons (although agreeing with his conclusion), stating that his Honour was wrong to have inferred that the Commissioner had not in fact been satisfied of the relevant matters.

With regard to the period of residency, the Full Court agreed with Logan J that the taxpayer's residency ceased when she left Australia on 1 May 2017 and therefore she was not a tax resident for the whole income year.

As indicated, the majority disagreed with the view of Logan J that art 25 of the Australia–UK DTA applied. Article 25 is a "non-discrimination clause" which provides that nationals of the one country (in this case, the UK) should not be subject to tax in the other country (in this case, Australia) that is "more burdensome" than the tax to which nationals of the latter country (Australia) "in the same circumstances" are or may be subjected.

The majority held that there was no discrimination on grounds of nationality as her nationality did not compel her to apply for a working holiday visa. There was a wide range of available visas which would permit a British national to enter Australia and earn income and, at least temporarily, attain the status of a resident. The taxpayer's decision to apply for a working holiday visa was a matter of choice.

The way the 183-day residency test applied in the circumstances in the absence of the Commissioner expressing whether he was satisfied or not satisfied in terms of the test raised some fundamental issues as to a court's power in relation to discretions conferred on the Commissioner by the taxation law. This issue is considered in the Tax Tips column of this issue of the journal (see page 169).

11. No effective disclaimer by beneficiary

The AAT has rejected a taxpayer's contention that she had effectively disclaimed her entitlement to an income distribution of $80,000 from a discretionary trust for the 2014 income year (*The Beneficiary and FCT*[6]).

By a resolution made on 30 June 2014, the trustee of the trust resolved (inter alia) to distribute $80,000 of the income of the trust for the income year to the taxpayer. The taxpayer's 2014 income tax return which was lodged on 17 July 2016 returned an amount of $7,804 as income but did not disclose the distribution.

The trustee of the trust had paid PAYG instalments of $31,248 relating to the taxpayer during the 2014 financial year and these instalments were included in the taxpayer's return as lodged. Consequently, when the return was processed, it generated a refund of $31,328 which was paid to the taxpayer on 27 July 2016.

Following a review of the taxpayer's return, the Commissioner issued an amended assessment on 30 April 2018 which included in the taxpayer's taxable income the amount of $80,000 as her share of the net income of the trust.

The taxpayer's objection to the amended assessment stated that she became aware of the distribution when she received the amended assessment and that she disclaimed the distribution on 6 April 2018 when she executed a document titled "Disclaimer of trust income" which purported to disclaim the distribution.

Another ground of disclaimer raised by the taxpayer related to the taxpayer's counsel (who was acting for her in relation to matrimonial property proceedings) on 23 March 2015 striking through the distribution in a draft income tax return sent to the taxpayer by the accountants engaged by her former husband to prepare income tax returns for the trust and the individuals.

The AAT noted that, despite being legally represented in relation to the issue, the taxpayer did not until April 2018 take the one, straightforward and conventional step that would have unequivocally disclaimed the distribution — signing a written disclaimer.

Additionally, the taxpayer lodging her tax return on the basis that she was entitled to the benefit of a credit for the amount of the PAYG instalments paid to the Commissioner by the trustee and retaining the refund of that amount generated on lodgment of her return was inconsistent with the taxpayer not accepting the distribution.

The taxpayer's relative inaction over the period between becoming aware of the distribution by late March 2015 and finally disclaiming it on 6 April 2018 around the time her objection was lodged, and claiming and retaining the PAYG instalments, indicated that she was reluctant to disclaim the distribution and indeed that it should be inferred that she accepted the distribution.

On balance, the AAT was not persuaded that the contrary indicators relied on, or other matters raised in the taxpayer's submissions, were sufficient to discharge the burden that fell on her to prove that such an inference should not be drawn.

As to the taxpayer's counsel striking through the distribution and the taxpayer signing that change, this occurred in such proximity to the taxpayer becoming aware of the distribution that it could not be inferred from the passage of time that she had already accepted the distribution. However, the AAT said that it was unable to accept that these actions were sufficient to disclaim the distribution. On her own evidence, the taxpayer had no concept of disclaimer in mind when this occurred. Nor was there any evidence that the taxpayer communicated the alleged disclaimer to the trustee either directly or through the accountants.

It is suggested that it may have been possible to argue that, in striking through the distribution shown in the draft tax return, the taxpayer's counsel was acting as an agent of the taxpayer. In fact, it appears that the return was lodged without the distribution being included.

It may be noted that the AAT refused the taxpayer leave to raise further disclaimer grounds.

12. Work-related deductions

The AAT has allowed in part a taxpayer's objection against the Commissioner's treatment of certain work-related deductions that the taxpayer had claimed for the 2016 income year (*Bell and FCT*[7]).

For that income year, the taxpayer was a construction worker with responsibilities as a construction site fire warden, first aid warden, OHS supervisor and the site foreman's assistant. The taxpayer predominantly worked at one construction site in an eastern suburb of Melbourne. The deductions claimed were in relation to motor vehicle expenses, phone expenses, home office utilities expenses, home internet expenses and the cost of a first aid course.

Claims of this nature are largely fact specific, but several points made by the tribunal may be noted.

In relation to the motor vehicle expenses, the AAT particularly mentioned the travel between the taxpayer's home and non-construction site locations, such as hardware materials and tool supply outlets, equipment hire outlets, fuel suppliers or his employer's head office.

The AAT said that a person whose duties require collection of supplies and materials consumed at a workplace location does not transform the travel between home and the place of collection of those items consumed in a workplace location simply by collecting those items on the way to work. Similarly, such a person does not transform travel from a place of collection of a workplace consumable to home and the travel from home to work the following day merely by collecting a consumable supply on the way home, taking that consumable supply home and taking the supply from home to the workplace location the following day. The fundamental nature of the travel from the point of collection to the employee's home, or from the employee's home to the place of collection of the workplace consumable, is travel between home and workplace. Absent the bulky goods exception applying, the character of the travel between place of collection and place of home and vice versa is not altered. If it were, a person who collected food consumables at a location close to home and then travelled an extensive distance to the workplace could transform the nature of

the travel simply by choosing a place of collection for a consumable close to home as opposed to a location close to the workplace.

In relation to the claim for telephone expenses, the AAT said that the nature of the taxpayer's duties compelled a conclusion that the use of a mobile telephone was an incidental part of his employment activities. Accordingly, some proportion of the telephone bill in aggregate was properly deductible. Allowing for some error in the identification of employment-related calls in the evidence led by the taxpayer, and taking on the Commissioner's calculation of 59%, a deduction of 50% of the mobile telephone bill was appropriate in the circumstances.

In relation to the first aid course, the taxpayer's evidence was that, while he was recorded as having received an allowance for the cost of the first aid course, that component of his allowance was not paid to him directly; rather, $363 was used to pay for the cost of the first aid course. In effect, the taxpayer had met the cost and incurred the loss or outgoing associated with the first aid course by constructive receipt of his allowance and use thereof to pay for the course. In those circumstances, the allowance was paid to the taxpayer and the taxpayer had paid for the course.

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References

1 [2020] FCA 1139.
2 [2020] FCAFC 139.
3 [2020] FCA 1186.
4 [2020] FCA 559.
5 [2020] FCAFC 135.
6 [2020] AATA 3136.
7 [2020] AATA 3194.

Tax Tips

by TaxCounsel Pty Ltd

The Commissioner's discretions: the court's role

The judgments in a recent Full Federal Court decision have considered the issue of the powers of the Federal Court in what may be called a "discretion" case.

Background

The conferral of discretionary powers on the Commissioner has been a feature of the federal taxation laws since their first enactment. There will be the "conferral of a discretionary power" where a statutory provision operates in some respect by reference to the Commissioner, for example, forming an opinion, being satisfied as to something, considering whether something is reasonable, or determining whether some time limitation should be extended in the circumstances.

Looking back into the past, a rather striking early example of a discretionary power conferred on the Commissioner was provided by s 16 of the *Income Tax Assessment Act 1915* (Cth). That section provided that, for the purpose of ascertaining the taxable income of a company, there was to be deducted from the total income of the company, in addition to any other deductions allowed by the Act, so much of the income as was distributed to the members, shareholders or debenture-holders of the company, but the section also provided for the consequences where "in the opinion of the Commissioner a company has not in any year distributed to its members or shareholders a reasonable proportion of its income".

There are many instances in the *Income Tax Assessment Act 1936* (Cth) (ITAA36) and the *Income Tax Assessment Act 1997* (Cth) (ITAA97), as currently enacted, that confer discretions on the Commissioner. Examples include the discretion in s 109RD ITAA36 to extend the period for the repayment of an amalgamated Div 7A loan,[1] the discretion contained in the definition of "resident" in s 6(1) ITAA36 that was considered in the recent decision in the *Addy* case (which is considered in this article), the discretion conferred by the general anti-avoidance provisions of Pt IVA ITAA36 to cancel a tax benefit or to make a compensating adjustment, and the discretions in relation to the imposition and remission of administrative penalties under the *Taxation Administration Act 1953* (Cth) (TAA53).

Often, a discretionary power is conferred on the Commissioner by the word "may". There is a general statutory rule which is to the effect that, where an Act provides that a person, court or body may do a particular act or thing, and the word "may" is used, the act or thing may be done at the discretion of the person, court or body unless there is a contrary intention.[2]

Some discretions unavoidable

The need for the conferral of a discretionary power on the Commissioner in some circumstances is almost self-evident. For example, where there is a prescribed statutory period within which something must be done or must occur if certain consequences are to follow or are not to follow, flexibility to avoid harsh consequences that could be occasioned if there is a failure to meet the statutory time limit in some cases can be simply achieved by enabling the Commissioner to extend the statutory period in appropriate cases.

By way of example, the CGT provisions contain a number of extensions of time discretions. One illustration of this is the power of the Commissioner to extend the time for the making of a choice under the CGT provisions. The effect of s 103-25 ITAA97 is that a choice that a taxpayer may make under the CGT provisions must be made by the day the taxpayer lodges their income tax return for the income year in which the relevant CGT event happened, or within a further time allowed by the Commissioner.

But, in some instances, why it has been thought necessary for the legislation to confer a discretion on the Commissioner, rather than simply having objective criteria or an objective test, is not clear. Indeed, one aim of the Tax Law Improvement Project which gave rise to the ITAA97 was, in the words of the explanatory memorandum to the Income Tax Assessment Bill 1996:

> "… to replace with objective criteria many of the discretions that the Commissioner of Taxation may exercise under the existing law, to more fully reflect the introduction of the self assessment system. Where a discretion is being replaced with more specific criteria, that change is explained in the explanatory material on the new law. In many cases, however, the change will merely replace the test of what the Commissioner considers to be reasonable with a simple test of reasonableness."

Despite this aim, there are many discretionary provisions in the ITAA36 that are yet to be rewritten and there are a considerable variety of discretions in the ITAA97.

Indeed, some of the problems that can arise if a discretion is conferred, rather than having objective criteria stipulated, have been starkly exposed in the recent decision of the Full Federal Court in *FCT v Addy*.[3] The case raised a number of issues, but what is of present relevance revolved around the correct construction of the definition of "resident of Australia" in s 6(1) ITAA36, and, in particular, how the discretion conferred on the Commissioner by the 183-day rule operates. Also, what the Federal Court's powers are on an appeal against an objection decision that raises the exercise, or the non-exercise, of that discretion was considered. It is these aspects of the decision in this case that are considered in this article.

The Addy case discretion

The *Addy* case was intended to be simply a test case as to the application and operation of the non-discrimination provision (art 25) of the Australia–UK double tax agreement. However, the case, to use the words of Davies J, had "a sad and sorry history" which had deflected from the important question for determination concerning art 25 for which the taxpayer received test case funding.

The question of the taxpayer's residency in the 2017 income year was not in issue in the objection and appeal proceedings when they were commenced, the Commissioner having accepted that the taxpayer was an Australian resident for tax purposes during the part of the 2017 income year that she was still in Australia, that is, from 1 July 2016 to 1 May 2017. The sole question for determination was then seen as simply being whether art 25 applied to preclude Australia from assessing the taxpayer at the rates specified as being applicable to "working holiday makers", and not at the rates of tax applying to all other resident taxpayers. Residency only became an issue about one month before the hearing before Logan J at first instance when the taxpayer sought to amend her appeal statement to contend that she was an Australian tax resident for the entirety of the 2017 income year (despite leaving Australia and returning to the UK in May 2017) and was thus entitled to the tax-free threshold without the threshold being pro-rated.

Supporting that ground was the contention that, when a person spends more than 183 days in Australia, the effect of the definition of "resident" is that the person is presumptively an Australian resident and satisfies that test of residency for the entirety of the income year in question, even though the taxpayer may leave Australia before the end of the income year.

The relevant part of the definition of resident in s 6(1) ITAA36 reads as follows:

> "***resident*** or ***resident of Australia*** means:
>
> (a) a person, other than a company, who resides in Australia and includes a person:
>
> (i) …;
>
> (ii) who has actually been in Australia, continuously or intermittently, during more than one-half of the year of income, unless the Commissioner is satisfied that the person's usual place of abode is outside Australia and that the person does not intend to take up residence in Australia; or
>
> (iii) …"

This definition had its origin 90 years ago when it was inserted into the *Income Tax Assessment Act 1922* by the *Income Tax Assessment Act 1930.*

As will be seen from what is stated above, for the 2017 income year, the taxpayer was in Australia for more than one-half of that income year.

Construction of subpara (a)(ii)

The Commissioner argued that the 183-day test operates to make someone a resident only where he has addressed the question of satisfaction, one way or the other. It was submitted that the first element of the test (183-days presence) does not determine the residence issue unless and until the second element (satisfaction) is considered. Each member of the Full Court rejected the Commissioner's contention.

Davies J said that the test for residency under subpara (a)(ii) was a standalone test of residency and operates, of its own force, to make a person a "resident" of Australia for Australian tax purposes where the taxpayer has been in Australia for more than 183 days, continuously or intermittently, in an income year, unless the Commissioner holds the requisite state of opinion. The test operates on the criterion of actual presence in Australia for at least half of the income year, and that test will be met in the absence of the Commissioner forming the requisite state of satisfaction. In this case, the Commissioner did not form such a state of satisfaction.

To similar effect, Derrington J said that the conclusion that the Commissioner did not consider the 183-day test and specifically did not turn his mind to the factual matters relevant to the proviso criteria seemed likely but it did not render the resulting circumstance devoid of substance. In part, this was because the 183-day test operates regardless of the actions of the Commissioner. If a taxpayer is present in Australia for the required duration, prima facie, they will be an Australian tax resident. It is only the exclusory proviso which is dependent on the Commissioner's involvement. If he fails to consider the proviso in circumstances where he is not obliged to do so, the test operates according to its terms. If the court accepted that at no time did the Commissioner consider the 183-day test, the taxpayer would nevertheless be a resident under that test as a consequence of the duration of her presence here. In the absence of the Commissioner turning his mind to the question of the proviso criteria for the purposes of the further amended assessment, the only conclusion which could be reached was that the taxpayer was a resident pursuant to the 183-day test.

Steward J said that nothing in the language of the 183-day test supported the proposition that the taxpayer can only be a resident if both of its limbs or elements favour that conclusion. His Honour also pointed out that the purpose of the test was to supplement the test of residency in ordinary concepts in a practical way. It permitted a conclusion to be reached about residency by the simple expedient of the taxpayer being physically in Australia during more than one-half of an income year. It would seriously undermine the utility of this test if it also required, in every case, the Commissioner to form a view about the taxpayer's usual place of abode and intentions about residency. The purpose of the carve-out was to ensure that someone who is truly a visitor to Australia, does not acquire tax residency because of an application of the somewhat arbitrary test of physical presence for 183 days. However, the carve-out will never apply "unless" the Commissioner chooses to consider it.

The carve-out and the court

Steward J (Davies J expressing her agreement) said it appeared that Logan J at first instance was of the view that the court could determine itself the factual enquiries which comprise the carve-out to the 183-day test. However, Steward J said that he was unable to agree with that proposition. He said:

"… the legislative scheme is quite clear. It is the Commissioner's function, and not that of the Court, to determine on the merits the usual place of abode of the taxpayer and her or his intention about residence."

It was argued that this conclusion was wrong for two reasons:

1. it did not take account of an amendment made in 2013 to s 14ZZO(b)(i) TAA53 and, in particular, of the words "what the assessment should have been"; and
2. because of what the majority of the High Court (Gibbs and Stephen JJ) said in *Kolotex Hosiery (Australia) Pty Ltd v FCT*.[4]

Each member of the court rejected these arguments.

In relation to 2 above, Steward J (Davies J agreeing) said that the Commissioner's power to apply the carve-out was no mere procedural step. Parliament had reposed into the hands of the Commissioner the responsibility of determining on the evidence both the location of the taxpayer's usual place of abode and the taxpayer's intention about taking up residence. These were matters for the Commissioner, and not the court, to be satisfied about. The role of the court was limited to determining whether the Commissioner had lawfully attained that state of satisfaction. It was limited to review in accordance with the decision in *Avon Downs Pty Ltd v FCT*.[5]

In relation to the *Kolotex* case, Steward J (Davies J agreeing) made several points, including:

- the *Kolotex* case concerned certain former provisions of the ITAA36 which limited the ability of a company to carry forward unused tax losses. In general terms, one of the requirements was that the Commissioner needed to be satisfied that the same requisite persons beneficially owned shares in the taxpayer company, both during the year in which the loss was incurred and the year in which the loss was to be used. In the *Kolotex* case, the Commissioner was not so satisfied. Gibbs and Stephen JJ decided that the Commissioner had erred in law in reaching that conclusion. However, their Honours did not remit the matter back to the Commissioner. Rather, based on alternative grounds raised for the first time before the court by the Commissioner, it was decided, by reference to those grounds, that the Commissioner could not otherwise properly be satisfied about the necessary continuity of ownership. It followed that the Commissioner had been correct to disallow the taxpayer's deduction;
- the taxpayer relied on the *Kolotex* case as authority for the proposition that, in an appeal to a court from the decision of the Commissioner, once the court was satisfied of the presence of error in the attainment by the Commissioner of his state of satisfaction, the court could decide for itself whether or not the Commissioner should, on the evidence before the court, be so satisfied. Steward J did not accept the correctness of that submission for the following two reasons: (1) the form of the relief ordered by Gibbs and Stephen JJ in the *Kolotex* case was the product of what the parties wanted the court to do; and (2) in any event, it should be accepted that Gibbs and Stephen JJ did not remit the matter for reconsideration because, in the *Kolotex* case, as a matter of law, only one conclusion was open to the Commissioner to reach with respect to the beneficial ownership of the taxpayer;
- the present case was not a case where it could be said that *only* one conclusion was legally open to the Commissioner in relation to the issue of both the taxpayer's usual place of abode and her intention to take up residence;
- the authority to determine whether the taxpayer's usual place of abode in the 2017 income year was in England and to ascertain whether she intended to take up residence in Australia, lay with the Commissioner; and
- although the taxpayer cited in her written submissions a number of authorities in support of the proposition that, based on the *Kolotex* case, a court may exercise powers and discretions reposed in the hands of the Commissioner, these cases did not clearly support the taxpayer's proposition.

Derrington J said that the proposition that the *Kolotex* case permitted the court to substitute its own conclusion as to a matter vested in the subjective consideration of the Commissioner, presupposed that a vitiating error had invalidated the state of mind relied on in question. In order to understand the scope of the court's power which was said to flow from the *Kolotex* case, it was necessary to identify the gateway through which a litigant must pass before becoming entitled to seek such relief. In other words, what kind of error will vitiate a state of mind formed by the Commissioner which operates as a precondition to the operation of a section or the exercise of a power?

Derrington J further said that the general rule was that, where a criterion for the operation of a provision depended on the formation of a state of mind by the Commissioner and that state of mind was found by a court to have been vitiated by error of the kind identified in the *Avon Downs* case (see below), the ordinary course was to remit the matter to the Commissioner to re-consider according to law. His Honour said that the general rule was qualified only by the narrow exception which permitted the court to refrain from remitting a matter in "extreme cases" where the Commissioner had only one decision open to him as a matter of law, being the decision which was in fact made. Viewed differently, although the state of mind was affected by error, it was an error, the absence of which could not give rise to the possibility of a different outcome and, as such, was not "material".

Some observations

It must be kept in mind that, where a taxpayer has been adversely affected by the Commissioner's exercise of a discretionary power and an adverse objection decision by the Commissioner, resort to the Federal Court is not the only course that a the taxpayer may take. The taxpayer may, alternatively, apply to the AAT for a review of the Commissioner's decision (s 14ZZ TAA53).

A party adversely affected by a decision of the AAT (that is, either the taxpayer or the Commissioner) may appeal to the Federal Court on a question of law (s 44 of the *Administrative Appeals Tribunal Act 1975* (Cth)).

The AAT's role

On a review of an objection decision, the AAT, so to speak, stands in the shoes of the Commissioner. This follows from the fact that, for the purpose of reviewing a decision, the tribunal may exercise all of the powers and discretions that are conferred by any relevant enactment on the person who made the decision, that is, the Commissioner in the present context (s 43 of the *Administrative Appeals Tribunal Act 1975*). This means that the AAT may undertake a merits review of the Commissioner's exercise (or failure to exercise) a discretionary power.

A party dissatisfied with a decision of the AAT in a taxation matter may appeal, as of right, to the Federal Court on a question of law, and the court may make such order as it thinks appropriate by reason of its decision, including an order remitting the case to be heard and decided again (s 44 of the *Administrative Appeals Tribunal Act 1975*).

Whether a decision of the AAT in relation to the exercise of a discretion case involves a question of law will turn on whether the AAT's purported exercise of the discretion is affected by an error of law in the sense described in *Avon Downs Pty Ltd v FCT*[5] (see below).

The Federal Court's role

In proceedings on an appeal to the Federal Court against an objection decision relating to an assessment, the taxpayer has the burden of proving that the assessment is excessive, or otherwise incorrect, and what the assessment should have been (s 14ZZO TAA53). The court may make such order in relation to the decision as it thinks fit, including an order confirming or varying the decision (s 14ZZP TAA53).

It is clear that, in such an appeal to the extent to which the decision relates to the exercise of a discretion by the Commissioner, the court could only intervene where the Commissioner's decision involves some error of law and that, unless there is a successful application in the *Addy* case for special leave to appeal to the High Court which reverses the Full Federal Court's reasoning on this issue, the law as to the powers of the Federal Court should, in a practical sense, be taken to have been settled by the Full Federal Court's decision; that decision would bind a single judge of the court unless, in a subsequent decision, the Full Federal Court decided not to follow the decision in the *Addy* case or there is a decision of the High Court on the point.

The classic statement on the question of law issue where there is a discretionary power involved is the following passage from the judgment of Dixon J in *Avon Downs Pty Ltd v FCT*:[6]

> "But it is for the commissioner, not for me, to be satisfied of the state of the voting power at the end of the year of income. His decision, it is true, is not unexaminable. If he does not address himself to the question which the sub-section formulates, if his conclusion is affected by some mistake of law, if he takes some extraneous reason into consideration or excludes from consideration some factor which should affect his determination, on any of these grounds his conclusion is liable to review. Moreover, the fact that he has not made known the reasons why he was not satisfied will not prevent the review of his decision. The conclusion he has reached may, on a full consideration of the material that was before him, be found to be capable of explanation only on the ground of some such misconception. If the result appears to be unreasonable on the supposition that he addressed himself to the right question, correctly applied the rules of law and took into account all the relevant considerations and no irrelevant considerations, then it may be a proper inference that it is a false supposition. It is not necessary that you should be sure of the precise particular in which he has gone wrong. It is enough that you can see that in some way he must have failed in the discharge of his exact function according to law."

To similar effect, in an earlier case[7] involving a provision of the *Income Tax Act 1924* (Qld), Rich and Dixon JJ, in a joint judgment, said:

> "But, notwithstanding the generality of the powers of the Court of Review, a particular provision may intend to invest the Commissioner with a discretion which is confided to him to the exclusion of that Court. Whether it does so is a question which must depend upon the language in which it is expressed and the subject matter with which it deals. The two paragraphs of s 14(4)(iv) now under consideration deal with a matter notorious for its difficulty, viz., the ascertainment of profits made or derived within a particular territory as a result, it may be, of operations conducted over a wider field. The language of the paragraphs is appropriate to give him an individual discretion. No doubt it is not incapable of the contrary construction, but, having regard to the subject matter and the form of expression, we think it sufficiently appears that the enactment means to withdraw from the consideration of the Court the correctness of the opinion of the Commissioner upon the matters in question … Of course this does not mean that the validity of the exercise of the Commissioner's discretion, as opposed to the correctness of his opinion, is not examinable. If he exercises his discretion capriciously, or fancifully, or upon irrelevant or inadmissible grounds, it may be set aside. Upon the present appeal no such question arises."

Reasons for decision

It will be appreciated from the above that, in some circumstances, for a taxpayer to make an informed choice in a discretion case between applying to the AAT for a review of the Commissioner's objection decision or appealing to the Federal Court, the taxpayer will need to know the reason or reasons why the Commissioner exercised a discretion in the way he did.

If the Commissioner has not provided reasons, the taxpayer may make a request to the Commissioner for a statement of reasons.[8] The effect of s 28 of the *Administrative Appeals Tribunal Act 1975* is that the taxpayer may make a written request to the Commissioner to give to the taxpayer a statement in writing setting out the findings on material questions of fact, referring to the evidence or other material on which those findings were based and giving the reasons for the objection decision; the Commissioner must, as soon as practicable but in any case within 28 days after receiving the request, prepare, and give to the taxpayer, such a statement.

Special leave?

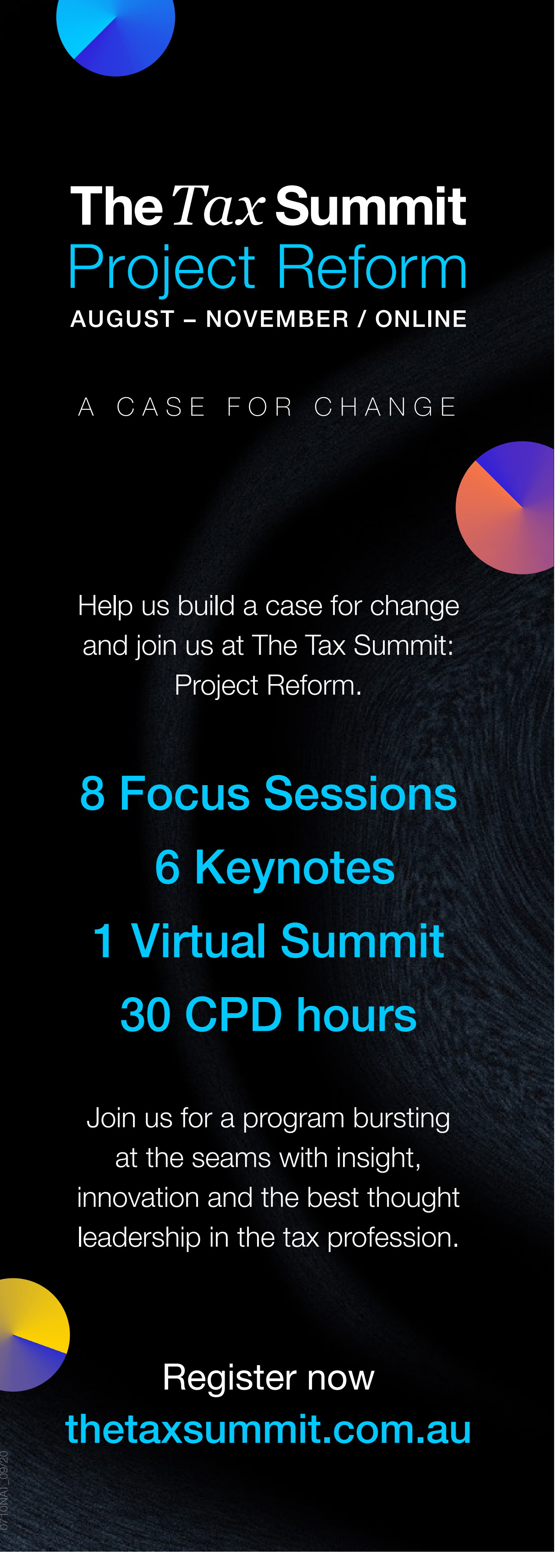
It is not yet known whether there will be an application to the High Court for special leave to appeal from the decision of the Full Federal Court in the *Addy* case. But even if there were to be a successful application for special leave to appeal, the High Court could limit the grant of special leave

to the question of the operation of art 25 on the Australia–UK double tax agreement.

TaxCounsel Pty Ltd

References

1. This discretion was considered in the Tax Tips column of the September 2020 issue of the journal (see page 110).
2. S 33(2A) and 2(2) of the *Acts Interpretation Act 1901* (Cth). In the case of the income tax laws, the statutory provisions reflect what would have been the case. For a decision in which it was held that the word "may" in the former s 46(3) ITAA36 did not confer a discretion, see *Finance Facilities Pty Ltd v FCT* [1971] HCA 12.
3. [2020] FCAFC 135. This was an appeal and cross-appeal from the decision of Logan J in *Addy v FCT* [2019] FCA 1768. The Commissioner's objection decision was the subject of an appeal to the Federal Court, that is, the AAT was not involved.
4. [1975] HCA 5.
5. [1949] HCA 26.
6. [1949] HCA 26 at [13].
7. *Australasian Scale Co Ltd v Commissioner of Taxes (Qld)* [1935] HCA 23.
8. It may be noted that, in *Kolotex Hosiery (Australia) Pty Ltd v FCT* [1975] HCA 5, Barwick CJ commented that it was of prime importance that the Commissioner, before or at the time of assessment, should apply his mind to the matters about which his satisfaction or lack of satisfaction has such importance, and that he should at the same time clearly record his relevant state of mind and the facts or his view of the facts on which it is based.



Mid Market Focus

by Andrew Burns, CTA, HLB Mann Judd

GST and fundraising during the pandemic

Many charities have been forced into rethinking their fundraising activities in the face of COVID-19 restrictions. As part of this, they should also review their GST responsibilities.

Introduction

Not only have the restrictions put in place to combat COVID-19 had a significant effect on businesses and individuals, forcing many of us to change the way we go about our lives, they have severely restricted the ability of many charities to raise funds. This is particularly true for charities which rely on fundraising events as their main source of income.

With restrictions on the size of gatherings, charities which rely on traditional fundraising events such as dinners, and gala shows to raise funds for their charitable activities, have been unable to run these essential events. Some charities have adapted by taking these events into the virtual world, with online events being streamed to supporters, as well as virtual fundraisers.

The author has even heard of a small charity which has an annual quiz night as its main fundraiser holding a virtual quiz night, with the first rounds of questions being recorded, then being made available to supporters together with a pack containing the other rounds.

When contemplating these alternative fundraising activities, the charity must also consider how GST may apply. The alternative activities may not be eligible for the same GST treatment as the normal fundraising events.

Background

Before exploring the GST rules which may apply to alternative fundraising activities, it is necessary to gain an understanding of the GST treatment of a "normal" fundraising event.

Section 40-160 of *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (GSTA99) provides endorsed charities, deductible gift recipients and government schools with the choice to treat any supplies made in connection with a fundraising event as being input taxed. For this purpose, a fundraising event is defined in s 40-165 GSTA99 as follows:

"(1) Any of these is a ***fund–raising event*** if it is conducted for the purpose of fund-raising and it does not form any part of a series of regular run of like or similar events:

(a) a fete, ball, gala show, dinner, performance or similar event;

(b) an event comprising sales of goods if:

(i) each sale is for a consideration that does not exceed $20 or such other amount as the regulations specify; and

(ii) selling such goods is not a normal part of the supplier's business;

(c) an event that the Commissioner decides, on an application made by the supplier in writing, to be a fund-raising event.

(1) Paragraph (1)(b) does not apply to an event that involves the sale of alcoholic beverages or tobacco products.

(2) The Commissioner must not make a decision under paragraph (1)(c) unless satisfied that:

(a) the supplier is not in the business of conducting such events; and

(b) the proceeds from conducting the event are for the direct benefit of the supplier's charitable or non-profit purposes.

(3) The Commissioner may determine, in writing, the frequency with which events may be held without forming any part of a series or regular run of like or similar events for the purpose of subsection (1)."

The Commissioner has issued *Goods and Services Tax: Frequency of Fund-raising Events Determination (No. 31) 2016* which puts a limit of 15 on the number of events of any one type which can be carried on during a financial year before it will be considered to be a part of a series or regular run of events, and therefore excluded from the election under s 40-160.

If a charity chooses to treat a fundraising event as input taxed, that treatment will apply to all supplies made during the event. This will include an auction of items, or a raffle conducted during the event.

However, this treatment will not extend to supplies which are considered to be a separate event. In its guide to the GST concessions for non-profit organisations, the ATO gives an example of a lottery where tickets are sold throughout the year, with the winner being drawn at a fundraising dinner. In this situation, the lottery and dinner are separate events, with the lottery tickets not being treated as input taxed, even if sold during the dinner. (The sale of the lottery tickets may be GST-free if the conditions under s 38-270 GSTA99 are met.)

The choice under s 40-160 must be made prior to the event.

Application to alternative activities

The key when determining whether a charity's alternative fundraising activities can be treated as input taxed under s 40-160 is to determine whether the activity falls within the definition of a fundraising event under s 40-165.

Clearly, as the current circumstances have required charities to adapt relatively quickly, and as many of the alternative activities had not even been contemplated a year ago, there is little or no specific guidance on whether these activities will qualify as fundraising events. However, by looking at the underlying principles and the reasoning in a number of private rulings, it is possible to draw reasonable conclusions.

Where there is uncertainty on whether an activity will qualify as a fundraising event, a charity should apply to the Commissioner for a determination. Sufficient time should be allowed for the Commissioner to make his determination in order for the charity to be able to make the choice under s 40-160 prior to the event.

Below is a discussion of some of alternative events which a charity may hold as a replacement for its more traditional fundraising events.

Online fundraising event

Where an online fundraising event is merely the replication of an event which could not be held due to restrictions on public attendance, it would be reasonable to conclude that it would have the same character as the physical event.

When deeming whether an online fundraising event may be treated as input taxed, is it not only necessary to consider the type of event, but also the length of time that it is available for access. An event which is streamed live, or a recording which is only available for a limited time before being removed from a charity's website, is more likely to qualify as a fundraising event than videos uploaded to YouTube in connection with a call for donations.

An example of such an event is a live performance by a musician which is streamed through the charity's social media channels, without being recorded for later viewing. Supporters may either be charged a fee for the streaming link or may make donations during the performance.

Ordinarily, a concert would be fall within s 40-165(1)(a) (being a fete, ball, gala show, dinner, performance, or similar event). Therefore, the charity would be able to elect to treat all supplies made at the event as input taxed, including any ticket sales, merchandise or donations made on the night.

It is reasonable to argue that the streaming of a concert should also fall within s 40-165(1)(a), as the main distinction is the physical location of the performers and viewers.

Online auctions

While it is possible to carry on a live auction online (auction houses do it all the time), charities which hold auctions as part of their fundraising activities may not have the necessary arrangements in place to allow them to effectively replace a live, in-person, auction with an online equivalent. It may be easier to list items on eBay or other similar platforms.

A charity auction is generally considered to fall within the events covered by s 40-165(1)(a) and is therefore eligible to be treated as input taxed. Where the charity is able to conduct a live online auction, it would be reasonable to conclude that this auction would also fall within s 40-165(1)(a).

However, where the auction is conducted using an independent online platform over a period of time, it would be unlikely to be similar enough to the events listed in s 40-165(1)(a) to qualify under that definition. It is also unlikely to qualify under s 40-165(1)(b) given the $20 limit on sales.

Therefore, for such an auction to be treated as input taxed, it will be necessary to apply for the Commissioner's discretion under s 40-165(1)(c).

A search of the register of private binding rulings does not provide any online auctions, but one ruling does involve a charity which placed donated items on consignment with a third party for sale.

This ruling confirmed that the sale of goods on consignment would not be a fundraising event under s 40-165(1)(a). However, in this particular situation, the application was made after the sales had occurred; therefore, the Commissioner was not able to retrospectively exercise his discretion under s 40-165(1)(c).

Without specifically stating whether the Commissioner's discretion would be exercised for future events, the ruling did state that similar consignment sales in the future may qualify under s 40-165(1)(c), based on the particular facts of that situation, if the application was made prior to the event.

Applying the principles in this private ruling to the online auctions that charities are making, it would be reasonable to conclude that they would be eligible to be treated as input taxed, but the charity should seek the Commissioner's discretion prior to listing the items for sale.

Third-party fundraisers

Rather than holding one large fundraising event with supporters coming together, a charity may encourage supporters to hold their own events, subject to limits on the number of people who can attend a gathering, with the proceeds from those events going to the charity. The charity may even provide resources that the supporters can use for their events.

In this situation, the supplies at the fundraising event are being made by the supporters, not the charity. Therefore, it will not be possible to elect to treat the supplies as input taxed under s 40-160.

As the event is being conducted by the charity's supporters, it will still be necessary to consider the supplies being made by the supporters as taxable supplies. Normal rules for determining whether a supply is a taxable supply will apply.

Simplistically, if the event is being carried on by an entity which is not registered for GST (and not required to be registered), or if the supplies are not made in connection with an enterprise which is being carried on, there will be no GST on the supplies.

If the entity carrying on the event is registered for GST, and the supply is related to an enterprise that they are carrying on, GST will apply to the supplies made in the same way that it would to the entity's other supplies.

An example of this might be a restaurant which has a special menu for an evening, with a percentage of the sales being donated to a charity. The restaurant will be required to remit 1/11th of the GST-inclusive sales price as GST.

When the proceeds from the event are paid to the charity, this payment will be considered to be a donation for GST purposes, and therefore would not be a supply.

Conclusion

The examples given above merely set out the issues which need to be considered. There are likely to be other, more creative, solutions which are being adopted to raise funds to enable charities to continue to provide their vital support to the community.

In a changing world, charities still need to be conscious of their GST obligations to ensure that they are able to maximise the funds available to them from any alternative events.

Andrew Burns, CTA
Manager
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The Tax Institute's 2020 CTA2B study period 1 dux discusses the practicality of the subject and how valuable its application is in developing his current knowledge and skillset.

Andrew Fernandes, Senior Accountant, Bentleys Chartered Accountants, Queensland

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

After graduating from university, I commenced work in a mid-sized accounting firm. This provided me with the foundations for my career in accounting and tax. After three years, I moved to a larger accounting firm, which gave me greater opportunity to work on my tax research skills. I now have around four a half years' experience.

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

The most valuable aspect of studying the CTA2B Advanced Tax subject is that it has provided detailed information on a range of areas which I deal with on a day-to-day basis. Furthermore, the course clearly outlines this information in the form of real-life examples.

What are your areas of new confidence?

After completing this subject, key areas where I have developed my skills include tax consolidation and the Div 7A rules. The learning outcomes for these topics have proved very useful in a practical sense, for example, when applying these rules to client groups which have such structures and agreements in place.

What was the reason for undertaking CTA2B with the Institute?

To improve my skills and knowledge in a number of tax-related areas that are commonly encountered in my role and, by doing so, ensuring that I can empower those whom I mentor with such skills, as well as assist clients as a result of this enhanced knowledge.

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

Finishing the CTA2B subject marks the completion of my Graduate Diploma of Applied Tax Law studied through The Tax Institute. Having completed both the Chartered Accountants Program and the Graduate Diploma of Applied Tax Law, I plan to take a break from studying any further tertiary courses, and instead continue to focus on putting what I have studied into practice.

What are the challenges of juggling study and work?

Organisational skills, coupled with adequate preparation, have always been my mantra when studying and working full-time. While passing the subject may be your immediate goal, it is the information you retain which will best serve you in your career and will be the key to getting the most out of the course.

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

Working in a business advisory/tax role, I cannot understate the value in undertaking this course. For any professionals wanting to expand their current knowledge and skillset, I would not hesitate to recommend the course – it is useful well beyond the classroom.

Member Profile

This month's column features Fiona Stapleton from Thomson Geer Lawyers, South Australia.

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Why are you a member of The Tax Institute?

The Tax Institute provides me with a great platform to build knowledge and networks within the industry. I have enjoyed engaging with other members and contributing to committees, such as the Women in Tax and Membership Committees. I have been a member of The Tax Institute since completing my law degree and plan to continue my membership throughout my career.

How is your membership beneficial to your practice and clients?

The Tax Institute's high-quality professional education and resources have been integral to my career development. I often refer to seminar papers, journal articles and other materials published by the Institute to help solve client issues. Membership provides me with the opportunity to network with experienced practitioners and to keep my tax knowledge up to date, which benefits my practice and clients.

How did you end up in tax?

I studied income tax in my final year at university and enjoyed the complexity and variety it had to offer. My lecturer encouraged me to continue to pursue a career in tax. I (thankfully) found myself working in an Adelaide-based tax team, with peers who are brilliantly minded and passionate about tax, and who continually support and challenge me in my career.

What are the challenges for tax practitioners this year?

This has been a particularly challenging year for tax practitioners. The global pandemic has brought many challenges, including Australia's first recession in almost 30 years. Tax practitioners have had to navigate constant legislative change and an abundance of federal and state stimulus packages, all while knowing that their clients are relying on them for guidance and advice more than ever. The pandemic has also highlighted many of the inefficiencies of the Australian tax system and this may be the perfect opportunity for tax reform.

Most memorable career moment to date

My memorable career moments relate to the positive client outcomes that I have contributed to, such as successfully convincing the Commissioner that the modern family can involve a long-distance marital relationship in the context of residency, and that high-stakes gambling can be a genuine hobby rather than a business. However, one of my most memorable moments has to be when I realised that, for the first time, *all* of my work was returned to me clean *without* any edits (as opposed to being totally illegible due to the countless edits in red pen — you know *that* Artline pen — so annoying!). It was a great feeling.

How do you relax?

With a bottle of tequila. Every night. All jokes aside, my favourite ways to relax are by entertaining friends and exercising. I also try to get outdoors as much as possible. When working in a demanding and technical environment, I think it is important to consciously find time to relax. It is easy to get lost in the constant work demands and self-inflicted pressure to perform — so don't forget that you need time to relax.

Advice to those entering the profession

Tax is challenging and complex. It is impossible to be an expert in all areas and you will never know everything. It is true that the first few years are the hardest as you are learning to find your feet. So, my advice is to give those early years everything you have — be committed, be curious and be hardworking. But, most importantly, run your own race and do not worry about what others are doing and you will be rewarded with a fulfilling career.

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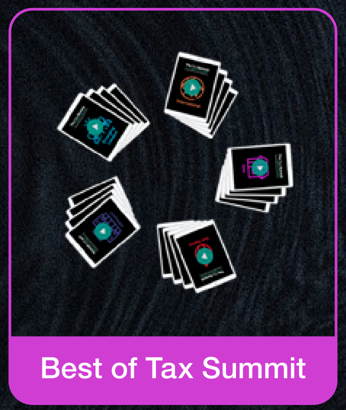

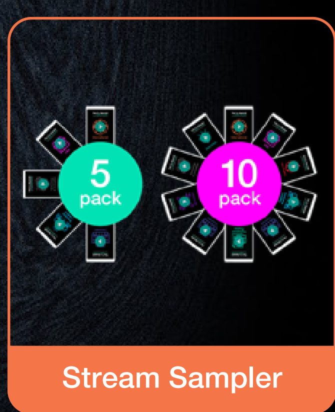

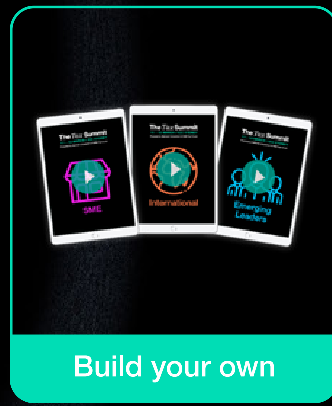

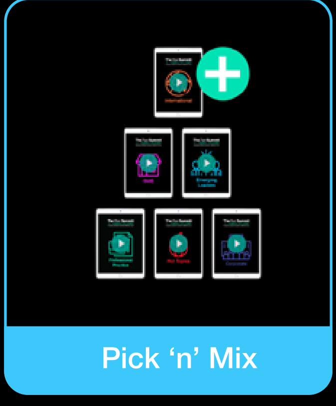

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Division 7A loan repayments: part 1

by David Montani, CTA, National Tax Director, Nexia Australia

Almost all minimum annual repayments under complying Div 7A loan agreements are made without transferring money. They are typically made by way of set-off against a dividend declared by the company, or purportedly made via a round-robin of payments. Part 1 of this article addresses the requirements to make a legally effective repayment by way of set-off. Where a repayment is not effective, the minimum annual repayment has not in fact been made, resulting in a deemed dividend. This is a fundamental issue that practitioners encounter when assisting their clients to comply with Div 7A. Also, there are broader tax, corporate and commercial issues and risks that arise, for both clients and practitioners. The article is written on the basis of an assumed level of Div 7A knowledge, and thus does not cover every relevant technical point. Part 2 of this article will consider common Div 7A circumstances where the particular structure does not naturally provide for making repayments by way of set-off, and the effectiveness of purported round-robin payment arrangements.

Background

When Div 7A of the *Income Tax Assessment Act 1936* (Cth) (ITAA36) was introduced in 1997, the company tax rate was 36%, after having been increased from 33%, and reduced from 39% before that, over the previous decade. These rates were significantly less than the top personal rate plus Medicare levy, a situation that continues to this day. For closely controlled private companies in particular, this has always created an incentive to draw after-company-tax profits (or unrealised profits) from a company in a form other than a dividend. The typical alternative form has been that of a loan. Drawing a dividend — franked, in most cases — triggered a top-up tax liability where a shareholder's personal tax rate was higher than the company rate. However, if funds were instead drawn in the form of a loan, there was no assessable amount, and thus no top-up tax liability.

Usually, there was no real intention of repaying such loans, and with no further tax liability, the shareholder accordingly enjoyed the use of a greater amount of funds. That is, the amount enjoyed was 64, 67 or 61 cents in the dollar of after-company-tax funds "borrowed", as opposed to about 51 to 52 cents in the dollar after paying top-up tax on a dividend. As for the lingering personal liability owing to their company and paying the ultimate final tax impost on those company profits, well, that was left to the executor of their estate to sort out. And if the estate had no assets left to repay the debt, or alternatively pay the final tax impost, too bad.

The form of the above extraction of company profits (ie a loan, never repaid), if left unchecked, resulted in no top-up tax being collected, despite the substance of the extraction being a dividend. Division 7A was introduced to redress this situation in a new way, replacing its predecessor, s 108 ITAA36, which had become obsolete in our self-assessment system introduced in the late 1980s.

In addition to loans, Div 7A also applies when private companies make payments and forgive debts. However, the vast majority of situations that practitioners deal with involve loans, and that is the focus of this article.

Purpose of Div 7A

The purpose of Div 7A is to redress the above tax-preferred accessing of company profits. It achieves this by deeming a private company to have paid a dividend where it makes a loan that is not a type that is excluded from this outcome. The company being taken to have paid a dividend is a fiction created by the law. No actual dividend has been paid, and the company's financial statements still record the reality of a loan advanced. However, for the purposes of tax law, s 44 ITAA36 brings the deemed dividend to account as assessable income, as it does with an actual dividend. The deemed dividend is assessable in the income year in which the loan is made and is not permitted to be franked.[1]

Division 7A applies not only to loans made to a shareholder, but also to an associate of a shareholder.[2] It also applies broadly where the trustee of a trust confers a present entitlement to a private company, and, before or after the conferral, the trust makes a loan to a shareholder in that company, or to an associate of a shareholder.

Division 7A is a much more effective integrity regime than its predecessor because it is self-executing. If a loan made by a private company is not an excluded type, the deemed assessable dividend is an automatic consequence, and is required to be disclosed on the borrower's tax return like any other assessable income. Accordingly, Div 7A is designed to motivate behaviour that will prevent this outcome. However, no carrot is deployed as a motivational tool, only a stick.

Wielding the stick

Under s 109D ITAA36, a private company is deemed to have paid a dividend if it makes a loan during an income year to a shareholder, or an associate of a shareholder, that is:

- not fully repaid before the "lodgment day" for that year;[3] and
- not one of the types of loans that Subdiv D of Div 7A excludes from being treated as a dividend.

The above results in an assessable deemed dividend arising to the borrower (even if not an actual shareholder).[4] However, no deemed dividend arises if the loan is one of the excluded

types, which are set out in Subdiv D. The particular type of excluded loan that we are interested in here is that covered by s 109N ITAA36. This provision sets out criteria for the loan which, if met, will result in the company not being taken to have paid a dividend in that income year.

The criteria are:

- the loan terms are codified into a written agreement, executed *before* the lodgment day;
- the interest rate on the loan for income years after the one in which the loan was made is equal to or greater than the benchmark interest rate for each year;[5] and
- the maximum term of the loan is seven years (unsecured) or 25 years (secured).[6]

The above criteria for this exclusion from being treated as a dividend also apply in the circumstances set out above where a trust has an unpaid present entitlement (UPE) owing to a private company, and the trust makes a loan to a shareholder in that company, or to an associate.

Division 7A loan agreements

Tax agents have generally taken the approach of purchasing from a legal firm a template Div 7A loan agreement that satisfies the above s 109N criteria. The purchase terms include permission to re-use the template over and over for different clients. Note that a tax agent must do nothing more than enter a client's details into the template, and thus is rendering an execution service only. It is critical that there is no contribution to the authoring of the agreement, as that could constitute the provision of a legal service, which tax agents are not permitted to do.

Template Div 7A s 109N-compliant loan agreements are typically structured as a facility agreement that satisfies the above criteria for loans made in an income year, as well as all future years. This enables a particular company (or trust) and a particular borrower to execute a facility loan agreement only once. A complying loan agreement between that particular lender and borrower will thus constantly be in place, covering all future loans.

Minimum annual repayment

Having a complying loan agreement in place prevents a deemed dividend from arising in relation to loans made in an income year. Next is the requirement in s 109E ITAA36 to make a minimum annual repayment each year after the one in which the loan was made. That is, there is no compulsion to charge interest or make any repayments in the year in which a loan is made. Interest is required to be charged only from 1 July in the next income year, and a minimum annual repayment is required by 30 June that year and each subsequent year under the loan term.

All loans advanced during an income year to a particular borrower are amalgamated and treated as a single loan for the purpose of calculating each subsequent year's minimum annual repayment. For example, if unsecured loans are advanced every year under a facility agreement, there could be up to seven minimum annual repayment calculations required per year for a particular borrower (eg for the "2019" loan, the "2018" loan etc) The calculation formula is set out in s 109E(6) (for which there is a calculator on the ATO's website[7]). All of these requirements are typically incorporated into template complying loan agreements.

If the borrower fails to make all or part of the minimum annual repayment in any year for any "amalgamated" loan, a deemed dividend arises equal to any shortfall.[4]

Division 7A effectively compels your client to "put their money where their mouth is". The legislation essentially lays out an ultimatum, while poised holding the stick. If your client asserts that the money they took from their private company is a loan, fine, it is a loan. But they are going to document it in writing and repay it with interest. It is either that or be assessed on a deemed dividend.

Payment by dividend set-off

The reality is that minimum annual repayments are virtually never paid by transferring money. Once a client has taken the money, it almost never comes back. Accordingly, it was clear when Div 7A was enacted that clients would need a way to effect cashless repayments. And the only effective way to do that was by way of set-off against a dividend declared by the company.[8]

The dividend would typically be franked, and by the end of the loan term, those profits taken from the company in the particular income year in the form of a loan will have been cleared out from retained earnings as dividends. This would achieve the largely unspoken objective of Div 7A — collect the top-up tax on those company profits, in most cases, over a seven-year unsecured loan period.[9]

The principle of mutual set-off is that, where two parties respectively owe an amount to each other, they can agree that each has paid what is owed to the other (to the extent of the lesser amount, if different). That is, each has made a legally effective payment to the other, without the need to transfer any money.[10]

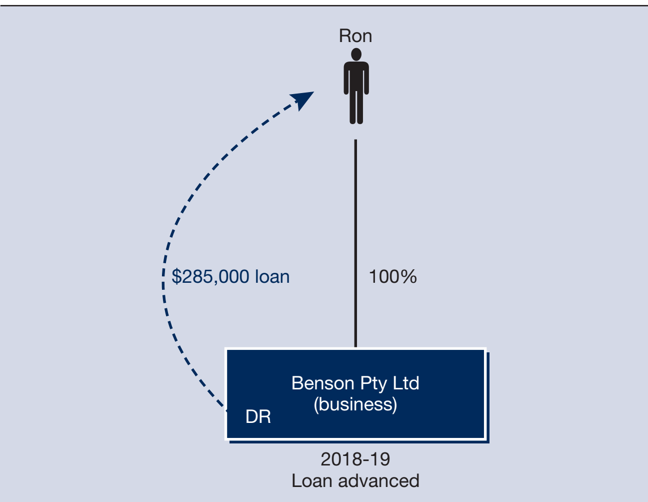
The agreement to make a payment by set-off can be express or implied. While a written set-off agreement is ideal, in practice, usually an implied agreement by actions is relied on between the company and the borrower to set off their mutually opposing obligations on 30 June each year. (The borrower is usually closely connected, such as a director of the company, or is a commonly controlled entity.) This is subsequently reflected in the accounts of the company and the borrower (if not an individual).[11]

Example 1. Loan repayment by set-off against a dividend

Ron Benson owns 100% of Benson Pty Ltd, which carries on a business. The company is profitable and has been paying company tax on its taxable income. Ron draws a salary, and he is on the top personal rate of 47%. During the 2018-19 income year, he drew an additional $285,000 as a loan (see Diagram 1).

On 14 May 2020, Ron and the company executed a complying seven-year Div 7A loan facility agreement. The company's 2018-19 tax return was due on 15 May 2020, and it was lodged on that day (including the required disclosure of the $285,000 loan to a shareholder or an associate). This meant that no deemed dividend arose in 2018-19 under s 109D ITAA36 in respect of the $285,000 loan.

Diagram 1. Loan to individual shareholder



Under the complying loan agreement, the loan commenced incurring interest on 1 July 2019 at the benchmark rate (which was 5.37% for 2019-20). The first minimum annual repayment of $49,916 (as calculated under s 109E(6)) was due by 30 June 2020. This figure was able to be calculated almost a year before (even though the Div 7A loan agreement had not yet been executed), as the benchmark interest rate for 2019-20 was announced in July 2019.

On 30 June 2020, Benson Pty Ltd resolved to declare a dividend of $50,000, and the company now owed Ron that amount. The dividend was fully franked at 27.5%. Ron and the company then agreed on that same day to apply the principle of mutual set-off to the extent of the $50,000 mutual indebtedness. This had the effect of the company paying Ron the $50,000 owed to him, and Ron paying $50,000 towards his outstanding Div 7A loan owing to the company. As this equalled or exceeded the minimum annual repayment, no shortfall deemed dividend arose to Ron in 2019-20 under s 109E ITAA36.

The interest for 2019-20 is calculated on $285,000 for 365 days, and on $235,000 for one day, totalling to $15,297. The accrual of the interest on 30 June brings the closing loan balance to $250,297. Another way of looking at it is that the $50,000 loan repayment comprised $15,297 of interest and $34,703 of principal reduction.

The above sets out the happening on 30 June 2020 of two distinct transactions:

1. the declaration of the dividend, creating a $50,000 liability owed by the company to Ron; and
2. the set-off arrangement, under which the company pays to Ron the above $50,000 owed to him, and Ron pays $50,000 towards his Div 7A debt owed to the company.

These two transactions are in Diagram 2.

The payments between Ron and the company under transaction 2 are legally effective, without having to transfer money. Further, the payment that Ron made to his company exceeded his $49,916 minimum annual repayment obligation under the complying Div 7A loan agreement. Ron will have a top-up tax liability of $13,448.[12] However, as Ron utilised his entire $50,000 dividend to make the payment to the company, he will need to fund the payment of the top-up tax liability from other sources.

Journal entries

The above transactions are subsequently recorded in Benson Pty Ltd's accounts by the journal entries set out in Table 1. In practice, the recording of the two transactions is usually combined in a single journal entry (see Table 2).

It is emphasised that the journal entries themselves do not execute those transactions. All journal entries do is record already executed transactions. The starting point for the payments to be effective is the declaration of the dividend, creating the company's $50,000 liability owing to Ron. Only then are there mutually opposing obligations, which is essential to effect the respective payments by way of set-off.[13]

Diagram 2. Payments by way of set-off

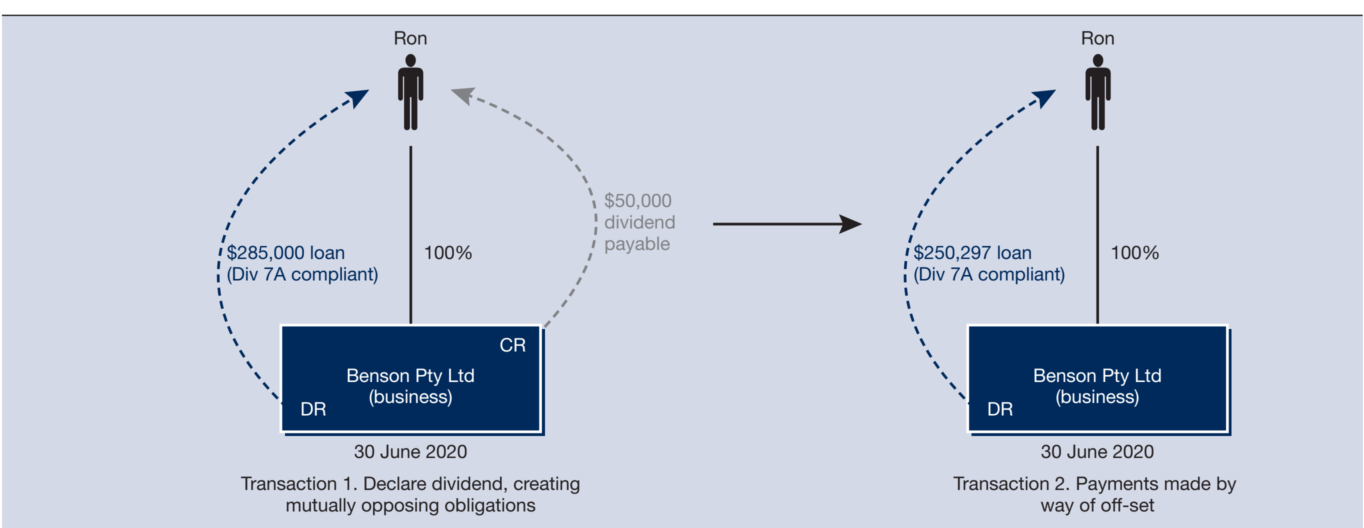


Table 1. Company journal entries

Benson Pty Ltd				
Records this transaction	**Date**	**Account**	**DR $**	**CR $**
Creation of liability owing to Ron	30 June 2020	Dividend paid	50,000	
		Dividend payable to Ron Benson		50,000
Payments by way of setting off mutually opposing obligations	30 June 2020	Dividend payable to Ron Benson	50,000	
		Interest income		15,297
		Loan to Ron Benson (Div 7A)		34,703

Table 2. Short-cut journal

Date	Account	DR $	CR $
30 June 2020	Dividend paid	50,000	
	Interest income		15,297
	Loan to Ron Benson (Div 7A)		34,703

Valid dividend declaration

The critical issue, on which the effectiveness of the cashless payments in example 1 turns, is the creation of that initial $50,000 company liability. That requires the dividend to be validly declared in accordance with the company's constitution and the *Corporations Act 2001* (Cth) (Corporations Act). That is effected typically by the board passing a resolution to that effect at a meeting of directors, or simply a resolution in the case of a single director company.

What follows is the matter of evidencing that the dividend resolution creating that initial liability was in fact made. Without such evidence, a client is exposed to the risk of the Commissioner taking the view that no such resolution was actually made. If that were to happen in example 1, it would trigger the following chain reaction:

- the company's $50,000 liability to Ron was not in fact created;
- there were therefore no mutually opposing obligations between the company and Ron (ie there was only the one obligation — Ron's Div 7A loan);
- the principle of mutual set-off therefore had no application, meaning:
  - the company made no payment to Ron; and
  - Ron made no payment to the company towards his Div 7A loan;
- a shortfall in the minimum annual repayment of $49,916 accordingly arose;
- under s 109E, the company is taken to have paid a dividend of $49,916 to Ron in the 2019-20 income year;[4] and
- Ron is assessed on the above deemed dividend, incurring a tax liability at 47% of $23,461.[1]

So, the key issue, on which everything turns, is evidencing that the resolution to declare the $50,000 dividend was in fact made.

Evidencing company resolutions is governed through the process of documenting minutes, which is set out in s 251A of the Corporations Act. Minutes are required to be prepared and filed in the company register within one month, and they must be signed within a reasonable time. In example 1, the deadline to file the minutes documenting the resolution on 30 June 2020 to declare the dividend was 30 July 2020.

But what if that deadline was missed?

Minutes filed late

The issues arising from filing the minutes documenting a resolution to declare a dividend *after* the one-month deadline can be broken down into the following specific questions:

- What are the Corporations Act consequences of the minutes being filed late?
- Does the late filing automatically result in the dividend declaration resolution being invalid?

Corporations Act consequences

In relation to the first question, filing minutes after the one-month deadline, or not signing them within a reasonable time, is a strict liability offence under s 251A(5A) of the Corporations Act. The penalty is set out in Sch 3 of the Corporations Act, which is 30 penalty units. From 1 July 2020, one penalty unit is $222. So, that is $6,660 per offence. However, the Australian Securities and Investments Commission (ASIC) does not seem to actively enforce this penalty with closely controlled private companies. This perhaps reflects ASIC's priorities when assessing risks among its many responsibilities arising in the course of administering corporate compliance.

Invalidate dividend declaration?

If the answer to the second question above is "yes", the above chain reaction happens, resulting in the deemed dividend of $46,916 in example 1. Section 251A(6) of the Corporations Act now comes into play, which provides that minutes which satisfy the requirements set out in s 251A are prima facie evidence of resolutions being passed and any other proceedings. In other words, s 251A-compliant minutes relieve directors from having to remember that they made a particular resolution for it to be valid — which is the whole point of minutes.

However, minutes filed late lose the evidentiary status that s 251A(6) provides. So, in relation to resolving to declare a dividend, the practical consequence of the minutes being filed late seems to be this: if no director can put their "hand on heart" and say that they remember that meeting, and they remember that they resolved to declare that dividend of that amount, it is open for the Commissioner to take the view that no such resolution was made, and thus no dividend was in fact declared. And if that is what he were to do, that chain reaction would follow, resulting in the deemed dividend.

Returning to the second question of whether the late filing of the minutes documenting a dividend declaration resolution *automatically* results in the resolution being invalid, the answer is no. Rather, what would need to happen is this:

- the Commissioner conducts a review or an audit;
- the client is taken to task over the minutes being filed late;
- the director(s) are challenged on their memory of that purported meeting or resolution;

then, despite Div 7A otherwise having been complied with, despite having collected the top-up tax as per the policy intent, but due only to the absence of minute-based evidence:

- the Commissioner takes the view that no such dividend declaration resolution was made, thus triggering the above chain reaction; and
- the Commissioner issues amended assessments to include the deemed dividend arising under s 109E ITAA36.

The author is not aware of any instances where the Commissioner has taken the above course for the sole reason of minutes being filed late. He may well have, but if he has, it is suspected that that would be widely known throughout the tax profession.

Judging risk

An inherent nature of being in business is that business owners are constantly judging risks. We therefore ask: what is the risk of the above Corporations Act and deemed dividend consequences happening for a closely held private company due solely to late-filed minutes? Experience tells us that the risk is very low. Accordingly, it would not be surprising if directors of such companies are relatively unconcerned about filing minutes late (and many may well be unaware of the one-month deadline). This is not to suggest that anyone should be casual about their obligations under any law. It is the role of advisers is to ensure that clients are aware, and thus can make informed decisions about prioritising their attention among the myriad of risks that they manage.

Distribution statement

The other relevant administrative obligation on paying a dividend is that of issuing a distribution statement. Subdivision 202-E of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) sets out the requirements for issuing distribution statements.

Private companies with a 30 June year end that pay a dividend during an income year are required to give a distribution statement to shareholders by 31 October after year end.[14] That allows time to decide the franking credit to be attached to the dividend, although that is usually decided at the time of declaring the dividend. Section 202-80 ITAA97 sets out the information that the distribution statement must contain. What is noteworthy is that there is no requirement for anyone to sign it. Backdating a document is never acceptable. However, as distribution statements are not required to be signed, the issue of backdating does not arise. Rather, it is simply a matter of whether or not the distribution statement was given to the shareholders by 31 October.

And so, we ask: what if it was not?

Issued late

What are the consequences if a distribution statement is given to a shareholder late? Part III of the *Taxation Administration Act 1953* (Cth) (TAA53) sets out the rules for various taxation offences and the consequences. Under s 8C(1)(a) TAA53, being late in giving any information or document to a person as required under a taxation law is the commission of an offence. Section 8Y TAA53 puts a company's responsibility on the shoulders of directors and other officers, and s 8E TAA53 sets out the consequences. For a first offence, giving a distribution statement late is punishable "on conviction" by a fine of up to 20 penalty units, ie up to $4,440. In this case, conviction is by summary conviction,[15] but that still requires the Commissioner to instigate a court process.[16]

In summary, a distribution statement issued after 31 October creates an exposure to the risk of the Commissioner instigating a prosecution and seeking a summary conviction by the court, which would result in a fine of up to $4,440 for the first offence.

Again, the author is not aware of any instances of the Commissioner instigating a prosecution of a director of a closely held private company for nothing more than causing their company to issue a distribution statement late. And again, if the Commissioner has, that would surely be widely known within the tax profession.

Nonetheless, the law is the law, and directors of closely held private companies that issue distribution statements late are exposed to the above consequences. However, experience tells us that the risk of such consequences happening is very low. Accordingly, it would again not be surprising if directors of such companies are relatively unconcerned about their obligation to issue distribution statements by 31 October (and again, many probably are not even aware of it).

In summary, where a company is late in providing a distribution statement, the consequence is the risk that arises

as set out above. But providing it late does not cause the dividend declaration to be invalid.

Dividend declaration summary

While clients should be informed of their deadline obligations to file minutes and to issue distribution statements, they should also be informed of the risks arising as a consequence of missing those deadlines. As we have seen, the risks are low, and missing those deadlines does not automatically invalidate a dividend declaration.

Having addressed the above issues in the context of the basic example 1 scenario, we can now branch out to other scenarios that frequently arise.

Example 2. Trust appoints income to corporate beneficiary

The approach in example 1 can be applied to other structures. The process is similarly illustrated with a trust appointing trust income to a beneficiary that is a company (see Diagram 3).

In this example, the trust owns the company, and therefore a similar approach to example 1 can be taken. Irrespective of whether the present entitlement is placed on sub-trust or allowed to become a Div 7A loan, the trust will have an obligation to pay the respective sub-trust interest or minimum annual repayment to the company.[17] The company resolving to declare a dividend will create mutually opposing obligations, which can then be immediately paid by way of set-off.[18]

Example 3. Trust advances Div 7A loan

Another frequent scenario is where a trust appoints income to a corporate beneficiary, the UPE is placed on sub-trust, and the trust then advances a loan to a shareholder (or an associate) of the company (see Diagram 4).

The situation in this example sets itself up for two distinct set-off arrangements in the course of complying with Div 7A. The sub-trust between the trust and the corporate beneficiary is typically dealt with by following the Commissioner's views in TR 2010/3 and PS LA 2010/4. That results in the trust being obligated to pay interest to the corporate beneficiary by 30 June in each year of the sub-trust agreement. That is typically paid, again not by paying money, but by way of a set-off arrangement, with the following mutually opposing obligations:

1. the corporate beneficiary resolves to declare a dividend by 30 June, creating a liability owing to the trust; and
2. the trust has an obligation to pay interest to the corporate beneficiary under the sub-trust agreement.

The above two obligations are illustrated in Diagram 5.

The mutually opposing obligations (1 and 2 above) are paid on 30 June by way of set-off. That is, the company pays the dividend to the trust, and the trust pays the sub-trust interest. The Corporations Act and distribution statement issues discussed above in relation to the resolution to declare the dividend equally apply here.

The trust's advancing of the loan to the borrower invokes Subdiv EA of Div 7A, which essentially borrows the Div 7A rules for company loans, payments, and forgiven debts. The policy reason is that the trust's advancing of the loan is effectively an extraction of realised or unrealised profits from the company.

Under Subdiv EA, an assessable amount will arise to the borrower unless the trust's loan is one of the excluded types in Subdiv D. Again, the relevant type here is where a s 109N-compliant loan agreement is put in place — essentially no different to that for loans made directly by a private company. Again, the borrower's minimum annual repayment obligation to the trust is not usually made by transferring money. Instead, as the borrower is usually a beneficiary, the typical approach is for the trustee of the trust to appoint an amount of trust income to the borrower. The trust income could comprise some or all of the dividend income, or income from other sources.[19]

This establishes the opportunity for the second set-off arrangement, with the following mutually opposing obligations:

3. the trustee's conferral of a present entitlement to trust income, owing to the beneficiary by 30 June; and
4. the borrower's s 109N-compliant Subdiv EA debt owed to the trust.

The above obligations are illustrated in Diagram 6.

Diagram 3. Loan or sub-trust with trust shareholder

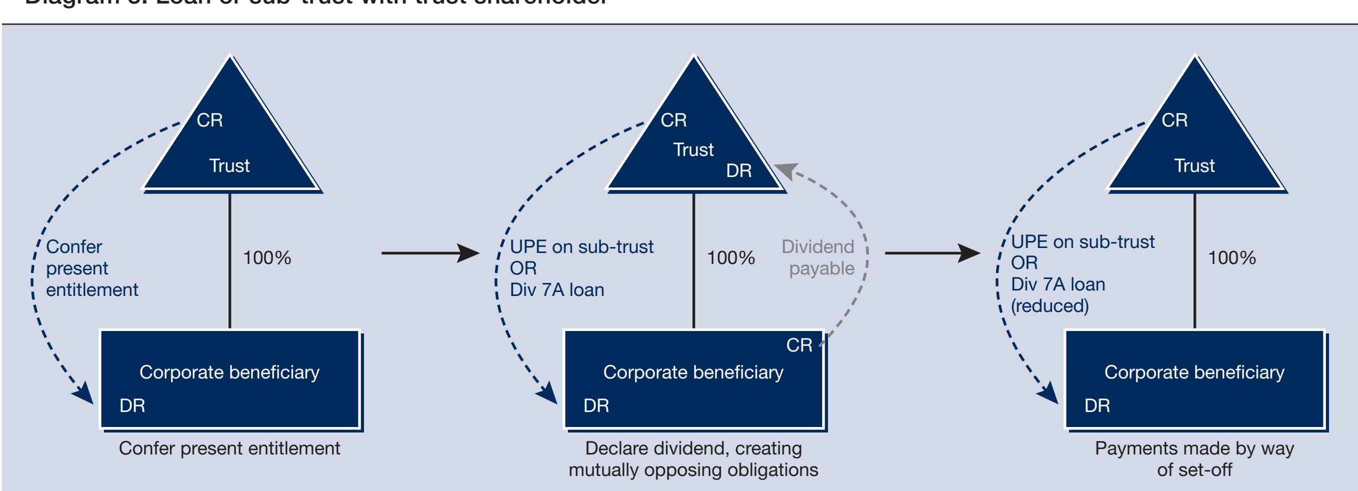


Diagram 4. Trust shareholder lends to associate

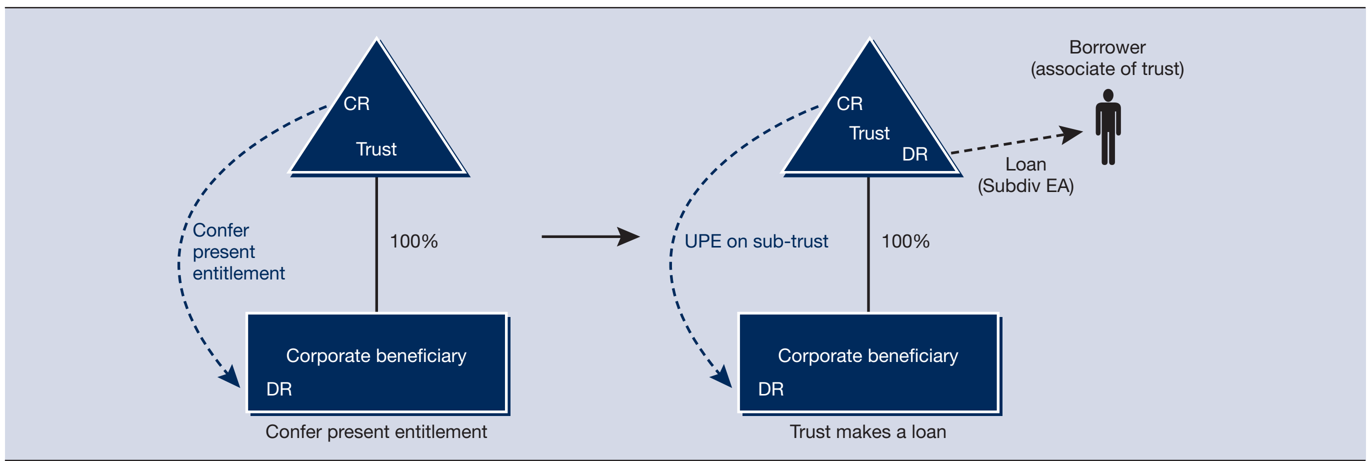


Diagram 5. Declare dividend

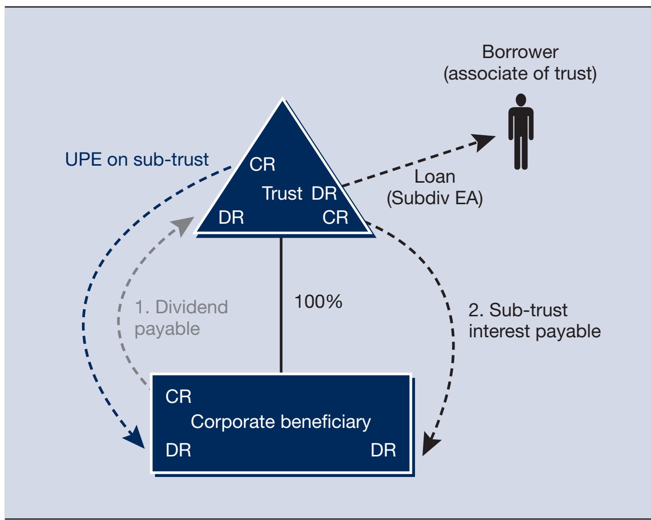
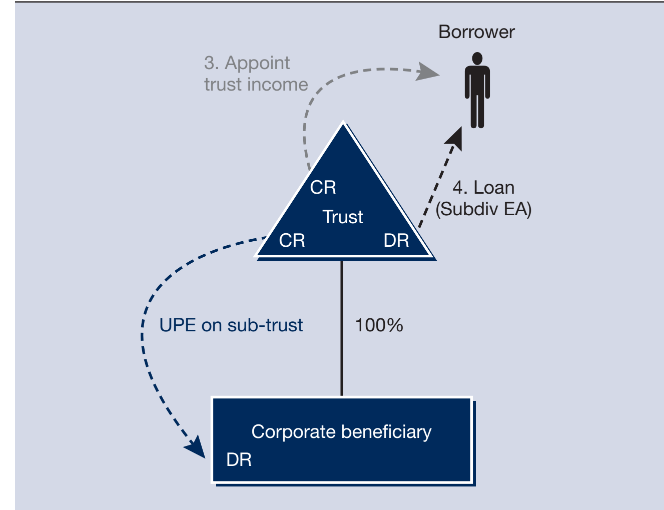


Diagram 6. Appoint trust income



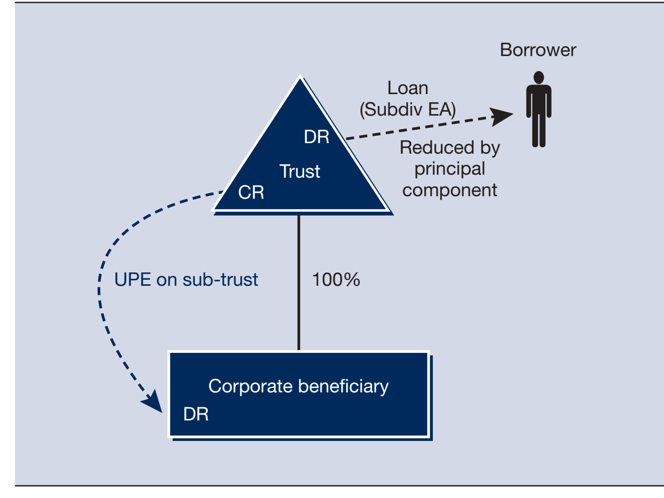
These mutually opposing obligations (3 and 4 above) are also paid on 30 June by way of set-off. That is, the trustee pays out the UPE, and the beneficiary/borrower makes a payment to the trust. The payment to the trust satisfies the minimum annual repayment obligation.

The final outcome reflects all required payments having been made (see Diagram 7).

The amount of the declared dividend, and the amount of trust income appointed, must be managed to ensure that there is sufficient trust income to at least match the higher of the sub-trust interest amount and the amount of the minimum annual repayment. In the same manner as noted earlier, the amount of each year's minimum annual repayment required to be paid to the trust is known almost a year in advance of the 30 June deadline.

Most of the time, the trustee of the trust is a company. Accordingly, the Corporations Act issues discussed above in relation to the minutes recording the resolution to declare

Diagram 7. Final outcome



a dividend apply equally here to the trustee's resolution to appoint trust income.

No mutually opposing obligations – what then?

The scenarios covered above all feature structures in which mutually opposing obligations can arise naturally between lender and borrower. While they all require doing something in order to create the required mutually opposing obligations (eg declare dividend, appoint trust income), they are normal processes readily able to be carried out in the ordinary course of those structures.

But what if a structure does not naturally provide for the creation of mutually opposing obligations between lender and borrower? This situation arises frequently, and it requires something additional to legally effect payments of money.

Diagram 8 illustrates a common structure that does not naturally provide for payments by way of set-off.

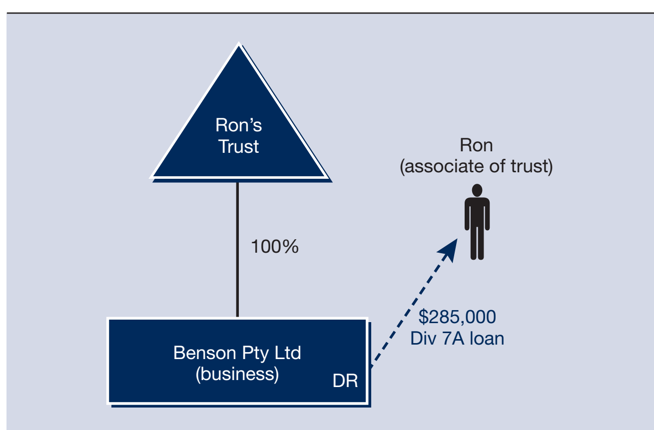
This is a variation of example 1, reflecting a more common structure and making this situation more realistic. The company declaring a dividend creates an obligation owing to the trust, not Ron. With no mutually opposing obligations between lender and borrower, there is no set-off opportunity to effect Ron's minimum annual repayment. This often results in Div 7A loan repayments purportedly being made via a journalised round-robin of payments. The ineffectiveness of this, and some suggested practical solutions, will be discussed in part 2 of this article.

Conclusion

Missing the respective deadlines for filing minutes or issuing distribution statements creates the noted risks for closely held private companies. However, in practice, those risks appear to be very low, and thus it is understandable that clients will prioritise their risk management attention elsewhere. But, importantly, missing those deadlines does not automatically invalidate dividends declared. Accordingly, Div 7A minimum annual repayments can still be made by way of setting off validly created mutually opposing obligations.

In other common circumstances, the particular structure does not naturally provide for creating mutually opposing obligations. The tax and commercial risks arising from how Div 7A loan repayments are often "made", and suggested solutions, will be discussed in part 2.

Diagram 8. Loan to non-shareholder



David Montani, CTA
National Tax Director
Nexia Australia

References

1 Section 109RB ITAA36 provides the Commissioner with a discretion to disregard the deemed dividend consequences or to permit the deemed dividend to be franked.

2 Defined in s 318 ITAA36.

3 The lodgment day is generally the due date for lodgment of that year's tax return for the company, or the actual date of lodgment, if earlier. If an extension is granted, this is merely the ATO allowing a taxpayer to lodge late without penalty — the due date for lodgment remains unchanged. Note that the loan must be fully repaid *before* the lodgment day. Repaying *on* the lodgment day is too late. S 109R ITAA36 contains integrity rules to combat "window-dressing" arrangements involving non-genuine repayments.

4 The amount of any deemed dividend is subject to the "distributable surplus" limitation in s 109Y ITAA36.

5 S 109N(2) ITAA36. The rate is announced each year in early July, for the forthcoming income year.

6 The requirements to qualify as a secured loan are set out in s 109N(3) ITAA36.

7 Available at www.ato.gov.au/Calculators-and-tools/Division-7A-calculator-and-decision-tool.

8 Making a repayment with the intention of the company subsequently advancing a new loan to the borrower would offend the s 109R integrity rule referred to above at reference 3.

9 This approach to extracting company profits comes at the cost of additional tax imposts for clients. The interest component contributes additional assessable income to the company (tax impost 1), which is then recycled back out to the shareholder as a dividend (tax impost 2). As this happens without transferring any money, it is a bit like taking money out of your left pocket, some tax breaking off, and then putting what is left in your right pocket. Sometimes, it can work out cheaper for a client to repay the entirety of their loan at once by set-off against a single dividend, borrow from a bank to pay the lump-sum top-up tax liability, and pay back the bank over seven years. To explore further, see D Montani, "Dealing with Div 7A loans: a different approach", (2013) 47(8) *Taxation in Australia* 488.

10 *FCT v Steeves Agnew & Co (Vic) Pty Ltd* [1951] HCA 26.

11 The Commissioner pragmatically accepts this, in an FBT context at least, according to MT 2050.

12 $50,000 + $18,966 imputation credit = $68,966 grossed-up dividend. Tax at 47% = $32,414, less $18,966 imputation credit, leaves $13,448 in top-up tax liability.

13 Dividends are often declared at the beginning of the year, on 1 July, with payment by set-off on that date, rather than waiting until 30 June. The reason is that, due to the earlier reduction in the loan balance, this reduces the interest component and thus the ultimate tax burden. However, the forthcoming year's minimum annual repayment (respectively for all years' Div 7A loans on foot) cannot be precisely calculated until at least a few days after 1 July, when the year's benchmark interest rate is announced. If the amount of dividend declared on 1 July falls short, the difference will need to be made up, otherwise a deemed dividend will arise under s 109E ITAA36 to the extent of the shortfall.

14 The Commissioner has a discretionary power to extend that deadline.

15 S 8ZA(4) TAA53.

16 S 8ZJ TAA53.

17 See the Commissioner's controversial views expressed in TR 2010/3, and the accompanying administrative protocols in PS LA 2010/4.

18 Paragraph 78 of PS LA 2010/4 stipulates the Commissioner's requirement that sub-trust interest must be actually paid. Paragraph 56 accepts that payments can be made by way of set-off.

19 The requirements in Subdiv 207-B ITAA97 for streaming dividends via specific entitlement may need to be observed.

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Demerger relief rules: what constitutes a "restructuring"?

by Cameron Blackwood, ATI, Partner, and Alistair Haskett, FTI, Associate, Greenwoods & Herbert Smith Freehills

With the release of TD 2020/6 and the accompanying public advice and guidance compendium, TD 2020/6EC, the ATO has finalised its position regarding the meaning of the word "restructuring" for the purposes of s 125-70(1) ITAA97 in the demerger relief rules. As expected, the ATO has maintained the views previously expressed in TD 2019/D1, which have been criticised for not reflecting the policy objectives of the demerger relief rules. The ATO does not accept that its interpretation of the demerger relief rules has become more restrictive, yet considers the new guidance should provide more transparency, consistency and clarity around the ATO's views of demerger relief. Absent a legislative fix, the authors expect that TD 2020/6 will make it more difficult to obtain demerger relief in all but the most plain and vanilla demerger transactions in the future, impeding transaction structures that would otherwise facilitate commercial objectives such as capital raisings.

Overview

On 22 July 2020, the ATO released TD 2020/6, finalising its views regarding the meaning of the word "restructuring" for the purposes of s 125-70(1) of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) in the demerger relief rules. TD 2020/6 has been the subject of much debate and discussion following the initial release of TD 2019/D1 on 20 March 2019. TD 2020/6 was accompanied by a public advice and guidance compendium, TD 2020/6EC (the compendium), which provides the ATO's responses to some of the comments received on TD 2019/D1.

As expected, the ATO has maintained the views previously expressed in TD 2019/D1, which have been criticised for not reflecting the policy objectives of the demerger relief rules. Absent a legislative fix, the authors expect that TD 2020/6 will preclude demerger relief from applying to all but the most plain and vanilla demerger transactions in the future, impeding transaction structures that would otherwise facilitate commercial objectives such as capital raisings.

A brief background

The events that led to TD 2020/6 being published are briefly summarised below.

Prior to the enactment of Div 125 ITAA97 in 2002, members in an entity that reorganised its business operations by splitting them into separate entities, and the entities undertaking the reorganisation, were exposed to capital gains tax (CGT) and/or income tax consequences, depending on the mechanics of the transactions. These consequences were an impediment to restructures that did not affect the economic ownership of the restructured operations and had the capacity to reduce the overall efficiency of the economy.

Following recommendations from the Ralph *Review of business taxation*,[1] Div 125 was enacted to increase efficiency by allowing greater flexibility in structuring businesses. It was intended that this objective be achieved by facilitating the demerging of entities by ensuring that income tax considerations are not an impediment to restructuring a business. Division 125 and associated provisions are referred to in this article as the "demerger relief rules".

After the demerger relief rules were enacted, it was not uncommon in the context of mergers and acquisitions and capital raisings to utilise demerger relief to facilitate a reorganisation prior to, or after, the relevant transaction taking place. The ATO accepted that transactions structured this way could access demerger relief. The ATO issued favourable class rulings in various instances,[2] most recently in the Sundance Australia/Texon Petroleum/Talon Petroleum deal in 2013 where Texon Petroleum demerged its subsidiary Talon Petroleum prior to Sundance Australia acquiring Texon Petroleum for scrip in Sundance Australia.[3]

In April 2018, the ATO was perceived to have adopted a different position after refusing to rule favourably in respect of the proposed AMA/Blackstone transaction. The transaction structure was effectively identical to the Sundance/Texon/Talon deal (ie a demerger followed by an acquisition) and, in the absence of public guidance from the ATO, the market was left in uncertain waters.

On 20 March 2019, the ATO released TD 2019/D1 which effectively confirmed the market's expectation that the ATO would no longer apply the law in the manner previously seen in the Sundance/Texon/Talon transaction. The authors understand that the ATO's invitation for comment on TD 2019/D1 was widely accepted by industry stakeholders, many of whom expressed concern that the ATO's position would undermine the efficacy of the demerger relief regime. Arguably, TD 2019/D1 hailed the beginning of a new era in which the demerger provisions will cease to operate effectively in a variety of innocuous demerger situations which, in the authors' view, are intended to be afforded relief from tax impediments.

The issue: what is a "restructuring"?

The fundamental condition for demerger relief is that "a demerger happens to the demerger group".[4] An element of

that condition is that there must be a "restructuring of the demerger group".[5] Additionally, it must be shown that, "under the restructuring":[6]

– at least 80% of the demerger group's ownership interests in the demerging entity become owned by members of the demerger group's head entity; and
– original interest holders acquire new interests "and nothing else" under the restructuring.

The "restructuring" concept is also relevant to requirements regarding proportionality (by number and market value) of new interests after the relevant subsidiary is demerged.[7] In this regard, the ATO states that:[8]

> "Subsection 125-70(2) talks about proportionality 'under', 'just before' and 'just after' the 'demerger'. Since under paragraph 125-70(1)(a) a demerger happens if there is a restructuring, the scope of the restructuring (including when it begins and ends) is also relevant to the proportionality conditions in subsection 125-70(2)."

There is no doubt that the restructuring of a demerger group will include the transaction or transactions which result in the head entity ceasing to hold, and the original interest holders starting to hold, at least 80% of the demerger group's ownership interests. However, if the relevant "restructuring" incorporates other transactions which occur before or after the separation transaction, satisfying the requirements for demerger tax relief, particularly the "proportionality" and "nothing else" requirements, can be problematic.

TD 2020/6

TD 2020/6 sets out the ATO views on what constitutes a "restructuring" of a demerger group for the purposes of s 125-70(1) ITAA97. While much of the substance of TD 2019/D1 remains unchanged in TD 2020/6, there are few notable amendments (summarised below) that businesses and participants in mergers and acquisitions and capital raising activities will need to be wary of.

In essence, TD 2020/6 maintains the ATO's interpretative views regarding the demerger relief provisions that prevented the AMA/Blackstone transaction from proceeding. Absent a legislative fix, the authors expect that TD 2020/6 will prevent all but the most plain and vanilla demerger transactions from occurring in the future. In circumstances where the federal government is looking to boost the Australian economy to facilitate a bounce-back from the COVID-19 crisis, the need for a legislative fix is all the more pressing.

The compendium addresses the charge that the ATO changed its position on the application of the demerger relief rules in 2018, stating that:[9]

> "While the ATO understands this perception, there was not a more restrictive view adopted in 2018. Rather, the view in the draft Determination is one that has been held for quite a few years. The purpose in issuing this Determination is to provide more transparency, consistency and clarity on the ATO's position in this area."

It might be doubted whether the tax community will accept this explanation. However, to the extent that there has been uncertainty regarding the ATO's interpretation since the AMA/Blackstone transaction, the authors would agree that clarity on the position is preferable, particularly if it provides the catalyst for a legislative fix.

For completeness, in the compendium, the ATO refers to two instances where the ATO issued a class ruling that it states reflects the views expressed in TD 2020/6.[10] One of those rulings merely states that the relevant "transaction does not qualify for the demerger concessions outlined in Division 125 of the ITAA 1997", without providing any reasons.[11] The other states that demerger relief was not available because the relevant demerger transaction was followed by a special distribution from the head entity of the demerger group, which the ATO ruled infringed s 125-70(1)(c) (the "and nothing else" condition).[12] While the latter example arguably demonstrates the views in TD 2020/6, again, the ruling does not contain elaborated reasoning. In those circumstances, and noting the various instances where the ATO has ruled that demerger relief was available in circumstances resembling the Sundance/Texon/Talon transaction, it is not surprising that the tax community did not identify the class rulings referred to in the compendium as articulating the interpretative views of the ATO.

The compendium also responds to a more fundamental question, namely, what integrity concern drove the positions in TD 2019/D1, and the mischief that the ATO's interpretation of the demerger relief provisions is seeking to guard against. The compendium states that:[13]

> "The integrity concern is that demerger relief is being claimed for transactions that should not qualify because they change the economic position of owners by involving more than the separation of a subsidiary. CGT consequences should be triggered for such a transaction."

The same line of reasoning permeates TD 2020/6. For example, para 8 states that:

> "The purpose or object of the conditions in subsections 125-70(1) and (2) is to determine whether the identified restructuring has resulted in a change to the economic position of the owners of original interests in the head entity of the relevant demerger group."

With respect, it is regrettable that, in its interpretation of the demerger relief provisions, the ATO should overlay a perceived integrity concern/policy objective that is not expressly stated in the legislation and is inconsistent with the ATO's past practice when providing guidance regarding transactions involving demergers. Further, the ATO's position treats Div 125 (or, more specifically, the "restructuring" concept) as an integrity measure, which it self-evidently is not. Integrity concerns that may arise in the context of a demerger have historically been adequately dealt with under other more specific legislative provisions, such as s 45B of the *Income Tax Assessment Act 1936* (Cth) (ITAA36).

In this regard, the compendium states that revised public guidance on s 45B is being considered by the ATO and may involve an update to PS LA 2005/21 (regarding the application of s 45B to demergers) to remedy the "perception of inconsistency"[14] arising as a result of the views expressed in TD 2020/6. With respect, it is not a perception — the approach of the ATO in TD 2020/6 is now clearly inconsistent. PS LA 2005/21 states in the context of s 45B(8)(i) ITAA36 (the s 45B issue that considers schemes involving the later disposal of ownership interests):

> "75 … In other words, the premise is that a prearranged disposal of the demerged interest or the interest in the head entity by the

> head entity's owners, may suggest the demerger was undertaken to transfer corporate assets to the shareholder, rather than restructure the business.
>
> 76. It is recognised that there are exceptions to this general premise. *A prearranged disposal of the head entity or demerged entity shares could have as its only substantial object increased business performance. There may be circumstances where the business performance of one or both of the head entity or demerged entity is enhanced by merging one of those entities with another like business structure. Such a merger could for example involve the disposal of the head entity or demerged entity under a scrip for scrip transaction. Alternatively, it may be that the efficiency of a business is enhanced by the introduction of a new group of owners, such as under a management buy–out.*
>
> 77. However, caution should be exercised in considering the purposes for which the pre-arranged disposal of the head entity or the demerged entity is undertaken. As noted in paragraph 45, a person may be found to have more than one substantial purpose. In other words, in light of all of the relevant circumstances, it might be concluded that a substantial business purpose is matched by a substantial tax purpose in regard to the disposal." (emphasis added)

New issues raised by TD 2020/6

Timing issues: when does the "restructuring" begin?

Determining whether the demerger proportionality (by number and market value) tests are satisfied requires a comparison of ownership before and after the demerger happens.

As noted above, the definition of "demerger" begins by stating that there must be a "restructuring" of the demerger group. It would seem to follow that, because the "restructuring" is part of the "demerger", the comparison of ownership should be tested before and after the restructure. As such, the test time for the purpose of the ownership comparison:

- starts no later than the first step in the restructuring; and
- ends no earlier than the last step in the restructuring.

In a new example 7 added in TD 2020/6,[15] the ATO states that the "restructuring" starts several months prior to the actual separation transaction. The example contemplates a listed construction and property development company taking steps to separate its residential property development business months in advance of the actual demerger. In particular, the company:

- incorporates a new subsidiary;
- transfers land, cash and other assets to the subsidiary in return for scrip; and
- substitutes the subsidiary as the applicant in various council applications, and novates certain employment contracts to it.

The ATO accepts that demerger relief would apply when the demerger transaction occurs.

What is notable about new example 7 is that the ATO states that the "preparatory steps and transactions … will form part of the restructuring of the demerger group".[16] In this regard, the ATO states that the fact that transactions or steps are separated in time by several months does not automatically mean that they cannot form part of the same restructuring, and that temporal proximity is a relevant, but not determinative, factor when establishing the objectively inferred plan for the reorganisation of a demerger group.

The ATO states that preparatory steps that do not change the economic position of original interest holders should not jeopardise the availability of demerger relief, but flags that steps or transactions that effect such a change may cause a failure of certain of the conditions necessary for demerger relief to be available. These views are qualified by a statement that:[17]

> "… the mere fact that ownership interests are transferred due to an independent decision by owners during the period of the restructuring (for example, through ordinary trading on a securities exchange) will not generally affect any of the conditions in subsections 125-70(1) and (2) as such transfers do not happen under the restructuring itself."

Applying the ATO's views on when the restructure commences means that, in the context of a scheme of arrangement, the test time could start months before the scheme record date. This is a further departure from ATO practice, which has previously accepted that preparatory steps are "pre-restructuring" and the scheme record date constituted the relevant objective reference point. If the restructuring commences at the time, for example, when the demerged entity is incorporated, in the authors' view, the ownership test time commences at that time. The practical implication is that a listed entity will never be able to satisfy the ownership test.

Amendments in TD 2020/6 as compared to the draft determination imply that the ATO is now of the view that the time "just before the demerger" is potentially different to the time "just before the restructuring begins" (the latter words having been deleted from new para 53). However, the ATO does not outline the basis for drawing this distinction or explain when the demerger is meant to commence for the purposes of applying the proportionality test. It is difficult to reconcile the ATO's interpretation with the words or purpose of the legislation. The incoherence in the position is further evidence of the ATO tying itself in knots by using Div 125 and the concept of "restructuring" as the main integrity provision rather than s 45B.

In the authors' view, the position is an overly restrictive interpretation of the demerger relief provisions which will constrain demerger activity.

Demergers and capital raisings

In addition to including a new example in TD 2020/6, the ATO has amended some of the examples previously included in TD 2019/D1.

Example 2 contemplates the board of a listed public company deciding to demerge a subsidiary that conducts a separate business unrelated to the business conducted by the public company.[18] The subsidiary will be listed on the ASX after the demerger has completed, and subsequently undertake a minor capital raising to allow it to pursue growth opportunities. Prior to the separation, the head company negotiates for an unrelated third party to acquire a "significant proportion" of the shares that the subsidiary will issue under

the capital raising. Certain shareholders in the subsidiary will not be eligible to participate in the capital raising (for example, because they do not hold a number of shares in the subsidiary above a certain threshold).

The ATO has made two notable amendments in example 2:

– the number of hypothetical facts have been reduced such that example 2 no longer contemplates that: (1) the capital raising equals half of the value of the subsidiary; (2) prior to the separation, the subsidiary distributes 50% of its net assets by way of a return of capital or dividend; (3) the subsidiary does not have sufficient operating profits or adequate cash flows from its operations to fund its business; and (4) the third party acquires a 50% stake in the subsidiary under the capital raising. The reference to certain shareholders not being eligible to participate in the capital raising is a new hypothetical fact. What is "significant" for these purposes is not explained; and
– the ATO has also refined its reasoning in its explanation of why demerger relief would not be available in a fact scenario such as that contemplated in example 2. In particular, the ATO states that: "The fact that the capital raising has one or more features that are certain to alter the shareholdings in Sub Co is significant. It suggests that the plan involves more than a capital raising that coincides with the separation of Sub Co, and is designed to change the economic position of shareholders in Sub Co."[19]

It appears that the ATO's amendments to the facts are intended to broaden the class of transactions to which example 2 will be relevant, further limiting the availability of demerger structures in the context of capital raisings. Additionally, example 2 indicates that, if negotiations with the third-party acquirer occurred after the demerger transaction had completed, demerger relief may be available. From a policy perspective, this appears to be an arbitrary and irrelevant distinction. It should not matter whether negotiations occur before or after the demerger happens, particularly given that the efficient separation of a listed company's business through a demerger is much more likely to be achieved if a third party can be locked in prior to the transaction being put to shareholders. The ATO position is especially perplexing because the perceived mischief in raising capital at market value is not obviously apparent.

Compliance approach

TD 2020/6 confirms that the ATO does not intend to devote resources to a specific compliance project to examine claims for demerger roll-over under Div 125 for CGT events occurring before the release of TD 2019/D1 (ie before 20 March 2019).[20] However, if the issues arise as part of the usual compliance activity undertaken by the Commissioner (which would include the ongoing streamlined assurance reviews), or as a result of a request for a ruling, a request to amend an assessment, an objection against an assessment or in submissions by the Commissioner in litigation, the ATO will act consistently with the views set out in TD 2020/6.

The compliance approach departs from the approach suggested in TD 2019/D1, which stated that the ATO's views would be applied both before and after its date of issue.[21] In this regard, the compendium indicates that the revised position is a recognition that the tax community perceived the ATO to have changed its position regarding the interpretation of the demerger provisions. The compendium states:[22]

> "The ATO has, however, had consideration to the concerns raised in comments in deciding on an approach to compliance. As noted in the final Determination, the Commissioner will not be devoting resources to a specific compliance project targeting claims for demerger roll-over relief for relevant transactions entered into before the date of the draft Determination."

Past transactions may still be looked at in the context of the ATO's usual compliance action (for example, as part of a tax performance program assurance review or because the taxpayer is already subject to compliance action). However, in such cases, when determining what action to take, the Commissioner will have regard to the reasons why a taxpayer concluded that the transaction was eligible for demerger roll-over relief, including gleanings that may have been obtained from past class rulings. This may also be relevant to the remission of any possible interest and penalties.

The prospect of retrospective reviews is probably not something that will concern most taxpayers given that public company transactions involving a demerger are highly unlikely to have proceeded without first obtaining an ATO ruling, which should be binding even if the ruling reflects views that are not consistent with TD 2020/6. However, private companies that have relied on guidance from prior class rulings, rather than obtaining a private ruling, may be exposed in the event that the ATO becomes aware of the transaction as part of a routine review.

Evidence of the scope of the plan of reorganisation

Finally, TD 2020/6 adds further guidance around the type of evidence that the ATO would look at for the purposes of determining the scope of a plan of reorganisation.[23] In particular, the ATO highlights that it will review all of the facts and circumstances, including contracts and deeds executed by or affecting the relevant entities (including contracts and deeds that are given legal effect by a court decision, for example, pursuant to a scheme of arrangement under Pt 5.1 of the *Corporations Act 2001* (Cth)), statements in documents filed with regulators, commercial factors, internal deliberations by a company's directors or the directors of a trustee company, statements by directors or influential owners, and announcements to any relevant securities exchange.

Potential legislative fix?

In December 2019, the federal Assistant Treasurer announced that the Board of Taxation (BoT) would undertake a review of the CGT roll-over rules with a view to "identify and evaluate opportunities to rationalise the existing CGT rollovers and associated provisions into a simplified set that have a substantially similar practical effect, but are easier to use and interpret".[24]

The review provides an opportunity for the BoT to consider the effect that the ATO's positions in TD 2020/6 are likely to have on business reorganisation activity and whether TD 2020/6 is inconsistent with the policy objectives of the demerger relief regime.

It is hoped that the BoT will recommend an appropriate legislative fix to expand demerger relief beyond the impact

of the ATO's interpretation, which will deny demerger relief for all but the most plain and vanilla demergers. Given other jurisdictions, such as the United States, allow multi-faceted transactions involving demergers (eg Lockheed Martin Corporation's split-off and merger of its Information Systems & Global Solutions business with Leidos Holdings Inc as a Reverse Morris Trust transaction), it is not clear why Australia would limit the options for restructures which can create economic value.

Options for legislative reform might include confining the "restructuring" concept to the transactions that occur between the group head company and its shareholders, or removing the "restructuring" concept from the legislation altogether.

For completeness, the compendium also notes that comments on TD 2019/D1 proposed that a safe harbour could be developed, such as a rule that a transaction that occurs three months prior to a proposed separation of a demerger subsidiary would not form part of the "restructuring" referred to in s 125-70(1). The ATO states that this proposal is being considered "in the context of a broader review of public guidance on Division 125",[25] suggesting that the ATO still has more to say on the topic of the demerger relief rules.

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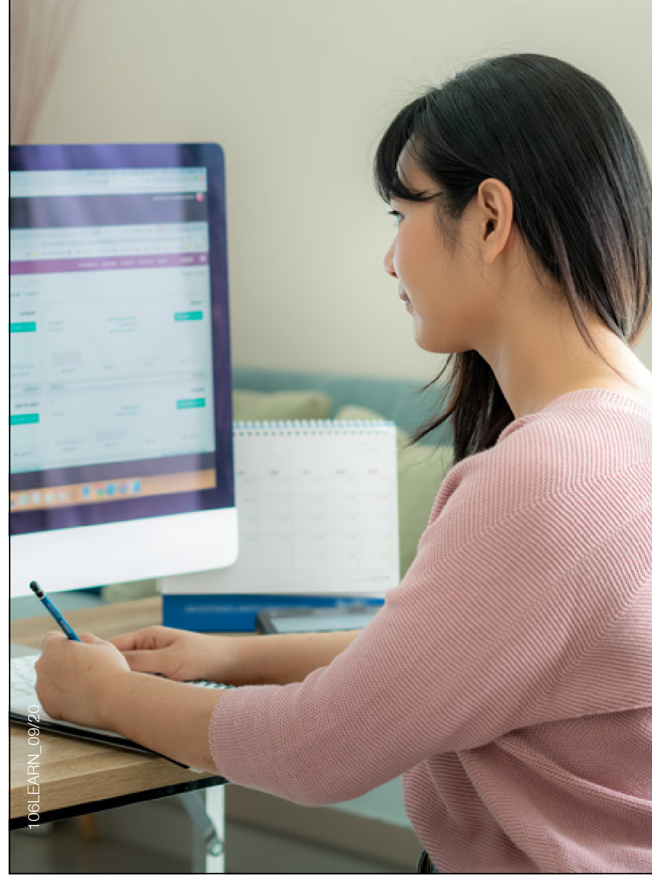

Considerations from Greig v FCT

by Miles Hurst, FTI, Partner, William Malouf, Senior Associate, and Aleksandra Pasternacki, Graduate, Baker McKenzie

Andrew Greig was certain that his investment in Nexus Energy Ltd (Nexus) was going to pay off. Despite declining share prices, he made 65 separate acquisitions of Nexus shares, expending over $11.8m, in the hope that the market would eventually recognise Nexus' value. Unfortunately for Greig, the market never would. In 2014, Nexus was placed into administration and his shares were transferred for nil consideration.

Although Greig's faith in Nexus may have been misplaced, his persistence in the ensuing dispute with the ATO was eventually rewarded. The Full Bench of the Federal Court found that Greig, an ex-mining executive investing for his retirement, held Nexus shares on revenue account and was entitled to deductions for their cost. Significant individual shareholders could be forgiven for their concern at this point, in particular, where hopes of claiming the CGT discount are cast into doubt.

The Full Court referred to the principle, articulated in *FCT v Myer Emporium Ltd*,[1] that gains from isolated business transactions constitute income where the property giving rise to the gain is acquired in a "business operation or commercial transaction"[2] for the "purpose of profit-making"[3] by the means actually giving rise to the gain. The corollary of this principle is that expenses will be deductible where incurred in the same circumstances.

Much of the Full Court's decision was spent unpacking the meaning of the words used in *Myer*. This was a simpler task as it related to the condition that property be acquired for the "purpose of profit-making".[4] The court was satisfied that Greig was possessed of that intention when acquiring Nexus shares, largely because there was no evidence to suggest the he intended to derive gains otherwise than by sale at a profit. In particular, there was no evidence to suggest that he anticipated any dividend income. The potential for dividend income (or, rather, the lack thereof) was also viewed as significant in the later decision of *XPQZ, KYZC, DHJP and FCT*[5] in which the Administrative Appeals Tribunal, citing *Greig*, found proceeds from the sale of shares by a closely-held trust to be ordinary income.

When addressing the meaning of the terms "business operation or commercial transaction", the court weaved its way back to 1985, the year in which Sydney University Emeritus Professor Ross Wait Parsons published *Income taxation in Australia: principles of income, deductibility and tax accounting*.[6] In it, Parsons discusses the expression "business deal" as used in a series of decisions which preceded *Myer* and which considered the former s 26(a) of the *Income Tax Assessment Act 1936* (Cth) (about profit-making undertakings). Ultimately, Parsons concluded that a transaction will qualify as a "business deal" if it is "the sort of thing a business person, or person in trade, might do".[7]

The Full Court equated the concept of a "business deal" with the concept of a "business operation or commercial transaction,[8] as developed and referred to in *Myer*. Having established that Greig was a sophisticated investor, with significant knowledge of and experience in the mining industry, and having regard to the frequency of his share purchases, the Full Court found that Greig's investment in Nexus was the sort of thing a business person might do. As such, the Full Court found that the conditions in *Myer* were satisfied and Greig's investment was held on revenue account.

On one view, the court's conclusion is quite unremarkable — Greig certainly does not match the description of the average private investor. He even spent over half a million dollars in legal fees seeking to prevent the compulsory transfer of his Nexus shares under the deed of company arrangement. However, the Commissioner's decision not to appeal to the High Court could be motivated by more than just the strength of Greig's arguments. Exposing a greater number of private investors to revenue taxation has the potential to restrict the availability of the CGT discount, which could mean more tax dollars collected from share trading and other investment activities.

As if still deciding whether to mourn or celebrate the Commissioner's loss, the ATO's decision impact statement on *Greig* is relatively ambiguous.[9] The decision impact statement notes that the Full Court's decision is not "inconsistent with existing advice and guidance",[9] but that, despite this preliminary view, the ATO will be reviewing TR 92/3 and TR 92/4. In the interim, founders, significant individual shareholders and those applying industry skill and experience to undertake share trading on a periodic basis should seek advice regarding the availability of the CGT discount and carefully consider whether investment expenses are deductible.

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A Matter of Trusts

by Will Monotti, Sladen Legal

Defining the beneficiaries of a discretionary trust

The trustee of a discretionary trust may benefit those who fall under the definition of "beneficiaries" in the trust's deed. Sometimes, the scope of that definition is unclear.

The trustee of a discretionary trust (sometimes known as a "family trust") holds property on trust for beneficiaries. The trustee is empowered under the trust deed to make distributions of income and capital to those beneficiaries at its discretion.

Each discretionary trust deed employs different terminology, but most deeds will list, either in a definition clause or a schedule, the "primary beneficiaries" of the trust, which may include a particular individual, that individual's spouse, their children and their lineal descendants. "General beneficiaries" or "secondary beneficiaries" may include broader relatives of the primary beneficiaries, such as siblings, spouses, widows and widowers, cousins, and nieces and nephews. Other structures may also fall within the class of general beneficiaries, including charities, companies controlled by one or more of the primary and/or general beneficiaries, and trusts of which one or more of the primary and/or general beneficiaries is a trustee, director of a trustee company, or a beneficiary.

Beneficiary clauses are often deliberately drafted as widely as possible to provide the trustee with flexibility when making distributions. A wide range of beneficiaries may also clarify that the assets are protected from creditors of a beneficiary or family law claims in relation to a beneficiary of the trust, as it is more difficult to attribute the trust assets to be an asset/property, or financial resource, of any given beneficiary.

Determining whether a person falls into the class of general beneficiaries of a discretionary trust requires a close reading of the trust's deed (or, if it is a testamentary trust, the will under which it is established). Some terms used in the definition of "beneficiaries" will have clear and established meanings. Others, such as "spouse" and "child", have taken on new meanings in a time in which blended families are common, where same-sex couples may now marry, and where many couples will establish relationships as "de facto" or "domestic partners" but not marry. In the absence of a definition in the trust's deed of those specific terms, this article intends to provide trustees with some guidance as to their meaning, using examples from legislation and the common law.

Defining "spouse"

Section 2CA of the *Acts Interpretation Act 1901* (Cth) provides as follows:

> "(1) For the purposes of any Act, a person is the ***spouse*** of another person (whether of the same sex or a different sex) if the person is legally married to the other person.
>
> (2) Subsection (1) has effect in addition to any provision of an Act that affects the meaning of ***spouse*** in a provision of that Act.
>
> Example: ***Spouse*** is defined for the purposes of an Act to include a de facto partner and a former spouse. Because of this section, a reference in the Act to a person's spouse covers any person who is legally married to the person, in addition to any person covered by the definition in the Act."

"Spouse" is distinguished under the same legislation from the term "de facto partner", which refers to a person who is in a "registered relationship" or "de facto relationship" with another person. Section 2F of the *Acts Interpretation Act 1901* provides that a person is in a de facto relationship with another person if they are not legally married to each other, are not related by family, and have a relationship as a couple living together on a genuine domestic basis. The factors which may indicate the existence of a de facto relationship are listed at s 2F(2), and include:

> "(a) the duration of the relationship;
>
> (b) the nature and extent of their common residence;
>
> (c) whether a sexual relationship exists;
>
> (d) the degree of financial dependence or interdependence, and any arrangements for financial support, between them;
>
> (e) the ownership, use and acquisition of their property;
>
> (f) the degree of mutual commitment to a shared life;
>
> (g) the care and support of children;
>
> (h) the reputation and public aspects of the relationship."

It should be noted that the legislation specifies that a de facto relationship can still exist even if one of the persons is married to another person, in a registered relationship with another person, or in a de facto relationship with another person.

There is some commonality in the criteria for a "de facto relationship" under the *Acts Interpretation Act 1901* and the criteria for a "domestic relationship" under the *Relationships Act 2008* (Vic), which is defined under s 35 of that Act as follows:[1]

> "'domestic relationship' means —
>
> (a) a registered domestic relationship; or
>
> (b) a relationship between two persons who are not married to each other but who are living together as a couple on a genuine domestic basis (irrespective of gender); or
>
> (c) the relationship between two adult persons who are not married to each other but are a couple where one or each of the persons in the relationship provides personal or financial commitment and support of a domestic nature for the material benefit of the other, irrespective of their genders and whether or not they are living under the same roof, but does not include a relationship in which a person provides domestic support and personal care to the other person —
>
> (i) for fee or reward; or

(ii) on behalf of another person or an organisation (including a government or government agency, a body corporate or a charitable or benevolent organisation);"

(See footnotes for equivalent provisions in other states and territories.)

"Spouse" remains the term used in most discretionary trust deeds when defining the scope of the class of beneficiaries. Certainly, in older trust deeds of the 1970s and 1980s, it would be highly unusual for the terms "de facto partner" or "domestic partner" to be included in such a definition, and with the legalisation of same-sex marriage only occurring as recently as December 2017, the rights of any same-sex partner would not have been recognised under any such definition. The distinguishing factor between the term "spouse" and the terms "de facto partner" and "domestic partner" does not relate to the nature of the relationship itself — whether it be romantic or platonic, short or long-lasting — but rather whether the relationship is a married relationship or not. It follows that, unless the trust's deed is otherwise silent, a definition of "beneficiary" that includes the term "spouse" in relation to another beneficiary refers only to a person who is married to that beneficiary.

This is supported by the decision of McMillan J in *Re Rouse*,[2] which considered the meaning of the term "spouse" in the context of the definition of "beneficiary" and "first appointor" under a discretionary trust deed. "Spouse" was defined in the deed but only in reference to the term "beneficiary". The word "spouse" was also used in the definition of "first appointor", but McMillan J held that, in that instance, "spouse" should carry its ordinary meaning and not the meaning set out in the trust's deed.[3] The ordinary meaning relied on by her Honour was drawn from *The Macquarie Dictionary* and the *Australian Law Dictionary*, and was a narrower one than that set out in the trust's deed — it did not encompass de facto or domestic partners, and instead referred to "either member of a married pair in relation to the other", or "the husband or wife of a person".[4]

It is worth noting that the superannuation laws present an alternative definition. Under the *Superannuation Industry (Supervision) Act 1993* (Cth), the "spouse" of a person includes a person who, "although not legally married to the person, lives with the person on a genuine domestic basis in a relationship as a couple".[5] This definition should be read as applicable to the superannuation legislation only, although it does perhaps indicate the malleability of the term "spouse" and its potential to change meaning over time.

If "spouses" are to be included or excluded as beneficiaries of a discretionary trust, the parties to the deed should consider including a definition of "spouse" and its scope — namely, whether that definition is to comprise both the ordinary meaning of the term "spouse" and the terms "de facto partner" and "domestic partner" as set out in the *Acts Interpretation Act 1901* and the *Relationships Act 2008* (Vic), respectively. Any deed of variation or exclusion of beneficiaries to an existing inter vivos or testamentary discretionary trust deed should contemplate the addition of a definition if the trust's deed is silent on the issue. The definition should also contemplate the scenario considered in *Re Rouse*, where the term "spouse" was examined beyond the context of the definition of "beneficiary".

Defining "child"

Ambiguity may also arise in relation to the term "child". The accepted meaning of this term is the "natural progeny" of a person, but there are a number of qualifiers to this definition.

First, the *Adoption Act 1984* (Vic) provides that an adopted child is considered, under the law, to be a child of the adoptive parent.[6] On this basis, it should not be assumed that the term "child", when used in a trust deed or will, refers only to a biological child of a person.

Second, the *Status of Children Act 1974* (Vic) dissolves the distinction between a child born of a "legitimate" relationship or otherwise.[7] This is distinct, however, from a situation where a woman conceives a child through participation in an IVF program — in that instance, where the woman has a partner (male or female), that partner may be considered a parent of the child, and where the woman has no partner, the donor is not considered to be a father of the child, whether the donor is known to the child or not.[8] Criteria as to the notion of paternity is provided for under ss 7 and 8 of the *Status of Children Act 1974*.[9]

If a trust's deed refers to "stepchildren" as beneficiaries, the question arises as to whether a person qualifies as a stepchild. This was considered in the decision of *Scott-Mackenzie v Bail*.[10] In that case, the Victorian Court of Appeal was required to determine whether an adult daughter of the domestic partner of a deceased person qualified as a stepchild of the deceased for the purposes of a claim for further provision from the estate of the deceased. The deceased was in a domestic relationship with the adult daughter's mother for 41 years, but the couple never married. The mother then died and, after her death, the deceased entered into a new relationship. The deceased left his entire estate to his new partner. The adult daughter of his former partner made a claim for provision under Pt IV of the *Administration and Probate Act 1958* (Vic).

The court considered the legislation carefully and noted that its wording reflected an intention to eliminate any discrimination between a "spouse" and a "domestic partner",[11] and that it followed that the same principles should apply to their children. The death of the adult daughter's mother did not sever the existence of the stepchild-stepparent relationship between the adult daughter and the deceased. The court determined that the adult daughter met the definition of "stepchild" under the legislation and was therefore an eligible claimant for provision from the estate.

It should be noted that the position is not necessarily the same under superannuation law. ID 2011/77 clarified that, in the event that a step-parent divorced from their spouse, and that step-parent subsequently died, the stepchild would not be considered to be a "dependant" for the purposes of the cashing rules under reg 6.22 of the *Superannuation Industry (Supervision) Regulations 1994* (Cth). ID 2011/77 does not address a scenario such as that in the case of *Scott-Mackenzie v Bail*, where the relationship was still in existence as at the death of one of the parties to it,[12] nor does it contemplate what would occur if the relationship were a de facto or domestic one, rather than a marriage. It remains to be seen whether the ATO will clarify the position following the decision of the Victorian Court of Appeal.

Where a trust includes primary or general beneficiaries that are part of a blended family, it would be prudent for the trustee to consider a variation to the deed to define the term "stepchild", and to provide clarity as to whether that term includes the children of a de facto or domestic partner born outside that de facto or domestic relationship.

Conclusion

The decisions in *Scott-Mackenzie v Bail* and *Re Rouse* indicate the court's willingness to defer to the prevailing ordinary definition of words such as "child", "stepchild" and "spouse" at the time. Nonetheless, the parties to a discretionary trust deed should be encouraged to consider including definitions of those terms in the deed before its execution to avoid the type of disputes that arose in those cases. If a court were required to analyse a definition of "beneficiaries" in a trust deed, it would be helpful if the settlor and trustee were able to explain the intended scope of the definition.

The trustees of trusts governed by older deeds should also contemplate an amendment to the trust provisions (if such an amendment is within the scope of the variation power) to add definitions of words such as "child", "stepchild" and "spouse", as the wording of such deeds may not be inclusive of parent–child and domestic relationships that are now recognised under law.

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References

1 See also: s 3 of the *Domestic Relationships Act 1994* (ACT); s 5 of the *Property (Relationships) Act 1984* (NSW); s 3A of the *De Facto Relationships Act 1991* (NT) (note the definition of "de facto relationship"); s 4 of the *Relationships Act 2003* (Tas) (note the definition of "significant relationship"); s 3 of the *Domestic Partners Property Act 1996* (SA); s 13A of the *Interpretation Act 1984* (WA) (note the definition of "de facto relationship"); in Queensland, see, for example, s 60EA of the *Family Law Act 1975* (Cth).

2 [2019] VSC 792.

3 Ibid at [94].

4 Ibid at [97].

5 S 10 of the *Superannuation Industry (Supervision) Act 1993* (Cth).

6 S 53(1) of the *Adoption Act 1984* (Vic). See also: s 45(1)(a) of the *Adoption of Children Act 1994* (NT); s 95 of the *Adoption Act 2000* (NSW); s 214(3) of the *Adoption Act 2009* (Qld); s 75(1)(a) of the *Adoption Act 1994* (WA).

7 S 3(1) of the *Status of Children Act 1974* (Vic). See also: s 39 of the *Parentage Act 2004* (ACT); s 4 of the *Status of Children Act 1978* (NT); s 5 of the *Status of Children Act 1996* (NSW); s 6 of the *Status of Children Act 1978* (Qld); s 6 of the *Family Relationships Act 1975* (SA); s 3 of the *Status of Children Act 1974* (Tas); in Western Australia, see, for example, s 47A of the *Administration Act 1903* (WA).

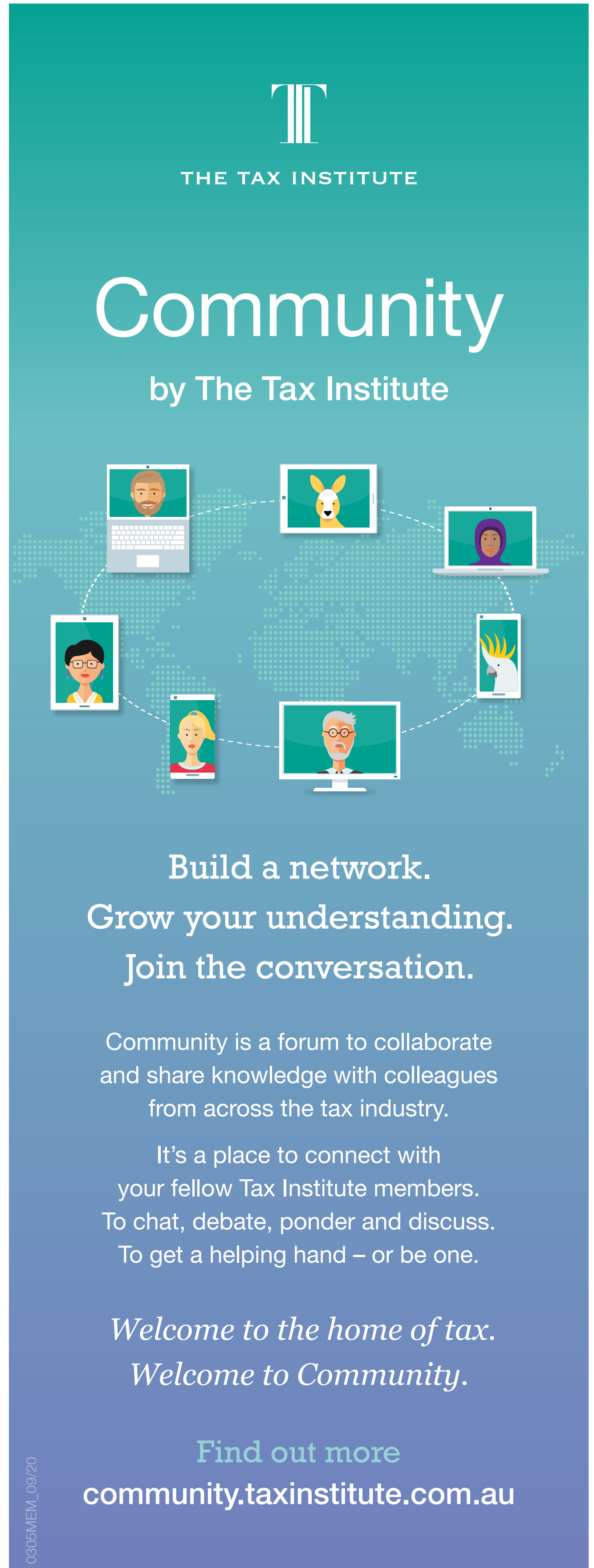
8 Ss 13 and 15 of the *Status of Children Act 1974* (Vic). See also: s 11 of the *Parentage Act 2004* (ACT); Pt IIIA of the *Status of Children Act 1978* (NT); s 14 of the *Status of Children Act 1996* (NSW); Div 2 of the *Status of Children Act 1978* (Qld); Pt 2A of the *Family Relationships Act 1975* (SA); Pt III of the *Status of Children Act 1974* (Tas); in Western Australia, see, for example, Subdiv 3 of Div 11 of the *Family Court Act 1997* (WA).

9 See also: s 5 of the *Status of Children Act 1978* (NT); s 10 of the *Status of Children Act 1996* (NSW); s 8 of the *Status of Children Act 1978* (Qld); ss 7 and 8 of the *Family Relationships Act 1975* (SA); ss 7 and 8 of the *Status of Children Act 1974* (Tas); Subdiv 3 of Div 11 of the *Family Court Act 1997* (WA); in the ACT, see, for example, Div 2.2 of the *Parentage Act 2004* (ACT).

10 [2017] VSCA 108.

11 Ibid at [40].

12 Note, however, that the ATO's view, as expressed in the June 2011 National Tax Liaison Group Superannuation Technical Sub-group meeting, is that the same principles would apply on the death of the natural parent.



Superannuation

by Daniel Butler, CTA, DBA Lawyers

Managing the TBC and minimising excess transfer balance tax

The transfer balance cap system is in urgent need of reform and simplification. The indexing system will make the system more complicated.

Overview

This article focuses on managing a member's transfer balance cap (TBC) with a view to minimising excess transfer balance tax (ETB tax). A brief background is provided to assist members and SMSF trustees to better monitor TBCs so that they can avoid or minimise ETB tax.

This article covers account-style pensions such as account-based pensions and transition to retirement income streams (TRIS) that are in retirement phase. A TRIS in retirement phase is where a member has satisfied a relevant condition of release and the other criteria in s 307-80 of the *Income Tax Assessment Act 1997* (Cth).

The TBC rules are very complex and can result in extra tax being raised, even from inadvertent oversights. Thus, expert advice should be obtained where there is any doubt.

The transfer balance cap

Broadly, the TBC is a lifetime cap of $1.6m that a member can transfer into retirement (ie tax-free pension) phase. Treasury suggested that the TBC rules would impact less than 1% of superannuation fund members in mid-2017. However, all funds must have the capability of monitoring and managing the TBC for each member.

The transfer balance account (TBA) is a ledger that tracks credits that are transferred into retirement phase and debits that are commuted from retirement phase. The net account balance of the TBA, called the "transfer balance" (ie total credits minus total debits), reflects a person's remaining TBC space. Importantly, credit and debit amounts are fixed at the time they are recorded in the TBA.

Importantly, investment gains and losses and pension payments do not impact the TBA.

A member who exceeds their TBC will have excess transfer balance earnings accrue on the excess transfer balance which are credited to their TBA, compounding that member's excess until it is rectified.

A common issue identified by the ATO where people exceed their TBC is when an SMSF member commutes the pension in their SMSF (eg a $1m pension) and then rolls their benefit into an industry or retail superannuation fund to commence a new pension. Large funds report TBA events on a monthly basis. Thus, the member has a credit for the pension they started in their SMSF (eg $1m) and they also obtain a credit from starting their new pension in the large fund (eg $1m, giving rise to a $2m credit with a $400,000 excess). Since SMSFs typically report on an annual or quarterly basis, the member's TBA may not reflect the debit from the commutation in the SMSF and they therefore still have two credits (eg 2 × $1m), giving rise to excess transfer balance earnings. However, SMSFs can report TBA events prior to their prescribed annual or quarterly deadlines and are encouraged to do so to minimise these types of issues.

A member can rectify an excess transfer balance by commuting an appropriate amount of their pension(s) together with any excess transfer balance earnings thereon to eliminate an excess transfer balance.

A superannuation provider, including an SMSF trustee, should make reasonable efforts to consult with the member on whether they would like any excess amount to remain within the superannuation fund in their accumulation account or whether it should be paid as a lump sum benefit.

Where an excess results from a reporting error by the superannuation fund, the trustee of that fund needs to lodge TBA reports to cancel the incorrect information and provide the correct information to the ATO as soon as possible.

Excess transfer balance earnings

A member with an excess transfer balance is deemed to derive notional earnings on the relevant excess amount that is subject to EBT tax which is payable by the member.

Notional earnings accrue on a member's excess transfer balance based on the general interest charge (currently 7.10% for the 1 July 2020 to 30 September 2020 quarter). These notional earnings compound daily, eg each day a member has an excess, notional earnings accrue on the excess amount.

Notional earnings cease being credited to the member's TBA when the ATO issues an excess transfer balance determination or the member ceases to have an excess transfer balance, whichever occurs first. This allows the ATO's determination to confirm a fixed amount to be commuted from the member's retirement phase (ie the amount of the excess plus the amount of notional earnings confirmed in the determination).

While excess transfer balance earnings accrued after a determination issues are not reflected in a member's TBA, the member remains liable for ETB tax on notional earnings until they remove the excess amount.

If a member rectifies an excess transfer balance before the ATO issues a determination, they should also calculate the notional earnings on the excess amount that needs to be removed from their retirement phase pension. Timely action by the member in removing any excess (including any notional earnings thereon) minimises any ETB tax that needs to be paid. Taking timely rectification action before a determination issues overcomes the need for the ATO to

issue a determination and allows the ATO to issue an ETB tax assessment instead.

Where a member does not remove the amount of the excess amount in time, the ATO will issue a determination. Broadly, this determination specifies the amount to be removed (ie the "crystallised reduction amount") and a default commutation notice is also issued that specifies the relevant fund(s) and pension(s) from which the excess must be removed within 60 days.

Where a member has more than one pension, they may elect the fund(s) and pension(s) that are commuted or partially commuted rather than merely accepting those specified in the ATO's default commutation notice, provided the total amount of commutations at least equals the crystallised reduction amount. This election must be lodged within 60 days of the determination.

A member should therefore notify the ATO of any commuted amount in the approved form as soon as practicable after a determination issues, and in any event within 60 days of a determination.

Failure to comply with a determination within 60 days can result in the pension ceasing to be in the retirement phase. This will result in the pension ceasing to qualify for a pension exemption from the start of the relevant financial year (eg if the member ceases to comply by, say, a 31 December 2020 deadline, the pension exemption is denied from the prior 1 July 2020). Since that pension is deemed to have ceased, a debit will then arise in that member's TBA for the capital supporting that pension.

Naturally, SMSF trustees should act in a timely manner to minimise any risk of a member's pension ceasing to be in the retirement phase and the adverse consequences flowing from a compulsory commutation notice. These adverse consequences require further adjustment to the member's TBA, loss of the pension exemption, and the requirement to commence a new pension if they wish to start a new pension within the member's remaining TBC. See Table 1 for a summary of excess transfer balance earnings.

Table 1. Summary of excess transfer balance earnings

The member exceeds their TBC.
The member should seek to rectify any excess as soon as possible.
If the excess is not rectified prior to a determination being issued, the member will need to: – respond to a default commutation notice nominating specified pension(s) and/or pensions in other fund(s); or – elect to nominate other pension(s) and/or pensions in other fund(s).
If the excess is rectified prior to the determination issuing, the member will be provided an excess transfer balance earnings assessment.
Failure to comply with a commutation notice within the requisite 60-day period can result in the relevant pension(s) ceasing, with loss of the pension exemption and the other consequences outlined above.

ETB tax

Once the excess amount and excess transfer balance earnings have been removed from retirement phase, the ATO will calculate the amount of ETB tax that is payable. Broadly, this tax is based on (adjusted for days that the member is in excess and the relevant interest rate etc):

$$\text{Excess transfer balance earnings from the day a person first exceeded the TBC until the date of rectification} \times \text{The excess transfer balance tax rate}$$

Note that notional earnings on the excess transfer balance accrue until the excess position is fully rectified. In contrast, the amount of notional earnings credited to the member's TBA is the amount stated in the ATO's determination.

The ETB tax (ie the tax rate on notional earnings) is 15% for excess transfer balances for first-time offenders. However, a 30% tax rate applies for subsequent breaches (see s 5 of the *Superannuation (Excess Transfer Balance Tax) Imposition Act 2016 (*Cth)). This tax is a personal liability of the relevant member.

Generally, a member has satisfied a condition of release on commencing a pension in retirement phase, so they can access the commuted amount if they wish to pay any ETB tax from those funds.

Excess transfer balance tax is due and payable 21 days after an assessment is issued and general interest charges accrue on any late payment. A member who is dissatisfied with a determination can object under the standard objection regime for taxation matters under Pt IVC of the *Tax Administration Act 1953* (Cth).

Market-linked pensions and other pensions

Excess transfer balance tax is not imposed for a breach of the TBC that is attributable to capped defined benefit income streams as these pensions are subject to special income tax rules. Further, there have been recent changes to the TBC rules with regard to market-linked pensions that commenced before 1 July 2017. The TBC provisions relating to these pensions are too complex to summarise in this article and expert advice should be obtained.

Conclusion

Care should be given when managing a member's personal TBC to ensure that they do not exceed their maximum cap. Further, credits and debits going in and out of the TBA should be monitored to ensure that a member has sufficient personal balance cap before they commence or commute funds into or out of a pension phase.

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Alternative Assets Insights

by Edwin Baghdasarayan, ATI, and
James Nickless, PwC

The ALDT and cross-border related-party interest-free loans

This article discusses the latest ATO published guidance on the arm's length debt test and cross-border related-party interest-free loans.

On 12 August 2020, the Australian Taxation Office released thin capitalisation guidance relating to the arm's length debt test (ALDT) and transfer pricing guidance relating to cross-border related-party interest-free loans.

The ALDT

The ATO released its finalised guidance dealing with the ALDT which applies as one of the options for determining deductibility of interest and other debt costs under Australia's thin capitalisation rules.

Specifically, the following publications set out the ATO's final views:

- final TR 2020/4 which provides the Commissioner's views on key technical aspects of the ALDT; and
- final PCG 2020/7 which provides guidance on the practical application of the ALDT, as well as a risk assessment framework in respect of the ATO's compliance approach.

With the above releases, the ATO continues to expand its public guidance on debt arrangements and thin capitalisation, confirming an ongoing strong focus on this topic to the taxpayer community. Common themes across these publications continue to be:

- the increased evidentiary burden required for taxpayers to support positions;
- the need to self-assess risk using these public guidelines; and
- an invitation to proactively engage with the ATO to obtain certainty and mitigate risk.

Cross-border related-party interest-free loans

The ATO has released draft updated guidance to PCG 2017/4 which deals with tax issues associated with cross-border related-party financing arrangements and related transactions. Specifically, the draft Sch 3 of PCG 2017/4 provides additional guidance on the application of Sch 1 of PCG 2017/4 to cross-border outbound interest-free loans between related parties.

Under this latest release, the Commissioner seeks to provide greater guidance and clarity to taxpayers on issues associated with outbound interest-free related-party debt. While the draft guidance concludes that such arrangements may be reasonable from a transfer pricing perspective based on specific factors and considerations which are covered by some worked examples, there remains a significant evidentiary burden for taxpayers to support such positions.

Although the updated practical compliance guideline does not cover inbound interest-free loans, it would be reasonable to expect consistency in the way the ATO considers such arrangements.

In detail

The ALDT

TR 2020/4

TR 2020/4 replaces the only other previous guidance on the ALDT issued by the ATO (TR 2003/1). TR 2020/4, which is largely consistent with the draft ruling previously issued by the ATO in May 2019 (TR 2019/D2), clarifies the ATO's perspective on points of legislative interpretation relating to the ALDT. The views expressed in the final ruling apply on both a prospective and retrospective basis.

Of particular note, TR 2020/4 continues to stress the evidentiary nature of the ALDT and the requirement for taxpayers to perform detailed analyses and prepare robust documentation to support the quantum of their debt under the ALDT.

PCG 2020/7

PCG 2020/7 formalises the ATO position for taxpayers to self-assess their risk outcome when applying the ALDT to a financing arrangement, which may need to be disclosed to the ATO either through the reportable tax position (RTP) schedule, or on specific request by the Commissioner (eg during a risk review). In addition, the practical compliance guideline explains the Commissioner's views on how the ALDT should be applied on a practical basis. PCG 2020/7 applies from 1 January 2019 (which is earlier than originally proposed by the earlier draft PCG 2019/D3 which had indicated that it would apply from 1 July 2019), and while substantially similar to the comments in the draft practical compliance guideline, there are some points of divergence.

In PCG 2020/7, the ATO has refined its view that the application of the ALDT is seen as posing a "greater risk of non-compliance relative to other tests available under the thin capitalisation rules", being a change from the draft guidance which suggested a "moderate to high risk of non-compliance with the statutory requirements of the thin capitalisation rules".

Similar to the draft guideline, the ATO has provided a risk assessment framework for self-assessing the "risk zone" applicable to a taxpayer's ALDT position. The risk zone that a taxpayer falls within dictates the level of perceived compliance risk and the corresponding level of resources dedicated by the ATO to review the position. The finalised

practical compliance guideline differs from the draft version on a few aspects — an expansion of risk zones to five categories (there were only three categories under the draft guideline) to provide greater differentiation of the risk levels for taxpayers which do not fit within a "low-risk" zone, and the fact that the Commissioner will request the taxpayer to disclose the self-assessed risk score in its RTP schedule (if a taxpayer is required to complete the schedule).

Some key takeaways from the ATO's risk framework and updated risk zones are:

- there has been no change in the criteria to achieve a "white" or "low-risk" zone outcome. The low-risk zones remain narrowly defined. In addition, the ATO has helpfully made it clear in PCG 2020/7 that, if a taxpayer falls within a low-risk zone, they are not expected to prepare detailed ALDT documentation to meet the standard set out in the guidelines, with the only requirement being the need to prepare an analysis setting out satisfaction of the relevant criteria to achieve the low-risk zone outcome;
- there has been a carve out of a new "low to moderate" risk zone (which is primarily based on an earlier concession (albeit not a separate rating zone category) in the draft guideline) where there is an alignment of credit ratings of either the global group or the entity to that achieved by the notional Australian business with reference to an arm's length debt amount;
- the ATO has also created a new "high-risk" category which covers any arrangements to the extent that they are not analysed, documented and evidenced having regard to the prescriptive guidance found in PCG 2020/7, or which involve arrangements that have at least two of the following characteristics:
  - cross-border related-party debt comprises more than 50% of the taxpayer's debt capital;
  - subordinated cross-border related-party debt comprises more than 25% of the taxpayer's debt capital; and
  - two years of positive earnings before interest and tax, and negative profit before tax during the previous five-year period.

  To the extent that taxpayers fall within the "high-risk" zone, the ATO has expressed that reviews of such arrangements are likely to be commenced as a matter of priority and that cases might proceed directly to audit, with less chance to resolve disputes through settlement or alternative dispute resolution; and
- all other cases not falling in the white, low, low to moderate, and high-risk categories are assigned a medium-risk rating.

It should be noted that a practical compliance guideline is not a ruling on the application of the law. It provides a risk assessment framework and is indicative of the approach that the ATO may take when reviewing ALDT positions, but a position that is "high risk" under the practical compliance guideline framework is not necessarily incorrect.

In conclusion

The taxpayer community continues to welcome guidance from the Commissioner on cross-border financing. With respect to the ALDT, following the withdrawal of TR 2003/1, the finalised guidance represents the latest perspectives of the Commissioner on both the technical points and the practical application of the ALDT. It is important for taxpayers to consider this guidance and, in particular, self-assess their ALDT position in accordance with the framework set out in PCG 2020/7 in order to ascertain the level of risk associated with their debt deductions position and the corresponding analysis and evidence required to manage an ATO review.

Cross-border related-party interest-free loans

The ATO has released its long-awaited guidance on its practical compliance approach to dealing with outbound interest-free loans between related parties — draft Sch 3 of PCG 2017/4 (Sch 3). This latest update outlines the factors under which the pricing risk score assigned under Sch 1 to outbound interest-free loans between related parties may be modified.

The draft does not specify the proposed date of effect for this new schedule, and the ATO has invited submissions on this as part of the consultation process. It is expected that a number of taxpayers may need to lodge income tax returns prior to the guidance being finalised, and they may be faced with reporting high-risk ratings in their RTP schedule that would potentially have been lower if this latest guidance had already applied.

The ATO's general view is that there is a high level of transfer pricing risk associated with outbound interest-free loans between related parties on the basis that these arrangements are typically not observed between third parties. Notwithstanding this, the purpose of Sch 3 is an acknowledgment that there are particular circumstances where an outbound interest-free loan is not considered as high a risk because it can be evidenced that a zero interest rate is an arm's length condition of the loan, or alternatively, the loan is in substance an equity contribution.

The draft guidance provides a few examples illustrating situations in which the ATO may or may not accept an interest-free loan as reasonable from a transfer pricing perspective. A few observations from these examples are as follows:

- the ATO acknowledges that it may be reasonable to provide interest-free funds to a subsidiary involved in mining exploration activities which do not (and may never) generate income, as such an entity would be unlikely to be able to borrow from an arm's length lender;
- on the other hand, the ATO would not consider an interest-free loan to be arm's length in a situation where funds are provided to a subsidiary which is profitable and has a track record of borrowing from independent lenders;
- similar to inbound financing arrangements, the analysis is heavily underpinned by commercial practices within the industry in question and the availability of evidence of financing transactions in the same or similar circumstances (or the lack thereof);
- while the examples listed in Sch 3 result in binary outcomes (ie the arrangement is treated as either interest-free debt/quasi-equity or bona fide interest-bearing debt), practically, there may be many

scenarios in which an outbound interest-free debt instrument could be bifurcated between debt and equity, with the debt amount being an amount that an arm's length lender would be willing to lend (which also makes commercial sense from the perspective of the borrower), being less than the total amount of the interest-free debt; and
– in example four in which the criteria for interest-free debt/quasi-equity is not satisfied, the ATO states that a taxpayer can transition to the green zone by charging an "appropriate arm's length interest rate", as opposed to a rate which, at a minimum, is equal to the cost of referable debt.

The draft schedule is only focused on the pricing subfactor within Sch 1, and also a reversal of the points allocated for the sovereign country risk of the borrower in order "to reflect the impact of the risk of the borrower appropriately" (read as, the higher the sovereign credit rating of the borrower's country, the more probability that the borrower could obtain funds from a third party lender, and therefore the greater the transfer pricing risk associated with an outbound interest-free loan). Outside of these two factors, it is acknowledged that points can still be scored for other factors (such as the currency of the loan if this is inconsistent with the operating currency of the borrower and/or lender).

The ATO recommends that Sch 3 is read in conjunction with TR 2014/6 (which covers the application of the reconstruction provisions set out in s 815-130 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97)) and TD 2019/10 (which deals with the interaction between the debt/equity rules in Div 974 and the transfer pricing rules), although the scope of Sch 3 is limited to assessing the transfer pricing risk of interest-free loans and does not deal with other tax aspects associated with these instruments.

The risk assessment framework

Schedule 3 introduces a top-down approach to assess the risk of outbound interest-free loans. This is discussed below.

As an initial observation, there is a level of overlap between the factors listed in the analysis below and the prior ATO guidance on outbound interest-free loans found in TR 92/11, which was the only ATO guidance available before Sch 3. It is also noted that the OECD's financial transactions guidance released in February 2020 also acknowledges that there may be some situations in which interest-free loans may be appropriate for funding that is equity-like in substance. The OECD guidance is less detailed than the ATO's position, but it may be reassuring for some taxpayers that the concepts in the ATO and OECD guidance are broadly aligned.

The base risk of outbound interest-free loans is "high"

Under the framework of Sch 3, outbound interest-free related party loans are considered to achieve a base "amber" risk rating under PCG 2017/4, just one notch below the highest risk rating ("red") (although the red zone risk rating can still arise based on the scoring of other factors, such as currency and the sovereign risk rating of the borrower).

Conditions reducing the base risk to "low to moderate" risk (the "minimum required factors")

The base risk rating of an outbound interest-free loan can be reduced to "blue" (low to moderate risk) if the taxpayer can demonstrate that the arrangement presents/meets the following features/conditions which would support its interest-free nature:

– The rights and obligations of the provider of the funds are effectively the same as the rights and obligations of a shareholder.

OR

– The parties had no intention of creating a debt with a reasonable expectation of repayment and, therefore, did not have the intent of creating a debtor–creditor relationship.

AND

– The intentions of the parties are that the funds would only be repaid, or interest imputed, at such time as the borrower is in a position to repay.

OR

– The borrower is in a position where it has questionable prospects for repayment and is unable to borrow externally.

Schedule 3 articulates the level of evidence expected to support the reasonableness of the above positions, with particular focus on the evidence required to demonstrate the inability of the borrower to borrow interest-bearing debt from a third-party lender. Broadly, a detailed analysis of the facts and circumstances in which the arrangement arises must be considered, including common funding practices in the industry, the activities of the business, and the financial position of the borrower.

Further conditions reducing the base risk to "low" risk

Schedule 3 then outlines circumstances which may contribute to further reduce the risk assessment of an outbound interest-free loan (from three points to zero, representing "green" zone/low risk). These factors need to be considered beyond the minimum required factors and be subject to a detailed case-by-case analysis. In this regard, Sch 3 provides some examples/conditions:

– if the taxpayer is able to demonstrate (by providing evidence of real market transactions) that independent parties in the same or similar circumstances would have entered into an interest-free loan based on the options realistically available to both parties. Off-take arrangements are called out as an example where the commercial benefit of interest could be substituted for consideration in another form (ie the delivery of a commodity/resource being extracted);
– the lack of a maturity date or lender's right to enforce payment;
– the deep subordination of the arrangement to other lenders' claims;
– the lack of conditions for a short repayment period or an ability to demand repayment; and
– the presence of restrictions (eg regulatory impediments) on an investment of additional equity into the country of which the borrower is resident.

Furthermore, Sch 3 states that, where interest-free loans have been legally documented as debt, a low-risk rating would be achieved if the taxpayer can demonstrate:

- that the purpose of the loan was to acquire capital assets for the expansion of the core business;
- where it is customary in the applicable industry to enter into longer-term investments;
- that there is evidence the borrower is not in a position to repay the loan until the project turns cash flow positive over the long term;
- that it is unlikely they would be able to secure funds externally; and
- that the purpose was aligned with the group's policies and practices in respect of funding needs.

The Commissioner confirms the expectation of consistency and alignment of the characterisation of the instrument under Subdiv 815-B ITAA97 and for all other income tax purposes, which would lead to further support for an overall low-risk score.

Most importantly, Sch 3 acknowledges that many of the factors listed which need to be considered in order to reduce the risk rating (and to defend a taxpayer's transfer pricing position under Subdiv 815-B) are based on qualitative considerations which will need to be considered on a case-by-case basis based on the commercial and financial relations between the parties. Therefore, it is critical that taxpayers undertake appropriate analyses and furnish corresponding evidence to support satisfaction of the factors listed above which reduces the level of risk associated with an outbound financing arrangement.

In conclusion

This is the first guidance of its sort since the transfer pricing laws were revised in 2013. The key takeaway in connection with the proposed Sch 3 is that, while the ATO considers economic arguments persuasive, the modifying factors outlined above will primarily have regard to available evidence which may be called on to support a taxpayer's self-assessed risk outcome (and ultimately, their transfer pricing position). It is therefore recommended that taxpayers consider a detailed analysis and compilation of corresponding evidence to support outbound interest-free positions, with reference to considerations contained within Sch 3.

For taxpayers required to lodge an RTP schedule, there will be disclosure obligations to consider. Currently, all outbound interest-free loans would be considered "high" or "very high" risk, and the new guidance may allow this to be reduced to a lower-risk rating in some cases. Judgment will be required to apply some aspects of the new guidance, and taxpayers will need to take care that they can support the judgment calls they make with appropriate evidence.

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Successful Succession

by Tim Donlan, ATI, Donlan Lawyers, and
Katerina Peiros, ATI, Hartwell Legal

Court-authorised wills

Court-authorised or statutory wills are a relatively new creation in succession law.

Commencing in South Australia in 1996, each of the states and territories have now enacted legislation enabling the making, revocation or variation of a will for a person who lacks testamentary capacity.[1]

Given our ageing population and an increase in the number of people suffering cognitive decline as they age, it is not surprising that the number of applications for statutory wills is also increasing.

What may at one time have been regarded by estate planning lawyers as a novel potential remedy only in the most extreme cases of mental incapacity and significant wealth, the possibility of having a statutory will made for a testator lacking capacity has gained recognition as a result of more general estate planning opportunities, including the use of testamentary trusts for taxation and asset protection reasons.[2]

Generally speaking, the legislation in each of the states and territories requires that, for the court to make a statutory will, the following criteria need to be satisfied:

– the person lacks testamentary capacity;
– the proposed will, alteration or revocation would accurately reflect the likely intentions of the person if they had testamentary capacity;[3] and
– it is reasonable in all of the circumstances that the proposed will should be made.

Given the lack of consistency in wording between each jurisdiction, the reliance of courts and practitioners on cases decided in other jurisdictions should be limited.

An application for a court-authorised will can only be made if the person the subject of the will is living at the time of the application (in South Australia, the requirement is implicit).[1] An applicant who stands to benefit under a proposed statutory will is not disqualified from making such application. However, the courts will treat such an application carefully to ensure that the applicant is an appropriate one.[4]

When assessing an application for a court-authorised will, the court must be satisfied that the applicant is an appropriate person to bring the application and has a real interest in its outcome.[5]

When considering an application pursuant to s 7 of the *Wills Act 1936* (SA), the court must take into account the following matters:

– any evidence relating to the wishes of the person;
– the likelihood of the person acquiring or regaining capacity;
– the terms of any will previously made by the person;
– the interests of:
  – the beneficiaries under any will previously made by the person;
  – any person who would be entitled to receive part of the estate of the person if the deceased died intestate;
  – any person who would be entitled to claim the benefit of the *Inheritance (Family Provision) Act 1972* (SA); and
  – any other person who has cared for or provided emotional support to the person;
– any gift for a charitable or other purpose that the person might reasonably be expected to give by a will;
– the likely size of the estate; and
– any other matter that the court considers relevant.

Importantly, the courts are not bound by the usual rules of evidence when assessing applications, and therefore evidence as to the person's history and circumstances and suggested testamentary wishes can be identified from a variety of sources.

Certain persons are generally be entitled to appear and be heard in any application proceedings, including persons "having a proper interest in the matter".[6]

When assessing capacity, it has been held "to be clear" that the traditional test for capacity in *Banks v Goodfellow*[7] applies.[8] In a recent case before the Supreme Court of Queensland, the court had to consider an application brought in relation to a person who had suffered a severe spinal injury and was to receive a large compensation payment.[9] Due to her injuries, she could not move her body or limbs, nor was she able to speak. She had not made any prior will, nor given any previous indication as to her testamentary intentions. Therefore, there was very little evidence available to the court to assist in determining whether the will was one that the person "might have made".

There was no evidence of cognitive impairment or incapacity. In addressing the issue of whether the person lacked the requisite testamentary capacity to have a statutory will, the court observed that "capacity to make a will requires not only the mental acuity necessary but also the ability to convey the testamentary intentions".[9] The application was ultimately granted, and a court-authorised will was made for the person on the basis of her lack of testamentary capacity.

The possible gap between what constitutes a lack of testamentary capacity in circumstances where a person may be able to weigh up information and make choices and decisions (and is able to understand their affect) but is unable to communicate those decisions has led to some commentators questioning whether a definition of "capacity" should be codified.[10]

Some jurisdictions have specifically addressed these issues. In South Australia, for example, "testamentary capacity" is defined in the legislation as meaning "the capacity to make a will" and that the cause of incapacity to make a will may arise from mental incapacity or from physical incapacity to communicate testamentary intentions.[11]

Circumstances where statutory wills have been authorised

Most commonly, cases where wills for a person lacking capacity have been made arise where an adjustment is sought as to the entitlements of beneficiaries under either an existing will or under an intestacy.

Common scenario's include cases where there has been some change in the nature of the relationship between a person and an existing beneficiary or a possible beneficiary, including both an improvement in the relationship or a breakdown.

In *AB v CB*,[12] the New South Wales Supreme Court authorised a will to be made that would leave the estate of a severely disabled child to her mother in its entirety and to the exclusion of her father in circumstances where the child had not had a relationship with her father for many years. In other cases, the courts have approved the revocation of an existing will and the making of a new will where there has been a breakdown in a relationship (such as a de facto relationship) such as to warrant a revocation that is in keeping with what the person's intentions might reasonably be expected to be.

In some cases, statutory will applications have been made where there is a need to remedy some concern as to a person's testamentary capacity at the time an existing will was made, or where there is some apparent defect in an existing will that would make it desirable to have the will effectively rectified by a subsequent statutory will during the person's lifetime rather than facing future court proceedings on the person's death.[13] In other cases, the courts have approved the alteration of an existing will where a change in a person's personal circumstances meant that a change in the executors of the will was appropriate.

In *Re Rak*,[14] the Supreme Court of South Australia authorised the making of a will where the applicant had concerns that a potential beneficiary under an intestacy would not be able to properly manage his own financial affairs and needed his inheritance held and managed through a protective trust.

Estate planning cases and opportunities

In what was perhaps the first case to capture the attention of estate planning lawyers from a taxation and asset protection perspective, the Supreme Court of Queensland approved the alteration of a will of a 90-year-old testator so as to include testamentary trusts for his beneficiaries (being his grandchildren).[15] The testator, Mr Matsis, had an estate estimated at being worth around $13m.

Mr Matsis had made a will some 11 years earlier naming his wife as his residuary beneficiary, with his grandsons to receive various gifts and his residuary estate if his wife predeceased him. The will was framed in simple terms, with outright gifting to the named beneficiaries. His wife died in 2007.

There was evidence that:

- at the time the will was made in 2001, Mr Matsis had discussed the concept of testamentary trusts but that he had not proceeded to make a will to include such trusts due to a sense of urgency; and
- Mr Matsis had an "entrepreneurial approach" to building up his personal wealth and it was understood by him that his grandsons would also do so in their business lives.

In 2012, Mr Matsis had lost testamentary capacity and by that time his grandsons had significant business interests (or, in the case of the youngest, an expectation of the same) and were motivated by asset protection and taxation measures. An application was made to the court seeking that a codicil to the existing will be made varying the terms of the gifts to the grandsons to include testamentary trusts.

The court held that there was sufficient evidence to conclude that the proposed alteration was or may have been a will, alteration or revocation that Mr Matsis would have made if he had testamentary capacity.[16]

While the courts have shown some level of flexibility in authorising the making of a will for a person lacking capacity, not all applications have succeeded or will succeed where the courts are not satisfied that there is any evidence that a person would intend to make the proposed will or alter an existing will. It is obviously easier to consider evidence of intention in cases where a person previously had capacity, than in cases where a person has never had testamentary capacity.

In *Boulton v Sanders*,[17] an application was unsuccessfully brought to have a new will made for an elderly woman, Miss Sanders, where her friend and former residuary beneficiary under her existing will had predeceased her. The will made no provision for a gift over in the event of the friend predeceasing and her estate would therefore pass on an intestacy to her nephews. The daughter of the deceased friend (who also provided care for Miss Sanders) brought an application for a will to be made that left the estate to her.

In refusing the application on the basis that there was no evidence that Miss Sanders had intended to change her will after the death of her friend or that an intestacy situation in favour of her nephews was not in keeping with her wishes, Balmford J noted that "it was a serious matter to make or modify a will and it is not to be lightly undertaken".[18]

It is noteworthy that, in *Re Matsis*, none of the grandsons of Mr Matsis were aware of any claims by creditors against them or of any circumstances likely to give rise to such claims in the future.

In *Saunders v Pedemont*,[19] the court refused an application for the making of a statutory will where one of the proposed wills would hold the interest of one of the proposed beneficiaries (who was an undischarged bankrupt) on trust until her bankruptcy was discharged. The court held, inter alia, that there was no evidence as to the proposed testator's attitude towards the bankrupt's entitlements or bankruptcy and that "he may well have taken the view that the best outcome for [the bankrupt] was to enable her to bring her bankruptcy to an end by paying her creditors and to start afresh with what remained from his estate".

It is apparent that there will likely be considerations of public policy by the courts when faced with applications concerning bankrupts or potential bankrupts as beneficiaries of any proposed court-authorised wills.

Conclusion

Statutory wills are no longer considered a novel remedy limited to wealthy estates. Practitioners should be aware of the opportunities that a court-authorised will can provide to alter the benefits arising under a previous will or

intestacy, rectify a defect in an earlier will, and in appropriate circumstances provide some asset protection and taxation advantages for potential beneficiaries.

Practitioners should also be aware of the cost consequences of an unsuccessful application. An application for a court-authorised will can only be made where the subject person is alive at the time of the application. Unlike the typical disputes and litigation in deceased estates where costs of even unsuccessful parties to a dispute are regularly ordered to be met from the estate, the courts are unlikely to be inclined to order that the costs of an unsuccessful statutory will application be met from the assets of a living, typically uninvolved, person during their own lifetime.[20]

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1 S 7 of the *Wills Act 1936* (SA); s 16A of the *Wills Act 1968* (ACT); s 18 of the *Succession Act 2006* (NSW); s 21 of the *Succession Act 1981* (Qld); s 40 of the *Wills Act 1970* (WA); s 19 of the *Wills Act 2000* (NT); s 22 of the *Wills Act 2008* (Tas); s 21 of the *Wills Act 1997* (Vic).

2 *Re Matsis; Charalambous v Charlambous* [2012] QSC 349; *Doughan v Straguszi* [2013] QSC 295.

3 The wording differs slightly in each jurisdiction. For example, in South Australia, the wording of the relevant section refers to the will accurately reflecting the likely intentions of the person. Compare the legislation in the ACT and in New South Wales, which requires that the proposed will is or is reasonably likely to be one that the person would have made, with the relevant legislation operating in Queensland, which states the requirement that the will "is or *may* be a will, alteration or revocation that the person would make if the person were to have testamentary capacity", and in Western Australia, the legislation refers to a will that "could be made" by the person if they had testamentary capacity. Any ambiguity as to the meaning of the words "could make" if the person had capacity is outside the scope of this article.

4 *Lawrie v Hwang* [2013] QSC 289.

5 *Re Will of Jane* [2011] NSWSC 624 at [88].

6 S 7(7) of the *Wills Act 1936* (SA) includes the person the subject of the application, a legal practitioner representing the person (or, with leave of the court, some other person representing the person), the Public Advocate, or the person's administrator, guardian, manager or attorney.

7 (1870) LR 5 QB 549 per Cockburn CJ at 565.

8 *Re Will of Jane* [2011] NSWSC 624; *Re Fenwick; Application of JR Fenwick & Re Charles* [2009] NSWSC 530.

9 *Re SB; Ex parte AC* [2020] QSC 139.

10 C Smyth, "What's new in succession law: Banks v Goodfellow sesquicentennial — is there anything new under the sun?", *Queensland Law Society's Proctor Magazine*, 4 September 2020.

11 S 7(12) of the *Wills Act 1936* (SA).

12 [2009] NSWSC 680.

13 *McKay v McKay* [2011] QSC 230.

14 [2009] SASC 288.

15 *Re Matsis; Charalambous v Charlambous* [2012] QSC 349.

16 *Re Matsis; Charalambous v Charlambous* [2012] QSC 349; see also *Doughan v Straguszi* [2013] QSC 295 for another case determined by the Queensland Supreme Court relating to the use of testamentary trusts from an estate planning perspective.

17 [2004] VSCA 112.

18 *Boulton v Sanders* [2004] VSCA 112; *Boulton v Sanders* [2003] VSC 405 at [32].

19 [2012] VSC 574.

20 See, for example, *Boulton v Sanders (No. 2)* [2003] VSC 409.

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