THE JOURNAL FOR MEMBERS OF THE TAX INSTITUTE

2021-22 Budget highlights

Robert Campbell, CTA

Cash flow boost: questions on interpretation

Bill Mavropoulos

Inbound interest-free loans: part 2

Ellen Thomas, ATI

THE TAX INSTITUTE

Contents

Cover article

Feature articles

Insights from the Institute

Regular columns

Invitation to write

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Tax News – at a glance

by TaxCounsel Pty Ltd

May – what happened in tax?

The following points highlight important federal tax developments that occurred during May 2021. A selection of the developments is considered in more detail in the "Tax News – the details" column on page 588 (at the item number indicated).

Budget highlights

The Treasurer announced a number of tax changes in the context of the 2021-22 federal Budget that was handed down on 11 May 2021 and the following gives brief details of the more significant of these changes. **See item 1.**

CGT and granny flats

An amending bill (the Treasury Laws Amendment (2021 Measures No 4) Bill 2021) which was introduced into parliament on 26 May 2021 contains the amendments to give effect to the proposed "granny flat" CGT changes that were announced in the context of the 2020-21 Budget. **See item 2.**

FBT: retraining and reskilling benefits

Also released by the government on 16 April 2021 was exposure draft legislation (and explanatory material) to give effect to the previously announced targeted fringe benefits tax exemption for employer-provided retraining and reskilling benefits. **See item 3.**

Miscellaneous proposed amendments

The Treasury has released an exposure draft Bill and Regulations (and supporting explanatory materials) that cover proposed minor and technical amendments to the Treasury portfolio laws. **See item 4.**

Identity fraud targeted

In a joint media release on 29 April 2021, the ATO and the Tax Practitioners Board (TPB) announced the release of draft guidance (by the ATO) and a draft practice note (by the TPB) relating to identity fraud. **See item 5.**

Apted: decision impact statement

The Commissioner has released a revised decision impact statement in relation to the recent decision of the Full Federal Court in *FCT v Apted* [2021] FCAFC 45. **See item 6.**

Discretion to retain tax refunds

The Commissioner has issued a practice statement that sets out the ATO's administrative approach to the extension in 2020 of the Commissioner's discretion to retain tax refunds (PS LA 2021/2). **See item 7.**

Imported hybrid mismatch rule

The Commissioner has issued a draft practical compliance guideline that contains practical guidance as to the ATO's assessment of the relative levels of tax compliance risk associated with hybrid mismatches addressed by Subdiv 832-H of the *Income Tax Assessment Act 1997* (Cth) (PCG 2021/D3). **See item 8.**

Freezing order

On 26 April 2021, the Federal Court (Davies J), on the Commissioner's application, issued an interim freezing order in relation to a taxpayer (a Mr Zou) who had failed to comply with a security bond notice to give security to the Commissioner for the due payment of a future tax-related liability (*FCT v Zou* [2021] FCA 433). **See item 9.**

Other decisions

There are several other recent decisions that have been handed down that should be briefly noted. **See item 10.**

President's Report

by Peter Godber, CTA

There's something for everyone

President Peter Godber on supporting a member community that spans across the tax world.

It's a busy time for our members as we approach the end of the financial year. You'll be busy working with clients and in your own business. I wish you good luck for this and the financial year to come.

The months of May and June are also when The Tax Institute conducts several state tax forums and local events. Many of these have different technical streams which showcase the breadth of knowledge and volunteer input that we attract to events at The Tax Institute. They are valuable opportunities to develop new skills and understanding in your own professional sphere.

Attendance at these events also highlights the range of members we have, from those starting out to seasoned experts, small practice owners, corporate tax heads and their employee teams, medium-sized practices, regulators, academics, and pretty much anyone with a desire to learn more about the changing tax world. It has been fabulous for these members to get back to face-to-face learning and delivery, and to mix with other members on a technical and social level.

The Tax Institute's current investment in our knowledge content systems, broader education offerings, and technical capabilities in the Tax Policy and Advocacy (TPA) team gives us the unprecedented ability to help members from this wide range of work environments. Wherever you fit into our community, we continue to improve and increase the ways in which you are able to learn through The Tax Institute.

Federal Budget 2021-22

Our *Federal Budget Report 2021-22* that issued in the early morning of 12 May is a wonderful example of the expertise held by our team and wider member network. Once again, it showed the coverage of issues that we have to deal with. While the Budget was not an exhausting one for tax changes, there were still many changes that members were interested in. These ranged across tax changes affecting individuals, growing businesses, larger corporates, superannuation, innovation, globally mobile taxpayers, tax disputes and administration. On Budget night, we assembled all of our TPA team, and they were accompanied by several volunteer members, who I thank for their assistance.

What the Budget night exercise showed me again is that we have the technical capability to analyse and express meaningful content about the Budget changes to a wide-ranging audience. Well done to all involved. It was a pleasure for me to participate as well, and to be in the subsequent lunchtime webinars where we analysed the changes for you. Our Budget report once again set a new benchmark for its narration and analysis. I hope you all use it as a reference point.

I also look forward to applying the same expertise, vision and collaborative spirit to our developing resources. We are increasingly working with technical committees and other members to ensure that what we deliver to you during the next year is practical and relevant to your career in tax.

Be involved, be informed

At our recent events, I have received feedback from a range of members about the value that they are getting from The Tax Institute at present. I hear lots of good things about the delivery of events and webinars that make me proud of what we are able to achieve as an organisation. Thank you for your feedback, and please, keep talking to us about your experiences. Your input is highly regarded.

Whenever I have these opportunities to speak to members, I encourage them to look more closely at what is on offer and how they could better utilise the services of The Tax Institute. Take a deeper look at *Tax Knowledge eXchange*, consider more structured learning for your staff, and engage directly with members of our TPA team who are at the cutting edge of current issues and consultations. There may be more on offer than you realise, and you may discover something that changes the way you work for the better.

No matter who you are or how you are currently connecting with us, I encourage you to dive deep into the many opportunities afforded to you by being a part of The Tax Institute. There is plenty here for everyone.

Once again, have a great end to the financial year.

CEO's Report

by Giles Hurst

Opportunities for lifelong learning

CEO Giles Hurst talks about how we help members to learn something new every single day.

I make it a point to learn something new every day, big or small. Lately, there has been ample opportunity to reach that goal.

Last month, our team tackled the federal Budget. Not only did I learn from the technical analysis and conversation happening in the Institute that night, but I also had the privilege of seeing our Tax Policy and Advocacy team and some very generous volunteers from among our members put their heads together and collaborate on an excellent Budget report. I gained a little insight into what we can all achieve with a great team and a healthy dose of enthusiasm.

I'm also pleased to report that, within the last month, everyone at The Tax Institute took some time out to reconnect with each other and take a closer look at our goals as an organisation. Where do we want to be in a year, five years, or 10? How can we get there? It was a fantastic opportunity for us all to learn more about each other on both a personal and professional level. I left invigorated with the knowledge that my team are dedicated to the Institute and its members and that they have many bright ideas for our future.

I learn something new every day. That's not by accident and it's not always facts and figures. But it is always a privilege.

Your learning at The Tax Institute

As tax professionals, our members understand the value of lifelong learning — perhaps better than most others. There is always something new to be discovered in tax. The Tax Institute has always held this commitment to knowledge and education as sacred. Our core purpose is to ensure that you enjoy as many opportunities to continue learning as you could want.

One of the key ways that we plan to do this during 2021 and into the future will be through our professional development events. Our committees always put on a wonderful program of technical expertise that you won't find anywhere else. Our wide network ensures that, no matter your area of interest, there will always be something for you on our event calendar.

I would also encourage you to consider getting involved beyond attendance. Raising your hand as a speaker or as part of an organising committee is an excellent opportunity to learn new skills beyond the technical, and perhaps to learn something new about yourself along the way.

We have held several in-person events this year, which I know is a positive step for many of you. During a year of working from home, I think we came to realise all the small, casual opportunities for growth and development that we miss simply by not connecting face-to-face with colleagues. I, for one, am glad to make a return to unexpected insights over a glass of wine at networking dinners.

For those of you who work in sole practices and don't always have the chance to talk shop with colleagues, brainstorm and overhear interesting tidbits around the watercooler, seeking out those opportunities for new learnings is all the more important. I am immensely pleased we can make that possible for you.

Our structured education programs are also full steam ahead. Now under the banner of The Tax Institute Higher Education, these programs continue to offer tax professionals an in-depth and focused tax education experience.

We are also working to bring our new micro credential offering to life for you this year. As an advocate for continual learning, and learning with clear goals and applications in mind, I'm very excited about this. Not everyone can commit to a full course of study — we are all busy professionals, juggling multiple commitments at any given time. That we will soon be able to afford you further flexibility and control over how, when and what you learn couldn't make me more proud.

And finally, failing all that, there is yet more opportunity to keep learning with us. We continue to publish a range of useful, practical and high-quality resources to help you improve each single day. Whether it's sitting down to mull over tax technical analysis in our journals, *Taxation in Australia* and *The Tax Specialist*, gleaning insight from expert speakers in our blog articles, or delving into specialist tools like our *Federal Budget Report 2021-22*, there are so many ways to use your time valuably. In fact, with our vast *Tax Knowledge eXchange* database, the learning opportunities are probably close to endless!

As you embark on the busy period of end of financial year, I hope that you can find the time to learn more about something you love. And as a member of The Tax Institute, I hope you take full advantage of the different ways we can help you along your journey of lifelong learning. Whether you're learning more about tax, your colleagues, or yourself and what you're truly capable of, it's never time wasted.

Tax Counsel's Report

by Julie Abdalla, FTI

Federal Budget 2021-22: a missed opportunity for tax reform

The recent federal Budget contained some tax measures but, overall, it focused on spending for economic growth. The question remains: when will we see genuine, holistic tax reform?

Federal Budget announcements

On the evening of Tuesday 11 May, the federal Treasurer, the Hon. Josh Frydenberg, MP, handed down the federal Budget 2021-22. While quite a number of tax measures were announced, it was certainly not a "taxing" Budget, but rather one focused on spending to facilitate Australia's economic recovery.

The Budget saw infrastructure, health, aged care and national security as key recipients of targeted expenditure. Other focus areas included measures and funding to address housing affordability, gender equality issues, and workforce participation. A balance was struck between measures intended to have a longer-term impact and those which are relatively more immediate in their effect.

Extension after extension

But where does tax reform fit in? We know that to support this kind of expenditure and, indeed, Australia's economic growth, we need a simple, efficient and fair tax system. We had hoped that the government would announce at least an intention to put holistic tax reform on its agenda. My fellow tax counsel, Angie Ananda, wrote about this in the March issue of this journal.[1] Instead, the government has continued its habitual practice of extending temporary measures and announcing new rules in isolation. The extension of a number of temporary measures was announced, including the full expensing measures and the loss carry-back measures. The extensions are positive moves but, without permanency or long-term planning, simply push out the problem for another year.

The digital future

There was a strong emphasis on the government's Digital Economy Strategy and on encouraging innovation. Relevant tax measures that were announced included the digital games tax offset, a more favourable depreciation regime for intangible assets, and the introduction of a patent box for medical and biotech innovation. These measures, and others announced outside of the digital landscape, are positive. However, bearing in mind the start dates and the arrangements and assets to which they will apply, their impact is overall generally limited and potentially a while away.

An announcement requiring further consideration

A change in the approach to determining individual tax residency was announced on Budget night. The Tax Institute supports reconsideration of the individual tax residency rules and their underlying complexities. However, we have some reservations about the proposed approach, particularly around the secondary tests and how they may apply.

The announced approach finds its origins in the Board of Taxation's *Reforming individual tax residency rules — a model for modernisation* report of March 2019. We acknowledge the substantial work done in the preceding years which led to the publication of the Board's report. Given the significance of the proposed changes, we hope that a comprehensive period of consultation precedes the enactment of enabling legislation. This is necessary to ensure that concerns raised previously may be properly explored and addressed, and the policy position clarified and expressly articulated.

Where to next?

While, in principle, we welcome most of the tax and tax-related measures announced in the federal Budget 2021-22, we consider that there is much more to be done. We will continue to persevere and lead the way on tax reform, for the benefit of our members and the tax system as a whole.

The potential areas of reform we identify in *The Case for Change* discussion paper require due consideration and will take some time to implement. They are not band-aid solutions or quick fixes. We know those kinds of measures are not sustainable and overcomplicate an already complex system.

The Case for Change is due to be published in the coming months and will present to the government some of the key issues that The Tax Institute and our members have identified in the current tax system, as well as potential options for reform. Some of the ideas that will be presented are radical and do not necessarily represent the views of each and every member. *The Case for Change* advocates for holistic reform and should be read as such: holistically. Issues and options for reform considered in isolation will only compound the problems in the current system.

The fundamental objective of *The Case for Change* is not to provide the government with a blueprint for the ideal tax system, but to spark the debate and put holistic tax reform on the agenda. We know there are pervasive issues in our tax system, and we want to initiate conversations which lead to action to address them.

Australia has emerged from the pandemic in a relatively strong economic position, stronger than most anticipated. We have a unique opportunity to pursue genuine tax reform to redesign a tax system that is simple, efficient and fair. We can only do so by starting the conversation and putting tax reform on the agenda.

Reference

1. A Ananda, "Will tax reform be delayed again?", (2021) 55(8) *Taxation in Australia* 392.


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Tax News – the details

by TaxCounsel Pty Ltd

May – what happened in tax?

The following points highlight important federal tax developments that occurred during May 2021.

Government initiatives

1. Budget highlights

The following are brief details of the more significant tax changes announced by the Treasurer in the context of the 2021-22 federal Budget that was handed down on 11 May 2021.

Temporary full expensing extension

Temporary full expensing is to be extended in its current form for 12 months to 30 June 2023 to allow eligible businesses with an aggregated annual turnover or total income of less than $5b to deduct the full cost of eligible depreciable assets of any value, acquired from 7:30 pm AEDT on 6 October 2020 and first used or installed ready for use by 30 June 2023. From 1 July 2023, normal depreciation arrangements will apply.

Temporary loss carry-back extension

The temporary loss carry-back measures that apply to eligible corporate tax entities are to be extended by one year. The extension will allow eligible entities to carry back (utilise) tax losses from the 2022-23 income year to offset previously taxed profits as far back as the 2018-19 income year when they lodge their 2022-23 tax return.

Intangible depreciating assets: tax-effective life

Taxpayers will be able to self-assess the tax-effective lives of eligible intangible depreciating assets, such as patents, registered designs, copyrights and in-house software. This measure will apply to assets acquired from 1 July 2023, after the temporary full expensing regime has concluded.

The tax-effective lives of such assets are currently set by statute and taxpayers will continue to have the option of applying the existing statutory tax-effective life to depreciate these assets.

Individual tax residency rules

The individual tax residency rules are to be replaced with a new, modernised framework. The primary test will be a simple "bright line" test — a person who is physically present in Australia for 183 days or more in any income year will be an Australian tax resident. Individuals who do not meet this primary test will be subject to secondary tests that depend on a combination of physical presence and measurable, objective criteria. The measure will have effect from the first income year after the date of royal assent of the enabling legislation.

Patent box: medical and biotechnology innovations

A patent box tax regime is to be introduced to further encourage innovation in Australia by taxing corporate income derived from patents at a concessional effective corporate tax rate of 17%, with the concession applying from income years starting on or after 1 July 2022.

The patent box will apply to income derived from Australian medical and biotechnology patents. The government will also consult on whether a patent box would be an effective way of supporting the clean energy sector.

AAT: debt recovery of disputed tax debts

The AAT's powers are to be extended to pause or modify ATO debt recovery action in relation to disputed debts that are being reviewed by the Small Business Taxation Division of the AAT. This measure is to take effect from the date of royal assent of the enabling legislation.

When considering applications, the AAT will be required to consider the potential effect on the integrity of the tax system and ensure that applications are in relation to genuine disputes.

Medicare levy low-income thresholds

The Medicare levy low-income thresholds for singles, families, and seniors and pensioners are to be increased from 1 July 2020 to take account of recent movements in the CPI so that low-income taxpayers generally continue to be exempt from paying the Medicare levy.

Self-education expense deductions

The exclusion of the first $250 of deductions for prescribed courses of education is to be removed with effect from the first income year after the date of royal assent of the enabling legislation.

Low and middle-income tax offset

The low and middle-income tax offset is to be retained for the 2021-22 income year.

Employee shares schemes

The cessation of the employment taxing point for the tax-deferred employee share schemes (ESSs) that are available for all companies is to be removed with effect in relation ESS interests issued from the first income year after the date of royal assent of the enabling legislation.

This change will result in tax being deferred until the earliest of the remaining taxing points (in the case of shares, when there is no risk of forfeiture and no restrictions on disposal, and in the case of options, when the employee exercises the option and there is no risk of forfeiting the resulting share and no restriction on disposal). There is a maximum period of deferral of 15 years.

Corporate collective investment vehicle

The corporate collective investment vehicle (CCIV) component of the measure titled "Ten Year Enterprise Tax Plan" — implementing a new suite of collective investment vehicles announced in the 2016-17 Budget — is to have a revised commencement date of 1 July 2022.

2. CGT and granny flats

An amending bill (the [Treasury Laws Amendment (2021 Measures No 4) Bill 2021]) which was introduced into parliament on 26 May 2021 contains the amendments to give effect to the proposed "granny flat" CGT changes that were announced in the context of the 2020-21 Budget.

Under the draft amendments, a CGT event would not happen on the entering into, varying or terminating of a granny flat arrangement if certain requirements are met. These requirements would include that the individual having the granny flat interest has reached pension age or has a disability, and that the arrangement is in writing and is not of a commercial nature. The CGT event would not happen only to the extent that it relates to the creation, variation or termination (as the case may be) of a granny flat interest.

A granny flat interest in a dwelling for this purpose is a right to occupy that dwelling for life.

The amendments are to apply from the first 1 July to occur after the day that the amending Act receives royal assent.

3. FBT: retraining and reskilling benefits

Also released by the government on 16 April 2021 was exposure draft legislation (and explanatory material) to give effect to the previously announced targeted fringe benefits tax (FBT) exemption for employer-provided retraining and reskilling benefits.

It was explained that the increased rate of globalisation and technological change, and the changing nature of work and the labour market, are among the forces driving the need for continued upgrading of skills throughout life. Retraining and reskilling play an important role in allowing Australia's labour force to benefit from the ongoing transformation of jobs and workplaces. Against this background, the government is supporting employers to retrain and reskill individuals for future employment opportunities.

To incentivise employers to retrain and reskill redundant (or soon to be redundant) employees so that they are better prepared to transition to their next career, the proposed amendments will provide employers an exemption from FBT on benefits provided to these employees for the purpose of enabling them to gain new employment.

When passed by parliament, the amendments are to apply to benefits provided on or after 2 October 2020 (the date the measure was announced).

4. Miscellaneous proposed amendments

The Treasury has released an exposure draft Bill and Regulations (and supporting explanatory materials) that cover proposed minor and technical amendments to the Treasury portfolio laws.

The proposed amendments seek to ensure that the law operates as intended by correcting technical or drafting defects, removing anomalies and addressing unintended outcomes. The more significant of the proposed amendments that relate to the taxation laws are briefly noted below.

Corporate loss carry-back choice

A new section (s 160-16) is proposed to be inserted in Div 160 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) to clarify the mechanism through which an entity may change its loss carry-back choice.

A change of a loss carry-back choice will need to be given to the Commissioner in the approved form within the limited amendment period (as defined in s 170 of the *Income Tax Assessment Act 1936* (Cth) (ITAA36)) for an assessment for an income year.

A changed loss carry-back choice applies as if it was always the entity's choice. That is, it takes effect from the day the original choice was made.

Franking account balance

It is proposed to amend ss 205-15(1) and 219-15(2) ITAA97 to ensure that a franking credit arises in circumstances where:

- a franking debit arises because the entity or company receives a tax offset refund;
- the entity or company's tax offset refund is subsequently reduced and the entity or company is liable to pay the Commonwealth the amount of the excess mentioned in s 172A(2) ITAA36; and
- the entity or company pays the amount of the excess.

In these circumstances, the amount of the franking credit is to be the amount of the excess, and the credit arises on the day on which the amount of the excess is paid.

The proposed changes would ensure that an entity or a company's franking account balance is restored to appropriately reflect the actual amount of the entity or company's tax offset refund.

Temporary full expensing

It is proposed to amend s 40-157 of the *Income Tax (Transitional Provisions) Act 1997* (Cth) to clarify that, when working out the cost of a depreciating asset that is capital works for the purpose of calculating an entity's total cost of investment for the 2016-17 to 2018-19 income years, ss 40-45 and 40-215 ITAA97 are to be disregarded. This clarification will ensure that the investment test interacts appropriately with the existing provisions in Div 40 ITAA97.

The Commissioner's perspective

5. Identity fraud targeted

In a joint media release on 29 April 2021, the ATO and the Tax Practitioners Board (TPB) announced the release of draft guidance (by the ATO) and a draft practice note (by the TPB) relating to identity fraud.

The media release states that the ATO and the TPB are focused on measures to intercept attempted identity fraud targeted at registered tax practitioners and their clients. The proposed new guidelines will strengthen and modernise the practices and controls that registered tax practitioners follow when verifying the identity of their clients.

The ATO has seen an increase in attempts by criminals to commit refund fraud by stealing the identities of taxpayers which has coincided with an increased reliance on technology and remote working practices. A lack of consistency to verifying the identity of clients has left individual tax practitioners vulnerable to attack. Practices that retain client identity documents insecurely are also at greater risk of having these documents stolen through physical break-ins.

The ATO's draft guidance encourages tax practitioners to voluntarily adopt the new client verification standard immediately, with the view for the standards to become compulsory in the future following an initial transition period and further consultation with the tax profession.

The ATO is not expecting that tax practitioners will need to go back and verify the identity of their entire client base as part of the transitional approach. Rather, tax practitioners are being asked that they perform identity checks from this point on, at the next opportunity in their normal dealings with clients.

The TPB's guidance will apply to all registered tax practitioners regardless of whether they use the ATO's online services or not.

The TPB noted that the *Tax Agent Services Act 2009* (Cth) does not expressly set out minimum requirements for tax practitioners to verify a client's identity. However, there are implications under the Act if tax practitioners fail to take reasonable steps to ensure that the identity of their clients is established. The TPB's draft practice note provides practical guidance and examples so that tax practitioners do not fall foul of their obligations and put their registration and business at risk.

Tax practitioners who are unable to successfully verify a client's identity and suspect potential fraud should contact the ATO immediately on 1800 467 033.

The ATO's draft guidance is available on the ATO website and the TPB's draft practice note is available on its website. The ATO and TPB are seeking feedback.

6. Apted: decision impact statement

The Commissioner has released a revised decision impact statement in relation to the recent decision of the Full Federal Court in *FCT v Apted*.[1]

In that case, which was an appeal from a decision of the AAT, the Full Court considered the operation of the requirement in s 11(6) of the *Coronavirus Economic Response Package (Payments and Benefits) Rules 2020* (Cth) (the CERP Rules) that an entity have an active ABN on 12 March 2020 (or a later time allowed by the Commissioner) in order to be eligible for a JobKeeper payment.

The Full Court held that an applicant for a JobKeeper payment who did not in fact have an ABN on 12 March 2020 (if the ABN register were to have then been inspected) could not satisfy the having an ABN requirement, and that the AAT's decision to exercise the discretion to allow the JobKeeper applicant to have an ABN at a later time was legally correct.

The decision impact statement states that the holding of an ABN as at 12 March 2020 supported transparency that a business existed at 12 March 2020. The reporting of supplies or income to the Commissioner is concerned with engagement with the Commissioner prior to 12 March 2020 concerning the business in operation. The inclusion of these elements in the integrity rule in the CERP Rules indicated that the JobKeeper payments for eligible business participants were in the ordinary case to be directed to businesses that were operating actively and doing so in view of the Commissioner as at 12 March 2020.

Having regard to that context, if the business was operating without visibility to the Commissioner as at 12 March 2020 (deliberately or otherwise), that would weigh against the exercise by the Commissioner of the discretion. Of course, in such cases it would also be relevant to understand the reasons why the business did not hold an ABN or had not reported supplies or income to the Commissioner by 12 March 2020. Where there is a reasonable explanation, in most cases the discretion would be exercised.

The Commissioner considers that the Full Court's decision and the Commissioner's view of the decision will apply equally to the identical requirements in ss 5 and 6 of the *Boosting Cash Flow for Employers (Coronavirus Economic Response Package) Act 2020* (Cth), having regard to the purpose and context of those rules. Similarly, the Commissioner accepts that those discretions can be reviewed, as part of a review of a decision on entitlement to cash flow boost payments, under Pt IVC of the *Taxation Administration Act 1953* (Cth) (TAA53).

The Commissioner considers that the court's decision applies to discretions contained in the integrity rules in the cash flow boost and JobKeeper legislation. It does not affect any other discretions that the Commissioner may exercise, including those relevant to determining ABN eligibility at a point in time, or deferral of lodgment due dates for tax returns or business activity statements (BASs).

In response to the court's decision, the Commissioner has also updated PS LA 2020/1 which is concerned with the exercise by the Commissioner of his discretion to allow further time for an entity to hold an ABN or to provide notice to the Commissioner of assessable income or supplies.

7. Discretion to retain tax refunds

The Commissioner has issued a practice statement that sets out the ATO's administrative approach to the extension in 2020 of the Commissioner's discretion to retain tax refunds (PS LA 2021/2).

The practice statement explains that, as part of the amendments made by the *Treasury Laws Amendment (Combating Illegal Phoenixing) Act 2020* (Cth) (the amending Act), changes were made to extend the Commissioner's discretion to retain a refund where a taxpayer has an outstanding notification (other than a notification under the BAS or petroleum resource rent tax (PRRT) provisions) that:

- is required to be given to the Commissioner under a taxation law (for example, an income tax return); and
- affects or may affect the amount of the refund.

The law does not limit the application of the extension to the discretion. However, PS LA 2021/2 recognises that the Commissioner's exercise of this extended discretion will not be taken lightly. In particular, the exercise of the discretion will be considered in circumstances where taxpayers are identified as engaged in high-risk behaviour (including those engaging in illegal phoenix activity).

PS LA 2021/2 provides ATO officers with guidance on when they may exercise the Commissioner's discretion to retain a taxpayer's refund. However, the practice statement does not apply to the exercise of the Commissioner's discretion to retain a taxpayer's running balance account (RBA) surplus or credit where:

- a notification under the BAS provisions, the PRRT provisions or single touch payroll is outstanding; or
- the Commissioner requires verification of information contained in a notification.

The exercise of the discretion to retain a refund should be considered where there are reasonable grounds to believe that:

- the taxpayer has an RBA surplus or other credit that has not been applied against a tax debt of the taxpayer;
- the taxpayer has an outstanding notification that they are required to give under a taxation law (other than the BAS or PRRT provisions);
- the outstanding notification affects or may affect the amount of the refund; and
- the taxpayer (including associates or controllers) is engaged in phoenix behaviour (during the first year after commencement of the amending Act), or the taxpayer is engaged in high-risk behaviour (including phoenix behaviour) (after the first year following commencement of the amending Act).

PS LA 2021/2 explains what may be considered as "phoenix" or high-risk behaviour and the length of time that the Commissioner may retain a refund.

8. Imported hybrid mismatch rule

The Commissioner has issued a draft practical compliance guideline that contains practical guidance as to the ATO's assessment of the relative levels of tax compliance risk associated with hybrid mismatches addressed by Subdiv 832-H ITAA97 (PCG 2021/D3).

The draft guideline sets out the expectations regarding the Commissioner's assessment of risk in connection with the imported hybrid mismatch rules, including the Commissioner's approach to reviewing whether a taxpayer has undertaken reasonable enquiries in relation to the rules for non-structured arrangements. This includes the level of supporting information that the Commissioner requires in order to demonstrate compliance in connection with non-structured arrangements and will also assist taxpayer's in preparing for any compliance reviews.

PCG 2021/D3 does not limit the operation of the law, and it does not replace, alter or affect the Commissioner's interpretation of the law in any way. It does not relieve a taxpayer of the legal obligation to comply with all relevant taxation laws.

The draft guideline does not deal with the core hybrid mismatch rules (in Subdivs 832-C to 832-G ITAA97), which must be considered before the application of Subdiv 832-H.

Recent case decisions

9. Freezing order

On 26 April 2021, the Federal Court (Davies J), on the Commissioner's application, issued an interim freezing order in relation to a taxpayer (a Mr Zou) who had failed to comply with a security bond notice to give security to the Commissioner in the amount of $24,762,187 by 5:00 pm on 5 January 2021 for the due payment of a future tax-related liability (*FCT v Zou*[2]).

Davies J said that she was satisfied on a prima facie level that the Commissioner had a good arguable case that: (1) the security notice met the requirements of s 255-105(2) TAA53; (2) the notice was served on Mr Zou on 4 December 2020 at the address for service; and (3) there had been non-compliance with the security notice.

Her Honour said that there were a number of reasons for being satisfied that there was a real risk of dissipation. These included:

- the future tax-related liability in the amount of $24,762,187 had since crystallised into an actual liability by the issue by the ATO of notices of amended assessment of income tax and penalties in March 2021, with due dates for payments variously of 22 March 2021, 29 March 2021 and 1 April 2021;
- Mr Zou had been assessed to tax on amounts of income which were undisclosed to the ATO, giving rise to the inference that Mr Zou had grossly understated his income over a number of years; and
- the significant amount of the tax liability, the failure to pay the tax debt, and the failure to comply with the security notice gave rise to an inference that there was a risk of asset dissipation.

The evidence was that: the property over which the security was required to be given was the only Australian real estate property of Mr Zou of which the Commissioner was aware; Mr Zou was now located in China; the property was presently not mortgaged; and it appeared that the property, at least at the time of the issue of the security notice, had been listed on the market for sale. Mr Zou appeared to have business interests in China and the ability and motive to sell the property and move funds offshore. He had also, on the evidence available, been uncooperative with the Commissioner in failing to respond to numerous requests for information and documents from the ATO and demonstrated a lack of willingness to comply with his obligations.

Taking all of those matters into account, there was a proper basis for concern of risk of dissipation of the property, either through the sale of the property or through that property being encumbered by Mr Zou to a third party, which would seriously compromise the ability of the Commissioner to enforce the security notice. Accordingly, orders should be made against him, restraining him from dealing with the property.

In aid of the freezing orders, her Honour said that it was also appropriate to make an order against the Registrar of Titles preventing dealings affecting the property.

Davies J also considered issues relating to the service of documents on Mr Zou.

10. Other decisions

There are several other recent decisions that have been handed down that should be briefly noted. These are:

- *KPTT v FCT*[3] in which Jagot J held that the identity of a taxpayer should not be suppressed in proceedings before the Federal Court on an appeal from a decision of the AAT in circumstances where there was a suppression order by the AAT and the AAT proceedings had not been finally disposed of. Her Honour referred to the relevant principles that apply when considering making suppression and non-publication orders under ss 37AF and 37AG of the *Federal Court of Australia Act 1976* (Cth);

- *Spencer and FCT* [4] in which the AAT partially allowed a taxpayer's objection against the disallowance of work-related expenses;
- *Birdseye and Tax Practitioners Board* [5] in which the AAT affirmed the decision of the TPB to cancel the tax agent registrations of an individual and a related company for breaches of the Code of Conduct but set aside the TPB's decision to the extent that it imposed a non-reapplication period on the agents; and
- *Norman and Tax Practitioners Board* [6] in which the AAT affirmed the decision of the TPB to cancel the registration of an individual but reduced the non-reapplication period imposed by the TPB from four years to two years.

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References
1 [2021] FCAFC 45.
2 [2021] FCA 433.
3 [2021] FCA 464.
4 [2021] AATA 1106.
5 [2021] AATA 1011.
6 [2021] AATA 848.

Tax Tips

by TaxCounsel Pty Ltd

Backdating

The backdating of a document can not only give rise to penalties, but it can also give rise to a range of issues much later.

Background

Practitioners are not infrequently confronted with the situation where some document that has taxation consequences has not been brought into existence in a timely manner.

In such a situation, there is a temptation to try to do things retrospectively. But, as will be seen, that course has quite a few drawbacks, ranging from legal ineffectiveness to the commission of an offence. And, as will also be seen, the backdating can come back many years later in a dispute with the ATO or a civil dispute between the parties.

This article briefly considers several points in relation to backdating.

The past cannot be altered

The most basic point from which the other points follow is the impossibility of altering the past by backdating a document. This has been referred to in numerous decisions of the courts.

Thus, for example, in *McDonald v FCT*,[1] Stone J (Beaumont ACJ agreeing) said, in the context of a contract for the sale and purchase of land, that the date of the formation of the contract is a matter of law and the parties cannot, by backdating the written document, rewrite history with the effect that a binding contract existed from the specified date.

By way of further example, in *Davis v FCT*,[2] Hill J said:

> "The parties to an agreement cannot effect a change to an agreement retrospectively so that the agreement between them is altered as against the rest of the world. The parties can, no doubt, enter into an agreement, binding as between them, that a prior agreement they have entered into will be construed in a particular way from the moment the prior agreement was entered into. But the original agreement will, so far as the Commissioner is concerned, govern their relationship until the time of its amendment. For example A and B may enter into an agreement which provides, inter alia, that certain income will, for the term of the agreement, be held by A in trust for B. Later the parties may as between them agree to alter the arrangement ab initio to provide that that income will not be held in trust for B, but will always be treated as belonging to A beneficially. The agreement will be binding inter partes, but for income tax purposes the income will, until the date of the agreement, still be treated as beneficially the income of B."

Hill J went on to say that the example he had given in the above passage was to be:

> "… distinguished from the case where parties have entered into an agreement under the mutual mistake that the document they have executed records the terms of their bargain when it does not. In such a case an application could be made to a court for rectification of the written document. But even where an order of a court is obtained to rectify the written agreement, the court order does not operate to alter the past. The order of the court merely recognises what has always been the case, namely that the true agreement between the parties was not that which they have mistakenly executed, but what they in truth agreed upon.
>
> As an alternative to an order of rectification the parties could execute a deed rectifying their prior writing. That deed, if truly operating to record that the parties were under a mutual mistake, and also setting out what the parties acknowledge to be the true agreement between them would not, any more than a court order, actually alter the position as between the parties. It would merely record that agreement as it always was. Whether by court order or by deed, rectification requires that there be a mutual mistake, that is to say what is required is that there be a common intention between the parties as to the effect that the instrument they signed would have had which was inconsistent with the effect which the instrument which they executed in fact had: cf *Commissioner of Stamp Duties (NSW) v Carlenka Pty Ltd* (1995) 95 ATC 4620. Mistake as to the revenue consequences of the agreement would not bring about the same result: *Baird v BCE Holdings Pty Ltd* (1996) 40 NSWLR 374 at 384."

In *Malik v Hussain Jr*,[3] a recent United Kingdom decision, Stephen Davies J said that a statement in a partnership agreement to the effect that a partnership has existed from a date preceding the execution of the agreement itself cannot in law operate retrospectively. At best, it may accurately reflect the past position but, if in fact there was no partnership during that period, such a statement in the agreement cannot retrospectively alter the situation.

And, importantly, an agreement such as is envisaged in the *Malik* case cannot be altered by the backdating of the partnership agreement.

Evidentiary issues

Clearly, if the date of the execution of a document had to be proved in all cases by a person relying on it, this would give rise to practical and time-consuming problems. The approach of the courts in relation to the date of a document was stated by Williams J in *Dillon v Gange*[4] as follows:

> "It is unnecessary to discuss the evidence with respect to the date on which the agreement was signed at any length. The document bears date 13th September 1939, and, in the absence of any proof to the contrary, there would be a presumption that it was executed on that date (*Anderson v. Weston* [1840] EngR 375)."

The usual acceptance, as a matter of course, of the date that a document bears as being the date on which it was signed was usefully explained by McPherson JA (Shepherdson J agreeing) in *Queensland Law Society Inc v Bax*[5] as follows:

> "… the act of falsely 'backdating' documents is plainly a serious matter. The ordinary presumption is that, unless there is affirmative evidence to the contrary, a document is taken to have been executed on the date it bears. Such evidence is often difficult to obtain particularly after a lapse of some time from the event. The presumption is therefore one on which business is habitually conducted and for that reason, among others, it is plainly important to maintain its integrity so

> far as possible. The date on a document is often critical in a number of ways. In the case of insolvency, it is capable of determining whether the transaction recorded or given effect in the instrument is liable to be set aside. It may also, as the Statutory Committee in this case noticed, affect rights of creditors to priority in equity. Such a priority may impinge on the rights of creditors against each other, or it may, for reasons explained in *Burns v. Stapleton* [1959] HCA 34 …, defeat, wholly or in part, the claim of a trustee in bankruptcy or a liquidator to invalidate a security asserted over the assets of the insolvent."

It needs to be kept in mind, however, that the date of a contract or other document may be put in issue. In *Re Gary Edwin Dowling and Catherine Maree Dowling Ex Parte: Richard Andrew Gagie v State Bank of New South Wales*,[6] Morling J said that he agreed that the date shown on an agreement may be contradicted by extrinsic evidence.

What can the consequences be?

The consequences that may flow from a backdated document will depend on the circumstances.

The prime consequence is that the backdating of a document cannot retrospectively alter the position of the parties; it can only operative prospectively from the date it was in fact executed.

Registration issues

The backdating of a document or documents may well be a matter that a regulatory body, such as the Tax Practitioners Board, may take into account when considering the registration of a tax agent, including when considering whether there has been a breach of the Code of Professional Conduct and whether the fit and proper test is met.[7] Principles of the Code of Professional Conduct that could potentially apply in relation to the registration of tax agents[8] include:

- acting honestly and with integrity;
- acting lawfully in the best interests of a client;
- providing a tax agent service competently; and
- taking reasonable care in ascertaining a client's state of affairs, to the extent that ascertaining the state of those affairs is relevant to a statement that the agent is making or a thing that the agent is doing on behalf of a client.

Penalties

In the case of the backdating of a document that is relevant to taxation liabilities, potential issues may arise for the taxpayer not only in respect of what may be called primary tax, but also under the administrative penalties and offence provisions of the *Taxation Administration Act 1953* (Cth) (TAA53) relating to statements.

For example, it is an offence under s 8K TAA53 to make a statement to a taxation officer that is false or misleading in a material particular, and an administrative penalty is potentially attracted under s 284-75(1) Sch 1 TAA53 where a statement that is made to the Commissioner is false or misleading in a material particular, whether because of things in it or omitted from it.

An amount that is derived from a document that is of no force at the relevant time because it is backdated, and which is included in an income tax return made to the Commissioner, could be a relevant false or misleading statement.

Also, the backdating of a document may, in certain circumstances, be an offence under the wider criminal law,[9] and the fact that the actual backdating is done by, say, the client will not absolve the professional person involved if the professional person is an accessory. For example, by virtue of s 11.2 of the Schedule to the *Criminal Code Act 1995* (Cth), a person who aids, abets, counsels or procures the commission of an offence by another person is taken to have committed that offence and is punishable accordingly.

A recent example

A recent example where backdating was involved is provided by the decision of Davies J in *Advanced Holdings Pty Ltd as trustee for The Demian Trust v FCT*.[10] In that case, it was conceded that:

- a document purporting to be a "unit certificate" of a trust called the Lewisham Estates Trust certifying that Demian Holdings Pty Ltd as trustee for the Demian Trust was the holder of the 100 units in the Lewisham Estates Trust and dated "15th May"; and
- a document purporting to be a transfer of 100 units in the Lewisham Estates Trust from Advanced Holdings Pty Ltd to Demian Holdings dated 15 May 2003,

which had been supplied to the Commissioner by the accountant and tax agent (a Mr Incollingo) of the relevant group of companies were actually created in 2015 and backdated to 15 May 2003. The Federal Court issued Mr Incollingo a certificate under s 128 of the *Evidence Act 1995* (Cth)[11] in respect of evidence that he gave under cross-examination and re-examination in relation to the issue of backdated documents and the provision of backdated documents to the ATO.

Other circumstances

The consequences that may arise in relation to the backdating of a document are not limited to taxation issues. For example, civil litigation may result from the beneficiaries of a discretionary trust becoming antagonistic among themselves (perhaps after the death of the original controller) and litigation may follow which exposes what has been done in the past. In such a case, if income distribution resolutions for an income year have, contrary to fact, been purportedly made on or before 30 June as required by the terms of the trust deed or, in practical terms, the income tax law, the income would belong to the default beneficiaries or, failing that, would be taxed to the trustee, usually under s 99A of the *Income Tax Assessment Act 1936* (Cth) (ITAA36).

Some observations

Tax practitioners must take care in relation to situations where there is the potential for a backdating issue to arise and have procedures in place that will overcome possible problems by ensuring that no backdating occurs.

It is also suggested that the government should consider the possibility of legislative amendments to overcome one situation where backdating issues can loom large. This situation is the annual distribution of the income of a non-fixed trust. The Commissioner previously had an administrative practice which (subject to the terms of the particular trust deed) broadly allowed a trustee two months after the close of an income year within which to make a distribution resolution that he, the Commissioner, would treat as being effective for the income year (see IT 328 and IT 329, both of which were withdrawn in 2011).

If suitable legislative amendments were to be made then, subject to the terms of any amendment power conferred by a trust deed, the trust deed could be suitably amended if necessary.

In relation to the possibility of a legislative change along the lines suggested, it may be noted that the Commissioner's former administrative practice is, it seems, recognised in s 96C(1)(b) ITAA36 and in s 269-65 Sch 2F ITAA36. The practice is also recognised in the explanatory memorandum to the Tax Laws Amendment (2004 Measures No. 1) Bill 2004 (see para 3.20) and in TR 2010/3 (see para 111). The fact that the Commissioner's former administrative practice is so recognised does not have any relevance to the operation of the trust provisions in Div 6 ITAA36 but does give some basis to argue that legislative change is required.

It may be noted that another important tax issue affecting trusts has been outstanding for a number of years. This is the issue considered in TR 2012/D1 which was issued in March 2012 and has not been finalised. This draft ruling considers the meaning of the expression "income of the trust estate" as it is used in Div 6 ITAA36.

TaxCounsel Pty Ltd

References

1 [2001] FCA 305.

2 [2000] FCA 44.

3 [2020] EWHC 2334 (Ch). Reference should also be made to the recent decision of Colvin J in *Shell Energy Holdings Australia Ltd v FCT* [2021] FCA 496.

4 [1941] HCA 5.

5 [1998] QCA 89.

6 [1992] FCA 160.

7 See on the Tax Practitioners Board's website under 2019 Compliance case studies "Dishonest acts result in registration termination" (available at www.tpb.gov.au/dishonest-acts-result-registration-termination). See also *Migration Agents Registration Authority v Bebawy* [2021] FCA 397.

8 See Div 30 of the *Tax Agent Services Act 2009* (Cth).

9 See, for example, s 137.2 of the Schedule to the *Commonwealth Criminal Code*.

10 [2020] FCA 1479. This case involved a number of issues and an appeal from the decision of Davies J has been heard by the Full Federal Court.

11 That section deals with privilege in respect of self-incrimination.

Mid Market Focus

by Jordan Phung, HLB Mann Judd

Foreign businesses in Australia: practical considerations

For foreign businesses looking at Australia as a potential market, there are usually several administrative, legal and tax hurdles to jump through before trading can commence.

Introduction

When setting up a business in Australia, in general, there are several key planning items that should be addressed. Many of these are not always front-of-mind but may result in costly mistakes if not planned for appropriately.

This article discusses some of the practical considerations that will need to be addressed before commencing business in Australia, such as choosing and setting up the appropriate structure, obtaining business and tax registrations, determining reporting obligations, and dealing with international tax obligations.

Choosing an appropriate structure

Generally, when a foreign business is looking to operate in Australia, it will either do so by setting up a branch office or by incorporating a subsidiary in Australia. As with most things in practice, choosing the right structure will depend on the relevant facts and circumstances of your client.

Some questions that practitioners should be raising with these foreign businesses include:

- What are the funding requirements for the Australian business?
- How will profits be repatriated to the foreign parent?
- How long are Australian operations intended to be carried on?
- What is the exit strategy?
- Where will the central management and control of the Australian business be located?

The main difference between the two structures is that an Australian company would be a separate entity for tax and legal purposes, whereas a branch is not. While the same Australian corporate tax rate may apply to a branch or subsidiary, having a corporate structure in place offers some important benefits, such as:

- asset protection for the foreign parent, as the creditors of the subsidiary would be limited to the assets of the subsidiary only;
- indemnity for directors of the foreign parent for the actions of the directors of the Australian subsidiary;
- it is easier to set up an Australian bank account;
- administrative benefits, particularly when dealing with Australian government bodies, financial institutions, other businesses and Australian employees;
- tax concessions that may only apply to, or would be easier for, Australian corporate entities, such as the R&D tax incentive scheme and the tax concessions for employee share schemes; and
- the ability to repatriate income to the foreign parent via dividends.

Choosing a branch will typically be desired where a foreign business is looking to do business in Australia for a short term, with minimal trading activity, and particularly when time is a critical factor. However, if this intention shifts, there is an option to convert a branch into an Australian subsidiary. A common approach is to transfer the branch assets to a newly incorporated company. While this may trigger a capital gains tax event, a roll-over may be available.

Setting up the structure

Once an appropriate structure is determined, the next step is to formally set up the structure with the Australian Securities and Investments Commission (ASIC). A foreign company must not carry on business in Australia unless it is registered with ASIC.

To set up a branch/permanent establishment, a foreign business must:

- determine if the foreign company needs to register with ASIC (ie whether the foreign company is actually carrying on a business in Australia);
- ensure that the desired name to be registered is available;
- prepare and lodge ASIC Form 402;
- appoint a public offer;
- apply for an Australian business number (ABN) with the Australian Business Register (ABR); and
- apply for tax registrations with the ATO and/or state revenue offices.

To set up an Australian subsidiary, a foreign business must:

- choose a name;
- decide on the type of company (eg private or public) and where it will be registered;
- decide on how the company will be governed (eg by a constitution);
- choose and get written consent for the company's registered office;
- choose and get written consent from officeholders;
- decide on a share structure;
- prepare and lodge ASIC Form 201;
- appoint a public officer;
- apply for an ABN with the ABR; and
- apply for tax registrations with the ATO and/or state revenue offices.

In either case, an individual who ordinarily resides in Australia will need to be appointed as the public officer for the branch/subsidiary.

Business and tax registrations

Regardless of whether a branch or a subsidiary is set up, a foreign business looking to conduct business in Australia must apply for an ABN and a tax file number (TFN). This can be done at the same time through the ABN application form on the ABR website.

However, foreign directors need to provide additional proof of identity if they are to be listed as directors of the Australian subsidiary, which may delay the processing of the ABN and TFN applications. Foreign directors also need to have their birth certificates, passports and/or driver's licence certified by a notary, which should be attached as part of the ABN application. From our experience, the additional verification required may add another one or two months to the ABN and TFN registration process.

Additional tax registrations (eg goods and services tax and fringe benefits tax) may also be required depending on the nature and scope of the Australian operations.

Tax reporting

A branch needs to lodge an annual Australian tax return with the ATO, in which it will be assessed on its income from Australian sources and can deduct costs incurred to generate that income. An Australian subsidiary would also need to lodge an Australian tax return, but it will be assessed on its income from worldwide sources.

As most foreign tax jurisdictions do not follow the standard June year-end in Australia, a substituted accounting period (SAP) may be obtained by lodging an SAP application form with the ATO to align the accounting period of the branch/subsidiary with that of the foreign parent.

While the ATO typically accepts SAP applications for an Australian entity to align its accounting period with its foreign parent, it is best to review PS LA 2007/21 to confirm the circumstances where an SAP will be granted.

Corporate tax rate

Another benefit of incorporating an Australian subsidiary is the potential to access the reduced corporate tax rate for "base rate entities". The standard corporate tax rate is 30%, but a reduced corporate tax rate of 26% applies for base rate entities for the 2021 income year.

The reduced corporate tax rate is only available if the Australian subsidiary:

- has an "aggregated turnover" of less than A$50m; and
- does not derive more than 80% of its income from passive investments.

Under the aggregation rules, the turnover of any entity that the Australian subsidiary controls, or is controlled by, will need to be aggregated and assessed against the turnover threshold. Any interest to income, capital and/or voting rights of 40% or more is considered a controlling interest for these purposes.

Financial reporting

Generally, Australian companies that are controlled by a foreign parent will be required to prepare and lodge audited financial reports with ASIC. However, audit relief is available under *ASIC Corporations (Foreign-Controlled Company Reports) Instrument 2017/204* if the following requirements are met:

- the company must be a small proprietary company, which is any company that does not satisfy two or more of the following criteria: (1) the company has a consolidated revenue of $50m or more; (2) it has consolidated gross assets of $25m or more; (3) it has 100 or more employees;
- the company must be controlled by a foreign company for all or part of the financial year;
- the company must not be part of a large group (ie the large group must not exceed two or more thresholds specified in the first requirement above);
- the directors must have resolved to rely on the relief no earlier than three months before the commencement of each financial year for which relief under the ASIC instrument is relied on;
- for the first year of reliance on the ASIC instrument, ASIC Form 384 is lodged; and
- ASIC must not have notified the company that it may not rely on the exemption.

In order to rely on this audit relief, ASIC Form 384 must be lodged within three months prior to the start of the financial year and ending four months after the end of the relevant financial year. Failure to apply for audit relief using the form within the specified time frame may result in a costly audit, even if the subsidiary is eligible for relief.

If an overseas company is carrying on business in Australia, it will be required to lodge the foreign parent's financial statements with ASIC each year.

International tax considerations

This article will not address all of the international tax issues that could apply as, once again, this will vary depending on the size and scale of the Australian operations. However, as a general rule, a branch/subsidiary must prepare and lodge an international dealings schedule (IDS), along with the annual income tax return, if it has dealings (eg transactions or loans) with foreign related parties that exceed A$2m. While this does not result in additional tax for the branch/subsidiary, the disclosures in the IDS may prompt the ATO to investigate its dealings with the foreign parent.

Depending on the degree of dealings that the Australian branch/subsidiary has with foreign related parties, it may be prudent to prepare transfer pricing documentation to support these dealings. Transfer pricing documentation typically requires a benchmarking analysis to be conducted to prove that the cross-charges between the branch/subsidiary and the foreign parent are at "arm's length" for tax purposes. This is a very specialised area of Australian tax law and a costly exercise to put in place.

Where the Australian branch/subsidiary is financed by a loan from a foreign related party, the thin capitalisation provisions also need to be considered where the interest expense on the loan exceeds A$2m. These provisions are complex to navigate and may effectively limit the interest expense deductible in Australia for entities that are heavily funded by debt relative to funding from equity.

Significant global entities

It is important to determine whether the Australian subsidiary is considered a "significant global entity" (SGE). Broadly, an SGE is any entity that is part of a group with annual global income of A$1b or more.

In addition to being subject to the country-by-country reporting regime, SGEs are subject to significantly higher administrative penalties. For example, an SGE could be fined a failure-to-lodge penalty of at least $111,000 for lodging an activity statement a few days late, whereas a large company that is not an SGE would only be fined $1,110 in the same circumstances.

Conclusion

Clearly, an administrative obstacle course is to be navigated before deciding how to do business in Australia. While some of the issues discussed in this article are more relevant to foreign businesses that are on the larger end of the spectrum, the reporting requirements for foreign controlled branches/subsidiaries are generally onerous, regardless of size.

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Higher Education

The foundation for providing holistic tax advice

The dux of CTA1 Foundations study period 3 explains the benefits of taking this core subject that covers the key components of the Australian tax system.

Bryan Soepardi, Assistant Manager, RSM Australia, NSW

Please provide a brief background of your career in tax.

I provide R&D tax advice to a cross-section of Australian businesses. I have enjoyed presenting technical papers at conferences and advised listed companies on change management initiatives. As a UTS Finance Honours graduate, I have also worked on financial modelling and tax advice in relation to the interaction of R&D tax benefits with other areas of Australian and New Zealand income tax law.

What was the reason for undertaking CTA1 Foundations?

Despite the potential to obtain an exemption for this subject, I elected to undertake this subject to re-acquaint myself with the "foundations" of taxation law. I found the subject to have an optimal balance of depth and breadth, with a focus on the practical skills required in a day-to-day role as a tax adviser.

What skill or knowledge areas have you gained by undertaking this subject?

I have gained an understanding of several key components of the Australian tax system, including an introductory yet practical grasp of how to apply the capital gains tax, small business entity and goods and services tax provisions, the tax implications of various business structures, and the components and key provisions and precedents informing the determination of taxable income.

Have you applied this new knowledge in your role?

Yes, the Structures module in particular has already provided a foundation for understanding the tax and legal implications of different business structures across a range of our clients' circumstances.

How did you juggle study, work and other commitments?

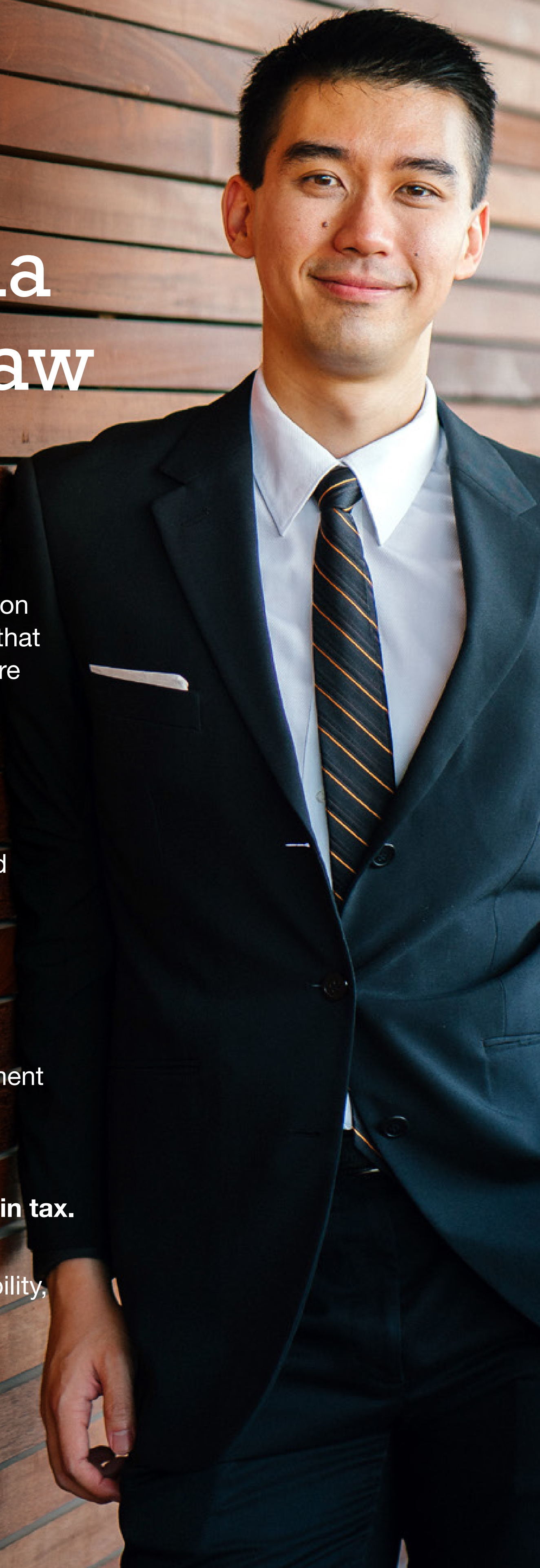
Prudent time management and an understanding employer! Book out your study leave in advance, communicate with your team regularly about your workload, and be unfailingly diligent in sticking to your study schedule.

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

Attaining my Chartered Tax Adviser qualification, then perhaps pursuing a Masters in Taxation!

What advice do you have for other tax professionals considering structured learning?

I view each of The Tax Institute's education programs as prerequisites for the contemporary tax professional. These programs provide a comprehensive and current review of all areas of tax law that together function as the foundation for providing good, holistic tax advice.



2021-22 Budget highlights

by Robert Campbell, CTA, Director, McLeod Campbell & Associates

Following on from the chaos of 2020, we take a look at measures proposed in the 2021-22 Budget which was handed down in the midst of a remarkable economic recovery, albeit with the shadows of COVID-19 still lurking. Australia's economy has rebounded strongly from shutdowns, border closures, international freight challenges and trade disputes. However, with the backdrop of the dreaded virus escaping quarantine and bourgeoning government debt, the road to recovery will be bumpy and somewhat uncertain. The 2021-22 Budget attempts to further encourage the economic recovery by preserving with tried and trusted methods of cutting taxes and encouraging business capital expenditure. Unfortunately, this means that any hope of taxation reform will need to be stashed away for another day.

Personal tax

Medicare levy low-income thresholds

The Medicare levy low-income thresholds are set to increase from 1 July 2020, as follows:

- singles: from $22,801 to $23,226;
- families: from $38,474 to $39,167;
- single seniors: from $36,056 to $36,705; and
- family seniors: from $50,191 to $51,094.

Family income thresholds increase by $3,597 (previously $3,533) for each additional dependent child or student.

LMITO

The government announced that the temporary low and middle income tax offset (LMITO) is to be retained at least until the 2021-22 income year.

To recap, the LMITO is determined based on taxable income:

- $37,000 or less: the offset is $255;
- between $37,000 and $48,000: the value of the offset increases at a rate of 7.5 cents per dollar to the maximum offset of $1,080;
- between $48,000 and $90,000: taxpayers are eligible for the maximum offset of $1,080; and
- between $90,000 to $126,000: the offset phases out at a rate of 3 cents per dollar.

Given the difficult economic climate, the author is of the opinion that this is a positive decision which will assist with the economic recovery.

Child care subsidy

In an attempt to make child care more attractive and to encourage increased levels of workforce participation, the child care subsidy (CCS) will change as follows:

- 30 percentage points for the second child and subsequent children aged five years and under in care, up to a maximum CCS rate of 95% for these children, commencing on 1 July 2022; and
- the CCS annual cap of $10,560 per child per year will be removed commencing on 1 July 2022.

While the author welcomes attempts to improve the accessibility of child care, he considers the proposal to be unnecessarily complex such that the goal of the proposal might be missed.

It is the author's view that holistic tax reform will offer up an opportunity to address underlying systemic issues which are limiting access to child care.

Self-education expenses

The non-deductibility of the first $250 of self-education expenses is set to be removed. The author welcomes this measure as it cleans up legislation left behind by historical changes.

Exemption for pay under Operation Paladin

Australian Defence Force personnel will be entitled to a full tax exemption on pay and allowances derived while deployed to Operation Paladin.

Superannuation

Abolition of the work test for those under 75

The work test for superannuation contributions is set to be abolished for those aged between 67 and 74, effective 1 July 2022.

The work test requires a taxpayer to work at least 40 hours during a 30-day period to be able to make voluntary superannuation contributions during an income year.

This measure will enable those aged 67 and over to increase their superannuation balances without having to meet an arbitrary test.

The author lauds this announcement despite the curious one-year delay in implementation.

Downsizer extension

The downsizer concessions enable an eligible taxpayer to make contributions to superannuation over and above their contribution caps and their transfer balance cap on selling a home in which they have lived for at least 10 years.

The maximum downsizer contribution is $300,000.

While these measures have been in place since 1 July 2018, it is estimated that only 22,000 households have taken advantage of this concession.

In order to assist with take-up of the concession, the minimum age will be lowered from 65 to 60, effective 1 July 2022.

The author supports measures which not only encourage the self-funding of retirement, but also encourage more housing stock to be available to growing families. However, with the proceeds under this measure counting towards the asset test for pension purposes, it remains to be seen if this change will increase the take-up rate of these rules.

Abolition of the superannuation guarantee $450 threshold

The government announced that, effective 1 July 2022, the current $450 monthly threshold in which superannuation contributions are mandated will be removed. The rationale behind this is that the $450 minimum earnings threshold effectively penalises about 300,000 employees, of which 60% are female.

With increased casualisation of the workforce, there are risks that some with multiple casual employers are being left behind by the superannuation system.

One word of caution, however, is that of the protection of low member balances. The author would like to see more measures adopted to prevent low superannuation balances from being eroded or lost, such that employers are faced with a superannuation burden while employees ultimately fail to realise a benefit, creating a lose–lose situation.

Relaxation of superannuation residency rules

In what is a pleasing decision, the government announced that the residency rules for self-managed superannuation funds (SMSFs) will be relaxed.

In order to remain a complying fund, an SMSF must be a resident fund. A superannuation fund is a resident where:

- the fund is established in Australia or has an asset in Australia;
- central management and control (CMAC) of the fund is in Australia; and
- the fund's active members must be Australian residents and must hold at least half of the fund's assets.

Currently, the CMAC requirement is deemed as satisfied for absences outside Australia for up to two years. Under the proposal, this two-year exception will be increased to five years.

The author welcomes this decision to lessen some practical concerns of workforce globalisation and mobility.

Transfer to KiwiSaver

The government announced additional funding for the ATO to better administer a scheme for transferring unclaimed superannuation to KiwiSaver accounts, which is the New Zealand equivalent of superannuation.

Small-to-medium enterprise taxpayers

Temporary full expensing

The current temporary measure allowing businesses with turnovers of up to $5b to fully deduct the cost of new depreciable assets will be extended by a further 12 months, such that it applies to new assets installed ready for use by 30 June 2023. However, the ability to fully deduct second-hand assets is limited to businesses with turnovers of under $50m, consistent with the current scheme.

While the author welcomes this measure in an attempt to further boost Australia's economic recovery, he cautions against the chasing of deductions at the expense of the financial position of a business.

Loss carry-back

The current loss carry-back rules will be extended by a further 12 months, with losses incurred up to the year ending 30 June 2023 being eligible to be carried back to the year ended 30 June 2019.

The current conditions will remain in place, that is:

- losses can only offset previously taxed profits; and
- a franking account deficit cannot be generated by the carry-back.

Employee share schemes

The government is proposing to remove the cessation of employment as a taxing event under an employee share scheme. As such, the taxing point will be deferred until the earliest of:

- in the case of shares, when any real risks of forfeiture are lifted and when disposal restrictions are lifted;
- in the case of options, when the option is exercised and any real risk of forfeiture over the resulting shares are lifted; or
- 15 years.

The government anticipates that this measure will make it easier for companies to offer employee share schemes.

SME recovery loans

Further to government announcements made during March 2021, the creation of SME recovery loans will continue on from the Coronavirus SME Guarantee Scheme.

Under the SME recovery loan scheme, the government will provide a guarantee for 80% of the loan, reducing the exposure of financial institutions to a mere 20% of the loan amount. However, to be eligible for a loan under this scheme, a business must:

- have a turnover of under $250m; and
- have been entitled to JobKeeper from 4 January 2021 or otherwise impacted by the recent NSW floods.

Unlike the predecessor schemes, loans under this arrangement can be for a maximum term of 10 years, can be secured against non-residential property, and must not carry an interest rate above 7.5%.

In light of the poor uptake of loans under the original schemes, it is hoped that the 80% guarantee, increased loan term and ability to take security will assist lenders in extending credit to businesses which require further assistance.

However, the author feels that the requirement to have been eligible for the last round of JobKeeper severely limits the ability for businesses which are still in financial distress to obtain necessary funding.

Corporate tax

Digital games offset

The government announced a tax offset at a rate of 30% of eligible expenditure on approved digital games.

The minimum expenditure under the offset is to be set at $500,000.

Industry consultation will take place during mid-2021 to further develop the detail around this proposal.

The aim of this measure is to provide support to other technology sectors by using gaming as a means to foster talent.

While the author welcomes this announcement, it is hoped that the government goes further to assist software development in Australia.

Effective life of intangible assets

The government announced that depreciable intangible assets acquired from 1 July 2023 will no longer be subject to the statutory effective lives.

From 1 July 2023, taxpayers will be able to self-assess the effective lives of new investments in patents, registered designs, copyrights and in-house software.

It is hoped that this measure will increase the attractiveness of using Australia as a hub to invest in and develop such intellectual property.

Patent box

The government announced the implementation of a patent box for medical and biotechnology patents. Under this proposed measure, income derived from qualifying medical and biotechnology patents will be taxed at the rate of 17%, compared with the corporate tax rate of 25% to 30%.

The government intends to consult closely with industry on the design of the patent box. The government will also explore whether expanding the patent box would be an effective way of supporting clean energy.

The author welcomes the announcement of a patent box and looks forward to participating in consultation with the government on its policy and design.

An internationally competitive patent box regime will support Australian businesses to undertake and commercialise their R&D and to continue to innovate. This will support the creation of skilled jobs in Australia. The design principles appear to be consistent with other regimes (albeit at a higher rate) and should not fall foul of OECD harmful practice regimes.

Corporate entity residency

The government announced amendments to clarify the corporate tax residency test. The amendments are in light of recommendations by the Board of Taxation and are intended to address uncertainty for foreign incorporated entities.

The government also announced that it will consult on broadening these amendments to extend to trusts and corporate limited partnerships (CLPs), which are subject to their own separate but similar residency tests.

The author welcomes the announcement that the government will consult on broadening the amendments which were announced in the federal Budget 2020-21 to extend to trusts and CLPs.

Taxation of financial arrangements

Technical amendments will be made to the taxation of financial arrangement (TOFA) provisions to facilitate access to the hedging method on a portfolio hedging basis.

The intention of these amendments is to reduce compliance costs and correct unintended outcomes such that taxpayers are not taxed on unrealised foreign exchange gains and losses unless this is elected.

This is yet a further attempt to make the TOFA hedging rules work. These rules have been the subject of much criticism since inception because they have failed to address the financial sector's practices.

The fundamental problem is having implemented such specific rules when the normal assessing, deduction and capital gain and loss rules could easily be amended in a very straightforward way to deal with hedging.

These changes will take effect on a prospective basis, applicable to relevant transactions that are entered into from 1 July 2022.

Corporate collective investment vehicles

The government announced that legislation will be enacted to introduce corporate collective investment vehicles (CCIVs) from 1 July 2022 (CCIVs were first announced in the 2016-17 Budget's "Ten Year Enterprise Tax Plan" measures).

The CCIV is an investment vehicle that has a corporate structure but with a flow-through tax treatment, to be used in the managed funds industry.

The government's aim of the CCIV is to enhance Australia's international competitiveness by allowing fund managers to offer investment products through vehicles that are more familiar with foreign investors.

The government previously proposed a CCIV tax and regulatory framework in the Treasury Laws Amendment (Corporate Collective Investment Vehicle) Bill 2017 and the Corporate Collective Investment Vehicle Bill in 2019, which set out:

– how its establishment, operational and regulatory requirements would be governed by a new Ch 8B of the *Corporations Act 2001* (Cth);
– certain amendments to other legislation such as the *Personal Property Securities Act 2009* (Cth) to support its implementation; and
– the tax legislation to govern its tax treatment, including features of an attribution regime.

Broadly for tax, the flow-through tax treatment of CCIVs is intended to align with that of attribution managed investment trusts, and investors in CCIVs generally will be taxed based on the underlying nature of the investment assets.

This proposal finds its origin in Board of Taxation reports going back over a decade and a regime that has been promised by successive governments over a similar time frame. One suspects that it is not quite as important to those governments as they have made out. The author expects that there will be new focus on these Bills, or least their content, as the government moves forward to implement CCIVs.

Other measures

Some other announcements include:

- $10.7m in funding a pilot program for digital cadetships;
- funding for an overhaul of the MyGov and My Health Record systems; and
- a review of the venture capital tax concessions, which will be subject to public consultation during 2021.

International tax

Individual tax residency

The government has announced that it will adopt the recommendations of the Board of Taxation contained in its *Reforming individual tax residency rules — a model for modernisation* report.

The current individual tax residency test is based on principles around residency, domicile, permanent place of abode, and some clearer tests such as the 183-day rule. This is the same as many other jurisdictions, even those that have a primary citizenship test.

The proposed changes will adopt a set of rules that start with a two-step process. The first step is a "bright line test" — the 183-day test as is presently the case.

Failing this 183-day test, the individual will need to test whether they are a continuing resident or commencing residency pursuant to secondary rules. While the proposed rules claim to be more targeted and objective, residency will still depend on each individual's circumstances.

These secondary rules set out criteria as to when an individual, who is in Australia for less than 183 days in an income year, commences or ceases residency and these rules adopt a day-count test, together with a new "factor test", that is, four objective factors of which any two need only be satisfied for an individual to commence to be resident. These are:

1. the right to reside permanently in Australia (including citizenship and permanent residency);
2. the ability to access Australian accommodation;
3. the presence in Australia of close family; and
4. the presence of Australian economic connections.

Some of these criteria are somewhat flexible concepts in themselves.

The author notes that the Board's report was not without controversy. What has been traded is a facts and circumstances test (criticised for uncertainty) with a set of tests that are considerably more complex.

The individual tax residency tests may lead to a more certain outcome once the complexities are worked through, and it is likely that more taxpayers will be treated as residents.

Removal of offshore banking unit concessions

The government announced the abolition of the current tax concessions enjoyed by offshore banking units (OBUs), which currently attract a 10% tax rate. This announcement is in light of OECD concerns about the OBU concessions being a harmful tax regime.

The current concessions will remain available to existing OBUs until the 2022-23 income year.

Exchange of information

The government will increase the number of countries with which Australia shares information to include:

- Armenia;
- Cabo Verde;
- Kenya;
- Mongolia;
- Montenegro; and
- Oman.

Residents of these jurisdictions will also be able to access the 15% withholding tax on managed investment trusts.

> *"The 2021-22 Budget is a fair attempt at encouraging Australia's economic recovery; however, it falls well short of reforming the tax system."*

Tax administration

Pausing debt recovery for small business

The author welcomes the move by the government to enable small businesses to apply to the Small Business Tax Division (SBTD) of the Administrative Appeals Tribunal (AAT) to pause or modify ATO debt recovery actions where the debt is being disputed within the AAT.

A small business for this purpose is defined as those with an aggregated turnover of less than $10m.

Currently, businesses must apply through the courts to pause or modify ATO debt recovery actions.

These changes will allow the SBTD of the AAT to pause or modify any ATO debt recovery actions (such as garnishee notices and the recovery of the general interest charge or related penalties) until the underlying dispute is resolved by the AAT.

ATO early engagement service

The government has announced that the ATO will introduce a new early engagement service to encourage and support new foreign business investments in Australia.

The service is envisaged to provide assurance to foreign investors about the operation of Australian tax laws and support in relation to federal tax obligations.

The author welcomes the announcement of this initiative and looks forward to participating in consultation with the ATO.

Other measures

Excise refund cap for small brewers

Effective 1 July 2021, eligible brewers and distillers will be able to receive a full remission of any excise they pay, up to an annual cap of $350,000.

Currently, eligible brewers and distillers are entitled to a refund of 60% of excise paid, up to an annual cap of $100,000.

JobTrainer Fund extension

The government will extend the JobTrainer Fund by providing $506.3m over two years from the 2021-22 income year.

The extended JobTrainer Fund will deliver a further 163,000 low fee and free training places, including 33,800 training places for existing and new aged care workers to upskill and 10,000 places for digital skills courses.

HomeBuilder Program

The HomeBuilder Program will be modified such that construction commencement will need to commence within 18 months of signing a building contract.

This measure provides further time for approved HomeBuilder participants as the original requirement was that construction had to commence within six months.

Home ownership for families

The government has several initiatives to support an individual's entry into the housing market by way of loan guarantees with eligible lenders.

Proposed to commence from 1 July 2021, the Family Home Guarantee will provide support to 10,000 single parents with dependants to enter or re-enter the housing market with a deposit of at least 2%.

The Family Home Guarantee is aimed at single parents with dependants, regardless of whether that single parent is a first home buyer or a previous owner-occupier.

Applicants must be Australian citizens of at least 18 years of age and have an annual taxable income of no more than $125,000.

The government also announced an extension of the existing First Home Loan Deposit Scheme for an additional 10,000 eligible participants, which will be available between 1 July 2021 and 30 June 2022. This scheme guarantees up to 15% of the property purchase price for eligible first home buyers seeking to build or purchase a newly built home.

Not-for-profits

Currently, not-for-profits (NFPs) can self-assess their eligibility for income tax exemptions with no reporting requirements to the ATO. From 1 July 2023, the ATO will require income tax-exempt NFPs with an active ABN to submit an online confirmation of their eligibility for income tax exemptions.

This measure will ensure that only eligible NFPs are accessing the income tax exemptions.

Deductible gift recipients

The following organisations have been approved as deductible gift recipients (DGRs):

– Australian Associated Press Ltd;
– Virtual War Memorial Ltd;
– Scripture Union Queensland.

The DGR status of the following organisations has been extended for a further five years:

– Cambridge Australia Scholarships Ltd; and
– Foundation 1901 Ltd.

The East African Fund Ltd (operating as School of St Jude Ltd) has been removed from the listing at the request of the organisation.

Conclusion

The 2021-22 Budget is a fair attempt at encouraging Australia's economic recovery; however, it falls well short of reforming the tax system. In this sense, it could be concluded that this is an "election Budget", designed to maximise the government's re-election hopes.

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Cash flow boost: questions on interpretation

by Bill Mavropoulos, Partner, VT Advisory

Tax practitioners can be forgiven for thinking that, if their clients have missed out on the cash flow boost, it is now too late to apply for this concession. Contrary to this assumption, a review of the cash flow boost arising in the quarterly business activity statement period 31 March 2020 can be instituted two years after the lodgment due date of that business activity statement. This article explores a different interpretation to that of the Australian Taxation Office of the eligibility criteria in the cash flow boost rules. The interpretation is relevant for taxpayers that are quarterly lodgers formed between 1 January 2020 and 12 March 2020. The interpretation uses established principles of statutory construction that have been reviewed by the Inspector-General of Taxation, and has been used as the basis for objection to the denial of the cash flow boost that was ultimately successful, albeit on a different basis.

The Australian Taxation Office has in recent times been challenged by the Inspector-General of Taxation (IGT) to review cash flow boost applications for taxpayers that may have commenced operations in January 2020 and are deemed ineligible by the ATO.

The principal argument that the IGT has levied is that the opening of a bank account in the December 2019 period may, in certain circumstances, be used to meet the requirement to have taxable supplies as modified by the cash flow boost legislation in a quarter ending before 12 March 2020 for quarterly lodgers.

Another potential pathway lays unexplored by tax practitioners as it relies on skills of statutory interpretation. The eligibility of any given business needs to be assessed by tax practitioners with reference to the underlying legislation and regulations, not ATO interpretations of these.

ATO decisions and interpretation

The ATO interpretation of eligibility in relation to "taxable supplies" is expressed as giving the ATO notice on or before 12 March 2020 that a taxpayer meets one of the following conditions:

- the taxpayer derived assessable income in relation to carrying on a business in 2018-19; or
- the taxpayer made a taxable, GST-free or input taxed supply (or a sale that would have been such a supply if you were registered for GST) for any tax period that started on or after 1 July 2018 *and ended before 12 March 2020*.

Relevantly, this is the ATO interpretation of a relevant provision of tax law. This is not the exact wording of the provision itself. A fundamental principle of statutory interpretation is to always distil meaning from the original text of the provision. To do the arduous work of going behind the ATO interpretation and critically evaluate whether the practitioner agrees with the ATO interpretation.

Importantly, before an ATO discretion can be requested, the meaning of the eligibility provision words should be reviewed. The discretion is typically requested when notification of the relevant taxable supplies as relevantly defined has been made to the ATO and is late.

Exact wording of provision

The eligibility criteria can be found in s 5(6) of the *Boosting Cash Flow for Employers (Coronavirus Economic Response Package) Act 2020* (Cth) (the cash flow boost law), which reads as follows:

> "For the purposes of paragraph (1)(f), the requirement in this subsection is satisfied if:
>
> (a) the entity made a taxable supply in a tax period that applied to it that:
>
> (i) started on or after 1 July 2018; and
>
> (ii) ended before 12 March 2020; and
>
> (b) the Commissioner had notice on or before 12 March 2020 (or a later time allowed by the Commissioner) that the entity had made the taxable supply."

The key here is to read the words of the provision in their context in order to arrive at their meaning.

Two interpretations

On a close and careful reading of the provision, it is quite evident that two different interpretations may be applied depending on how one reads the words of the provision in their context.

The first interpretation is the one that the ATO makes: that the *taxable supply* and the *tax period* are the objects that must fall between 1 July 2018 and 12 March 2020 (the ATO interpretation).

However, on the face of the words used, another interpretation is open that can reasonably be made out. This other interpretation is that the sole object that must fall within the period started on or after 1 July 2018 and ending before 12 March 2020 is a taxable supply (the alternative interpretation).

Exploring the two interpretations

The guidance in correctly construing a legislative provision commences with an examination of the purpose of the provision. Guidance on this is set out as follows in s 15AA of the *Acts Interpretation Act 1901* (Cth):

> "In interpreting a provision of an Act, the interpretation that would best achieve the purpose or object of the Act (whether or not that purpose

> or object is expressly stated in the Act) is to be preferred to each other interpretation."

The leading case on statutory interpretation provides further guidance on construction. The case, *Project Blue Sky Inc v Australian Broadcasting Authority*,[1] relevantly provides:

> "The primary object of statutory construction is to construe the relevant provision so that it is consistent with the language and purpose of all the provisions of the statute."

The purpose of the cash flow boost law self-evidently is to provide cash flow relief to employers that existed before 12 March 2020 and the onset of the COVID-19 pandemic. This can be gleaned from the explanatory memorandum provided with the Bill enacting the cash flow boost law and the words of the legislation as a whole.

As a matter of logic, a tax practitioner should keep in mind that s 5(6)(b) of the cash flow boost law provides for a discretion to report taxable supplies later but does not extend that discretion to tax periods ending late.

When one drills down into the relevant legislation, the purpose of the eligibility provision in the cash flow boost law is to act as a prerequisite that must be satisfied to meet the requirements of s 5(1)(f) of the cash flow boost law (the related provision). This related provision relevantly reads as follows:

> "An entity is entitled to a payment (known as a ***cash flow boost***) for a period covered by subsection (2) if:
>
> …
>
> (f) either:
>
> (i) the entity is an ACNC-registered charity at any time in the period; or
>
> (ii) the entity had an ABN on 12 March 2020 (or a later time allowed by the Commissioner), and the requirement in subsection (5) or (6) is satisfied; and"

This highlights two relevant considerations in respect of the related provision that are relevant to the construction of the eligibility provision. First, it appears that a registered charity (provided it is registered from 1 March 2020) will meet the related provision. Second, the implicit purpose of parliament when considering this related provision is undoubtedly that an entity with an ABN on 12 March 2020 (provided they met additional requirements) should meet this condition.

Based on the purpose for the eligibility provision gleaned from a close reading of the related provision, it would be reasonable to form the view that the additional requirements applying to entities that are not registered charities are meant to act as an integrity measures to ensure that only entities running legitimate businesses and making taxable supplies as at 1 March 2020 at the latest (being the same day that the charity requires registration) should be allowed to claim this concession.

The case for an alternative interpretation

To determine whether the ATO interpretation or the alternative interpretation should be preferred at tax law, reference should also be had to a specific tax law precedent on the constructional issue for a tax provision. Relevantly, Gibbs J in *Cooper Brookes (Wollongong) Pty Ltd v FCT*,[2] stated that:

> "On the other hand, if two constructions are open, the court will obviously prefer that which will avoid what it considers to be inconvenience or injustice. Since language, read in its context, very often proves to be ambiguous, this last mentioned rule is one that not infrequently falls to be applied."

In light of this rule, on application of the ATO interpretation, a taxpayer with a business activity cycle that is monthly will be able to access the cash flow boost where their first taxable supplies are in January or February 2020, but quarterly cycle entities will not.

To put this another way, according to the ATO interpretation, taxpayers that commence business from 1 January 2020 and lodge quarterly (when they have formidable start-up costs and professional fees) will be ineligible for the cash flow boost regardless of making taxable supplies from inception until 12 March 2020. If these taxpayers were monthly lodgers, however, they would be eligible. A rejection of the ATO interpretation and acceptance of the alternative interpretation would cure this injustice.

If the alternative interpretation is accepted, a taxable supply would need to be made by an entity between 1 July 2018 and 12 March 2020. The supply would need to fall within a tax period but that tax period would not be constrained by any dates. The only thing constrained by dates would be the taxable supply itself. In this manner, monthly and quarterly lodgers would be treated in the same way for the purposes of the eligibility provision. All businesses commencing from 1 January 2020 would be able to receive much needed assistance in meeting start-up and professional costs that would have otherwise been met from normal trading revenue.

Application to a particular taxpayer's facts

Consider a particular taxpayer that made taxable supplies as required between 1 July 2018 and 12 March 2020. When considering the eligibility of this taxpayer, the only question arising is whether the ATO will apply a discretion to do away with the notification requirements for these taxable supplies.

The inability to apply discretion as to the tax period that a taxable supply falls into would no longer be relevant. Indeed, the way the provision is drafted hints that it was always parliament's intention to constrain when taxable supplies would meet the eligibility criteria but never to apply this second test of when a tax period itself would end.

Takeaway

The ability to question an ATO interpretation is a key skill of specialist tax practitioners. In this and other areas of the tax law, interpretation is critical in guiding clients and constructively engaging with the ATO on differing interpretations. This is because businesses that missed out on this concession deserve clarity in relation to their entitlements, as do all Australian taxpayers.

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References

1 [1998] HCA 28 at [69].

2 [1981] HCA 26 at [6].

Inbound interest-free loans: part 2

by Ellen Thomas, ATI, Partner, PwC

This is the second part of a two-part article that considers tax issues that can arise in relation to inbound interest-free loans. The first part focused on the varied circumstances in which an interest-free loan could be treated as an equity interest for tax purposes. This second part discusses other issues that can arise in relation to interest-free loans, such as s 45B of the *Income Tax Assessment Act 1936* (ITAA36) (if the loan is treated as an equity interest), whether an interest-free loan should be included in adjusted average debt for thin capitalisation purposes, cost base issues, Div 7A ITAA36, and the commercial debt forgiveness rules. While interest-free loans are relatively simple instruments that are commonly used in a company's capital structure, it is clear that significant complexity can arise if an interest-free loan is closely examined.

Section 45B

Application of s 45B if the IFL is an equity interest under Div 974

If the interest-free loan (IFL) were an equity interest under Div 974 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97), s 45B of the *Income Tax Assessment Act 1936* (Cth) (ITAA36) would need to be considered in relation to repayments of the IFL. Section 45B is concerned with ensuring that companies do not distribute what are effectively profits to shareholders as preferentially-taxed capital rather than dividends.

If s 45B applies, repayments of principal under the IFL may be treated as unfranked dividends. As such, dividend withholding tax[1] would be payable on repayments made to non-resident lenders, and Australian resident lenders would be required to include the repayments in their assessable income.[2] It is also possible that the ATO could debit the borrower's franking account.

PS LA 2008/10 addresses returns of capital. The same analysis applicable to shares should apply to an IFL. If the IFL is treated as an equity interest, the s 45B analysis is complex.

Application of s 45B if the IFL is an equity interest under the transfer pricing rules

Section 45B ITAA36 can only apply if a person who entered into or carried out any part of the scheme did so for a purpose of enabling a taxpayer to obtain a tax benefit.

The significant difficulty in applying the purpose test in s 45B if the IFL is treated as an equity interest under the transfer pricing rules is that the equity interest arises due to a substitution of the arm's length conditions. There would be no relevant entity that had any purpose of providing a capital benefit under an equity interest and therefore it is likely that s 45B would not apply.

Thin capitalisation

Generally, the thin capitalisation rules only apply to the extent that the borrower's adjusted average debt (AAD) exceeds its maximum allowable debt (determined, for example, under the safe harbour debt test or the arm's length debt test). A key advantage of debt interest IFLs is that they are typically not included in the borrower's AAD for thin capitalisation purposes and so do not impact the borrower's thin capitalisation position. However, in some situations, a question arises as to whether the IFL should in fact be excluded from AAD (as discussed below).

Debt deductions: TD 2019/12

TD 2019/12 concerns the definition of "debt deduction" in s 820-40(1)(a)(iii) ITAA97. TD 2019/12 states that all deductible costs of raising finance through debt capital incurred directly in connection with the debt capital, and all deductible costs directly incurred in maintaining the financial benefit received in association with the debt capital, are debt deductions within the scope of s 820-40(1)(a)(iii). An example of such costs are the costs of tax advisory services giving rise to or in connection with the IFL, including drafting agreements and valuing or pricing the debt capital.

Notably, the TD 2019/12 contemplates (at para 20) that costs may be apportioned to various instruments. Therefore, a fee paid for advice in relation to a refinance (but not specifically to an IFL) may arguably be apportioned such that some of the costs are allocated to the IFL.

There is no monetary threshold in the definition of "debt deduction", so it is likely that even $1 of costs that could be allocated to an IFL would be relevant. Further, the deduction does not need to actually be claimed; the deduction just needs to be available (s 820-40(1)(b)).

Given the broad approach in TD 2019/12, it is very likely that an entity that has put an IFL in place has either paid someone to draft the agreement, to value the instrument, or to provide tax advice in relation to the instrument.[3] It is therefore expected that IFLs may be included in the taxpayer's AAD, at least according to the ATO.

Numerous concerns with TD 2019/12 have been raised.[4] The question of how advisory or drafting costs relate to "obtaining or maintaining the financial benefits" under an IFL is especially perplexing. The ATO unsatisfactorily addresses this issue by stating that it is a factual enquiry as to whether the costs (relevantly apportioned) have a "close and direct connection" with obtaining or maintaining the financial benefits received or to be received. However:

- s 820-40(1)(b)(iii) ITAA97 refers to amounts "directly incurred in obtaining or maintaining the financial benefits received" and do not refer to the debt interest itself. Therefore, costs that relate to the actual flow of finance (s 974-20(3) ITAA97) should arguably be distinguished from costs that relate to the instruments that create the legal obligations (s 974-55 ITAA97). This would mean that things like legal costs and the mere costs of accounting for an instrument and tax advisers or valuers etc would be irrelevant; and
- the relevant costs that are listed as examples in s 820-40(2) ITAA97 (especially in para (b), relating to the discount in respect of a security, and para (c), relating to fees and charges) are costs directly incurred in relation to securing the debt rather than obtaining advice on the terms, scope and consequences of default.

Assuming the IFL is included in thin capitalisation, a question then arises as to what amount is to be included in AAD. The starting point is generally the "average value" of the debt capital. From an accounting perspective, an IFL is recorded at its net present value, with the difference between face value and net present value recorded in equity (net of deferred tax). The discount is then "unwound" to profit and loss over its term. Assuming the IFL should be included in AAD for thin capitalisation purposes, the question arises as to what value should be picked, ie whether it should be the discounted accounting liability, or the discounted liability plus the portion recognised in equity.

The ATO appears to favour the conclusion that an IFL should be valued at face value. Paragraph 5 of TD 2020/2 provides that:

> "An entity's debt capital must be valued in its entirety in the manner required by the accounting standards regardless of whether it comprises debt interests that are classified as financial liabilities, equity instruments or compound financial instruments under the accounting standards."

Cost-free debt capital

Where an IFL is "cost-free debt capital", it is added to an entity's AAD calculation (under s 820-85 ITAA97 for an outward investor (non-authorised deposit-taking institution) or under s 820-185 ITAA97 for an inward investor (non-authorised deposit-taking institution). Once an IFL is cost-free debt capital and included in AAD, it will also be included in "average debt" for the purposes of determining the extent to which debt deductions are denied (under s 820-115 or 820-220 ITAA97).

Cost-free debt capital is only a relevant consideration if no debt deductions (under s 820-40(1)(a) ITAA97) are allocated to the IFL (ie the IFL is not otherwise included in AAD).

The cost-free debt capital rules were inserted as an integrity measure to ensure that there would not be an increase in the borrower's assets without any corresponding increase to its AAD. The concern of the legislature was that there would be an opportunity for the safe harbour debt amount calculations to be manipulated by providing an IFL and then repaying it shortly after the borrower's valuation day.[5]

An IFL will be treated as "cost-free debt capital" only where:

- the lender and the borrower use different valuation days or a different number of valuation days (assuming the lender is itself subject to the thin capitalisation rules) (s 820-946(3) ITAA97); or
- the loan is for less than 180 days (s 820-946(4)).

Where a borrower has non-resident lenders provide an IFL, cost-free debt capital is unlikely to be a material issue. However, where a resident lender provides the IFL, the borrower will require information regarding the lender's own approach to thin capitalisation in order to ensure that the IFL is not cost-free debt capital.

> *"The question of how advisory or drafting costs relate to 'obtaining or maintaining the financial benefits' under an IFL is especially perplexing."*

Cost base issues

Valuation issues

An IFL will generally be worth less than the face value of the loan. In a market transaction, the market value of a debt instrument should be equal to its face value on issue. Since an IFL has no interest payable at inception, the market value will be lower than the face value.[6] This is because the time value of money needs to be taken into account.

Dealing at arm's length

Given the difference between the face value and market value of an IFL, it becomes relevant whether the borrower and lender have dealt with each other at arm's length in relation to the IFL. If the answer is no, in some circumstances, for tax purposes the cost of the IFL will be its market value rather than its face value.

Generally, the question is whether the "dealing" was at arm's length, not whether the parties are arm's length parties. The case law on dealing at arm's length is well known and is not explored in this article.[7]

Typically, the borrower and the lender in relation to an IFL would not be dealing at arm's length. An IFL is an instrument that is not readily observable between unrelated parties and it is assumed, for the purposes of this discussion, that the IFL has not resulted from an arm's length dealing between the parties.

CGT

An IFL is a CGT asset from the lender's perspective. The CGT rules are not relevant to the borrower as the IFL is not an asset.

Assuming the parties did not deal at arm's length with respect to the IFL, the market value substitution rule in s 112-20 ITAA97 may apply to change the first element of the cost base of the loans[8] as the lender paid more than the market value of the IFL to acquire it. When the IFL ends (eg by being repaid), CGT event C2 would happen, and it would be expected that the lender would make a capital gain due to the amount received (ie the face value) exceeding the cost base.

A non-resident would generally disregard any such gain (under s 855-10 ITAA97), unless the IFL is held through a permanent establishment. The IFL would not be taxable Australian real property, nor would it be an indirect Australian real property interest, as the IFL would not be a "membership interest"[9] in the company (even if the IFL is an equity interest for the purposes of Div 974 ITAA97).

Traditional securities

Section 26BB ITAA36 would similarly recognise a "gain" on redemption of the IFL, assuming the parties are not dealing with each other at arm's length and the Commissioner makes a relevant determination.[10] However, TR 96/14 provides (at paras 90 to 91) that an adjustment would not normally be made in relation to an IFL.

Qualifying securities

If parties are not dealing at arm's length, the issue price of the security can be taken to be the consideration that might reasonably be expected for the issue of the security (s 159GP(2) ITAA36). However, this does require a Commissioner determination. As is the case for traditional securities, the Commissioner is unlikely to make a determination in relation to an IFL unless there are unusual circumstances.[11]

Even if the Commissioner did make an adjustment to the IFL under s 159GP(2), this would be disregarded for the purposes of the withholding tax provisions (s 128AA(2) ITAA36).

TOFA

Division 230 ITAA97 contains an arm's length dealing adjustment (s 230-510). However, this does not apply to the cessation of a debt interest or loan. The explanatory memorandum to the Bill that became the Tax Laws Amendment (Taxation of Financial Arrangements) Act 2009 (at para 10.82) explains that the rationale for excluding debt interests and loans is that it would otherwise impute a time value of money compensation to the instrument.

Ordinary income

The face value acquisition price and redemption price of an IFL would be respected when considering whether the IFL gave rise to ordinary income and, as such, no profit or income would be recognised.[12]

Foreign exchange gains and losses

A foreign exchange gain in respect of an IFL made by a non-resident lender may be subject to tax in Australia if the gain has an Australian source, subject to the application of a double tax agreement or the investment manager regime in Div 842 ITAA97.[13]

Division 7A

An unusual consequence can potentially arise under Div 7A ITAA36 where the non-resident lender is a company that meets the definition of a "private company" (under s 103A ITAA36). There is no requirement for a "private company" to be an Australian resident. It is therefore possible that arrangements entered into by a non-resident private company can have repercussions in Australia.

If the Australian borrower is an "associate" of the lender's shareholder when the loan is made, Div 7A must be considered. As noted earlier in this article, the meaning of "associate" has arguably expanded since the High Court's decision in *BHP Billiton Ltd v FCT*.[14] It may be the case now that it could be concluded, depending on the circumstances, that a minority shareholder in the borrower is an associate of the borrower, with the result that the lender's own shareholders may be associates of the borrower itself.

If Div 7A applies, the IFL could be treated as a dividend paid to the borrower if it is not fully repaid by the end of the lender's year of income and the company has a distributable surplus.

Division 7A would not apply if the borrower itself is a company (s 109K ITAA36).

Commercial debt forgiveness

An IFL is a debt. It would be a "commercial debt" for the purposes of Div 245 ITAA97 if interest on the IFL were deductible, had it been paid (s 245-10 ITAA97).

The release, waiver or assignment of an IFL may cause the commercial debt forgiveness rules to apply. Likewise, a subscription of shares to enable a payment in, or towards discharge of, an IFL may cause a debt forgiveness.

There are time limitations under the *Limitation Act 1969* (NSW) (and equivalent legislation in other states and territories) on the rights of a creditor to bring an action for the recovery of debts. If an IFL is an at call loan and no action has been taken in the relevant period, or if the IFL has a term of greater than six years and no repayments are to be made until maturity of the loan, there may inadvertently be consequences under the debt forgiveness rules.

Anti-avoidance

The final way in which an IFL can cause unintended consequences is if Pt IVA ITAA36 applies. There may be a tax benefit in relation to an IFL, such as:

- the lender not being liable to include interest income in assessable income or pay interest withholding tax, if the IFL were interest-bearing; and
- the borrower having a deduction allowable in relation to its interest expense that would not be available if the IFL were interest-bearing and included in AAD.

Of the eight factors to be considered in relation to the sole or dominant purpose test, it is particularly important to establish why the IFL was entered into, and what the particular benefits of that instrument were over an interest-bearing debt instrument or equity. The likelihood of the company being able to pay unfranked dividends is also likely to be relevant, as well as the thin capitalisation capacity of the company if the IFL were included in AAD.

Conclusion

Inbound related-party IFLs can give rise to many complications. Some of the difficulties are well known (eg Div 974, s 45B and Pt IVA). However, in some cases, there have been changes in the administration of IFLs (eg thin capitalisation), which means that it can be easy to underestimate the consequences of including an IFL in a company's debt capital structure.

This article concludes that the multitude of issues that need to be considered in relation to IFLs can be navigated. However, there is inherent risk, and some of the technical issues are difficult and tiresome to address if pressed, particularly having regard to the fact that, due to low interest rates, the "related scheme" analysis may result in schemes being aggregated into an equity interest.

Interest-free loans continue to be used because of their commercial benefits. However, the comfort level is being slowly eroded through tax law changes and changes in interpretation, and it would be prudent to approach IFLs with caution.

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References

1 The maximum rate of dividend withholding tax is 30%; this can be reduced under an applicable double tax agreement between Australia and the lender's country of residence.

2 Australian resident lenders would pay tax at their marginal tax rates.

3 It is noted that the "entity" must incur the costs, and TD 2019/12 may therefore not apply if the relevant costs were incurred by a separate entity (eg fees were issued to the offshore client).

4 See TD 2019/12EC.

5 See para 1.37 of the explanatory memorandum to the Bill that became the *Taxation Laws Amendment Act (No. 4) 2002.*

6 In order to assess the value of an IFL, a discounted cash flow approach is generally used. The discounted cash flow methodology takes the promised future cash flows of an IFL and discounts them at a rate reflecting the market rate of interest that would be payable on a debt instrument, with an equivalent credit and interest rate risk to the IFL.

7 See *Australian Trade Commission v WA Meat Exports Pty Ltd* (1987) 75 ALR 287 at 291 (cited in *Barnsdall v FCT* [1988] FCA 192 at [13]).

8 See ATO ID 2003/235. This interpretative decision has been withdrawn because it is a straightforward application of the law.

9 As defined in s 960-135 ITAA97. For there to be a membership interest, there must be a "member" as defined in s 960-130 ITAA97 (ie a member or stockholder in the company). While debt interests are specifically excluded from being membership interests (ie shares that are debt interests), there is no corresponding rule that deems a non-share equity interest to be a membership interest.

10 See s 26BB(3) ITAA36, and paras 78 to 83 of TR 96/14.

11 See para 70 of TR 96/14.

12 See the comments in *FCT v Myer Emporium* [1987] HCA 18 regarding economic equivalence.

13 For example, if a foreign exchange gain arises from the lender disposing of, ceasing to own or otherwise realising the investment (s 842-215(1)(a) ITAA97).

14 [2020] HCA 5.

Superannuation

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

BDBNs: how long can they last in all Australian jurisdictions?

The Court of Appeal has held that it is possible for an SMSF's deed to be drafted to enable a BDBN to last for more than three years and that this is the position in all Australian jurisdictions.

The Court of Appeal of the Supreme Court of Western Australian recently handed down its decision in *Hill v Zuda Pty Ltd*.[1] It provides a strong answer to the question of how long a binding death benefit nomination (BDBN) can last in *all* Australian jurisdictions.

Facts

Ms Hill was the only child of Alec Kumar Sodhy (the deceased). The deceased was in a de facto relationship with Ms Murray.

In 2011, the deceased made a document purporting to be a BDBN. The BDBN was in favour of Ms Murray.

The deceased died in 2016. Importantly, the deceased died more than three years after making the BDBN.

Key issue

Ms Hill brought an action. She contended, among other things, that:

> "[the binding death benefit nomination] was signed more than three years prior to the deceased's death, and so had ceased to have effect under reg 6.17A(7)(a) of the SIS Regulations."

Why is this still an issue?

Many people may be surprised to hear that there are still questions around whether the *Superannuation Industry (Supervision) Regulations 1994* (Cth) apply to BDBNs. After all, the ATO commented on this issue in SMSFD 2008/3:

> "… the governing rules of an SMSF may permit members to make death benefit nominations that are binding on the trustee, whether or not in circumstances that accord with the rules in regulation 6.17A of the SISR."

In other words, the ATO confirmed that it is possible for an SMSF's deed to be drafted to enable a BDBN to last for more than three years. However, the ATO is (broadly speaking) not a law-making body. All that SMSFD 2008/3 can really stand for is that the ATO will not treat a non-lapsing BDBN as causing a contravention of the *Superannuation Industry (Supervision) Act 1993* (Cth) or the *Superannuation Industry (Supervision) Regulations 1994* (Cth) (SISR94), from a regulatory compliance viewpoint.

A court, on the other hand, effectively is a law-making body. Certain Supreme Court decisions have held that it is possible for an SMSF's deed to be drafted to enable a BDBN to last for more than three years.[2]

That being said, Australia is a federation of states. What one judge decides in one state (eg in Queensland or South Australia) is not binding in other states (eg in Western Australia or Victoria). This is a very important point to bear in mind, especially in, for example, Victoria, where there is no Victorian case law directly on point.

What did the Court of Appeal decide?

The Court of Appeal pointed to the High Court decision of *Farah Constructions Pty Ltd v Say-Dee Pty Ltd*,[3] where the High Court stated:

> "Intermediate appellate courts and trial judges in Australia should not depart from decisions in intermediate appellate courts in another jurisdiction on the interpretation of Commonwealth legislation or uniform national legislation unless they are convinced that the interpretation is plainly wrong."

Therefore, the Court of Appeal stated that:

> "… this court should accept the construction adopted in *Cantor Management* until such time as the decision is overruled by the High Court. On that basis, we regard ourselves as bound to construe reg 6.17A of the SIS Regulations as not applying to self managed superannuation funds."

In other words, the Court of Appeal held that it is possible for an SMSF's deed to be drafted to enable a BDBN to last for more than three years *and that this is the position in all Australian jurisdictions* (including, for example, Victoria).

Concluding thoughts

It is difficult to think of a situation where a client would want a three-year lapsing BDBN. Naturally though, a client should always regularly review and consider whether their BDBN is still appropriate for their current circumstances.

Therefore, it is important that an SMSF deed expressly and clearly allows for non-lapsing BDBNs. Further, SMSFs with BDBN provisions that rely on reg 6.17A SISR94 should be updated as a matter of urgency.

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References

1 [2021] WASCA 59.

2 See, for example, the decisions of the Queensland Supreme Court in *Munro v Munro* [2015] QSC 61, and *Re Narumon Pty Ltd* [2018] QSC 185.

3 [2007] HCA 22.

Alternative Assets Insights

by Sach Pelpola and Peter Collins, FTI, PwC

Imported hybrid mismatches

Taxpayers need to consider PCG 2021/D3 in order to deduct payments made to offshore related parties.

On 21 April 2021, the ATO provided 19 pages of draft guidance in PCG 2021/D3 which sets out the Commissioner of Taxation's approach to assessing whether a taxpayer has undertaken reasonable enquiries in relation to the imported hybrid mismatch rules.

PCG 2021/D3 sets out the level of supporting information that the Commissioner expects taxpayers to obtain prior to filing their income tax returns, in order to claim deductions for payments made to offshore related parties. The practical compliance guideline is an important consideration, particularly for taxpayers preparing income tax returns for the second year of operation of the Australian hybrid mismatch rules (ie year ended 31 December 2020 or ending 30 June 2021).

PCG 2021/D3 provides welcome guidance for taxpayers grappling with these rules in a self-assessment environment but does set a high bar in terms of the information and documentation expected to be obtained by all taxpayers in relation to the global operations of a multinational company (MNC).

In detail

The Australian hybrid mismatch rules were released in draft form in late 2017, enacted in August 2018, and took effect for tax periods commencing on or after 1 January 2019. In the authors' experience, it continues to be the case that many subsidiaries of foreign MNCs are finding it challenging to interpret and apply this complex and novel legislation which can impact any related-party cross-border payments (and, in some cases, third-party payments) that are otherwise deductible for Australian income tax purposes.

A key element of difficulty is the imported hybrid mismatch rule which requires Australian taxpayers to make judgments about the operation of foreign tax laws, as well as the presumption that the Australian taxpayer has perfect knowledge of the overseas group structure, relevant foreign tax law, and the flow of payments through the global group structure. This "tracing" exercise arguably may involve payments that have no direct or commercial link to payments made by the Australian entity and can make it very difficult to apply in practice. In the authors' experience, this tracing rule typically goes further than other countries that have adopted the hybrid mismatch rules designed by the Organisation of Economic Co-operation and Development (OECD) as part of the base erosion and profit shifting project.

Australia operates a self-assessment system which places the onus on taxpayers to ensure compliance with the tax laws. However, in many cases, the information required to fulfil this obligation in relation to imported hybrid mismatches may not be available in Australia.

PCG 2021/D3 is designed to explain the ATO's assessment of compliance risk associated with the imported hybrid mismatch rules, including the level of documentation that is expected. The practical compliance guideline is very detailed, but the key elements and takeaways are as follows:

- the Commissioner's view is that taxpayers should not claim a deduction for a payment to an offshore related party unless they are able to obtain sufficient information from the global group to support a conclusion that the deduction in respect of the payment is not disallowed under the imported hybrid mismatch rules. It is expected that the Australian entity will document its enquiries and obtain the information prior to lodgment of the income tax return, and this documentation would be capable of being provided to the Commissioner within a reasonable time of a request being made. Taxpayers that have not obtained information prior to lodgment, but later confirm entitlement to a deduction for that payment, can lodge an amendment request to claim the deduction;
- the Commissioner expects that, regardless of whether the hybrid mismatch is structured or not, the Australian taxpayer would readily have the necessary information to undertake the assessment or, failing that, its foreign affiliates will provide "full and complete disclosure" of "all relevant information" to the Australian entity;
- it is expected that members of the "Division 832 control group" will have robust processes in place to identify any relevant hybrid mismatch outcomes and inform the taxpayer accordingly;
- the ATO's recommended approach to undertaking enquiries involves the taxpayer making and documenting formal requests for information and the responses. Taxpayers need to make requests to the responsible individuals or suitably qualified representatives responsible for the group. The appropriately qualified responsible individuals must include the person who is primarily responsible for the group's tax obligations, such as the head of tax for the group;
- for Australian headquartered groups, PCG 2021/D3 indicates that an internal file note of the relevant information and positions adopted (including justification) will be sufficient and that the responsible individual may include the public officer;
- the ATO's recommended approach can be achieved by a "top-down" approach (identify whether the group has any hybrid mismatch outcomes) or a "bottom-up" approach (determine if payments made by Australia, directly or indirectly, fund an offshore hybrid mismatch). An appendix to PCG 2021/D3 sets out the information that the Commissioner considers relevant to demonstrating

compliance with each of these approaches, and this information may be requested when the ATO is assessing risk during any engagement or assurance activity;

- PCG 2021/D3 includes a complex risk rating involving eight categories based on a number of factors, including the materiality of related-party payments and compliance with the ATO's recommended approach to making reasonable enquiries. The situations where a taxpayer can disclose a "green" or "low risk" rating are limited to situations where taxpayers:
  - demonstrate that there are no offshore mismatches or that all offshore mismatches have been neutralised by either Australia or a foreign country's hybrid mismatch rules; or
  - where the Australian taxpayers have not sought to claim deductions for payments made to members of the Div 832 control group;
- some taxpayers may be required to report this practical compliance guideline risk rating on the reportable tax position schedule which is lodged with their annual income tax return. The impact of this will depend on various factors, including the timing of the final practical compliance guideline. Therefore, at this time, it is not clear if income tax returns for the year ended 31 December 2020 will be impacted;
- the Commissioner also makes it clear that any assessment must consider the nuances of the Australian hybrid mismatch rules and it is not sufficient for taxpayers to rely on any analysis undertaken based on the OECD principles or a foreign jurisdiction's equivalent of the imported hybrid mismatch rules;
- PCG 2021/D3 sets out the ATO's approach to penalties in relation to the imported hybrid mismatch rules, including where the Commissioner will consider that a taxpayer has taken "reasonable care". This will be relevant in any circumstance where it is determined that a taxpayer has not correctly applied the imported hybrid mismatch rules and a tax shortfall is identified;
- PCG 2021/D3 will apply both before and after its issue; and
- taxpayers are invited to comment on PCG 2021/D3, including the proposed date of effect, by 21 May 2021.

In December 2020, the New Zealand Inland Revenue released an exposure draft setting out the steps that taxpayers are expected to have undertaken before claiming deductions for payments to offshore related parties under the imported hybrid mismatch rules. In most scenarios, the Inland Revenue's expectation is that the New Zealand taxpayer will obtain a written statement from the group's head office tax function confirming the steps that have been taken to ensure that there are no imported hybrid mismatches that have been funded by the New Zealand payer. The approach adopted by the Commissioner in PCG 2021/D3 appears to require much more detailed work to be undertaken prior to filing the Australian income tax return.

Practical compliance guidelines are not prepared for the primary purpose of expressing a view on the way that a tax law provision applies and are not public rulings. Therefore, PCG 2021/D3 does not provide guidance in relation to any of the challenging interpretative issues associated with the imported hybrid mismatch rules, and taxpayers are expected to adopt positions on these issues. For example, an important and potentially contentious issue is which countries may be considered to have corresponding foreign hybrid mismatch rules (including countries in the European Union and the United States) where these countries have adopted certain rules dealing with hybrid mismatches. This may impact the existence of an offshore hybrid mismatch under the top-down approach, as well as the tracing that may be required under the bottom-up approach. PCG 2021/D3 also hints at potential ATO views, for example, the practical compliance guideline expresses a concern about a view being taken that not all payments between entities must be traced.

The takeaway

All taxpayers making related-party cross-border payments will need to consider PCG 2021/D3 and what work may be required to meet the proposed ATO requirements prior to lodging their Australian income tax return. Although these ATO requirements are not required by law, it will be important to consider the consequences of not meeting the ATO's expectations, including the tax return disclosures that may be required (after PCG 2021/D3 is finalised) and the impact on penalties in the event that a tax shortfall is later identified.

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Events Calendar

June 2021

STATE/EVENT	DATE	CPD
Online		
2021 Agribusiness Intensive	9/6/21	13
2021 WA Tax Forum	17/6/21	12
Queensland		
2021 Agribusiness Intensive – face-to-face	9/6/21	13
2021 Local Tax Club – Part 5: Property issues	23/6/21	1.5
Victoria		
2021 Yarra Valley Tax Retreat	1/7/21	12
Western Australia		
2021 WA Tax Forum – face-to-face	17/6/21	12

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Cumulative Index

The following cumulative index is for volume 55, issues (1) to (11). Listed below are the pages for each issue:

Legislation

Rulings and other materials

Cases

A

B

Authors

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