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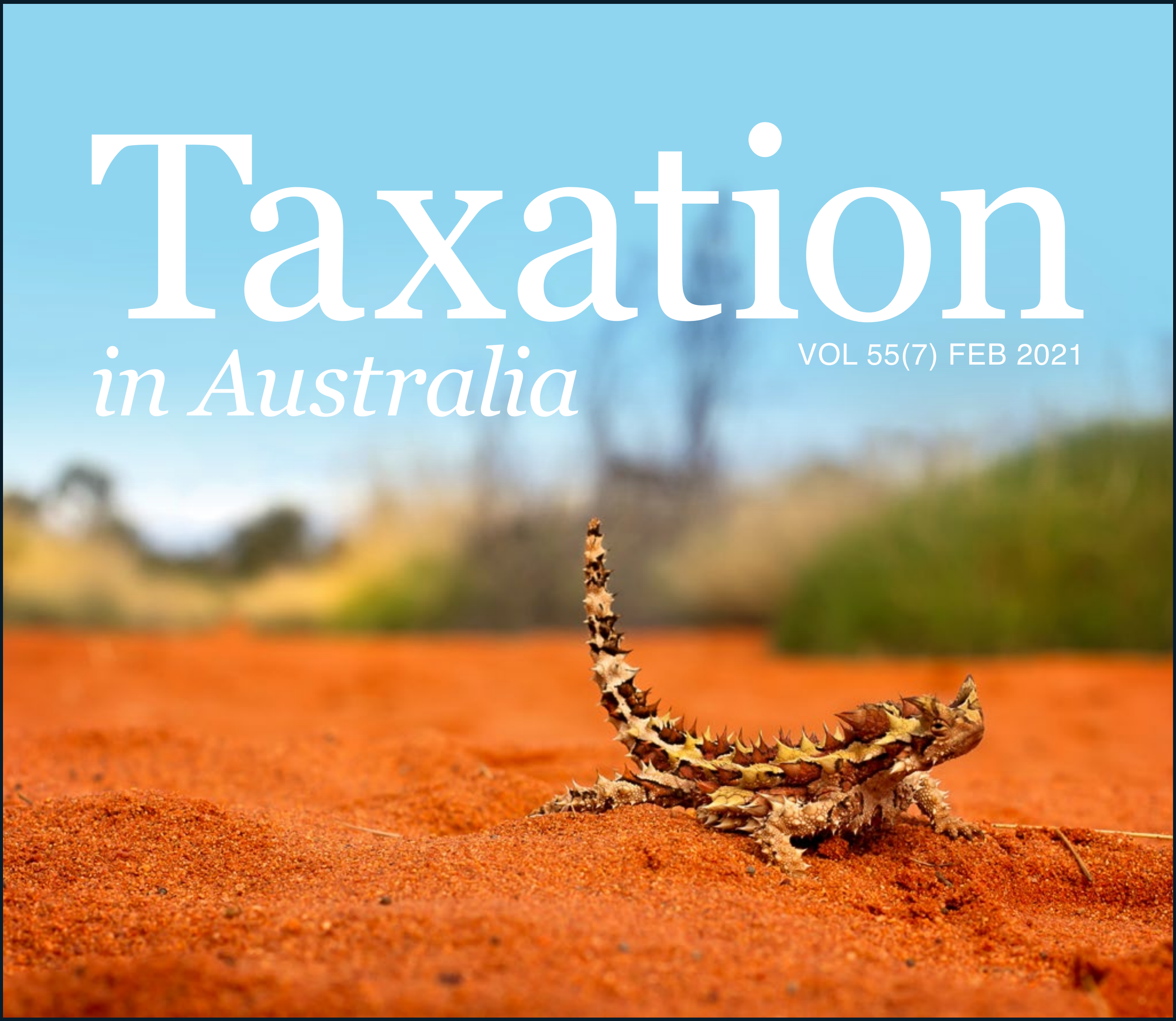

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THE TAX INSTITUTE

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

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Tax News – at a glance

by TaxCounsel Pty Ltd

December – what happened in tax?

The following points highlight important federal tax developments that occurred during December 2020. A selection of the developments is considered in more detail in the "Tax News – the details" column on page 337 (at the item number indicated).

Temporary full expensing amendments

The *Treasury Laws Amendment (2020 Measures No. 6) Act 2020*, which became law on 17 December 2020, amended the temporary full expensing concession provisions and the backing business investment provisions in the income tax law to provide greater flexibility in accessing the concessions. **See item 1.**

Tax Practitioners Board review

On 27 November 2020, the government released the final report, and its response, to the independent review of the Tax Practitioners Board. **See item 2.**

Commissioner's discretion to retain tax refunds

The Commissioner has issued a draft practice statement in relation to the changes that were made by the *Treasury Laws Amendment (Combating Illegal Phoenixing) Act 2020* to extend the Commissioner's discretion to retain a tax refund (PS LA 2020/D2). **See item 3.**

Taxpayer alert: imputation benefits

The Commissioner has issued a taxpayer alert in relation to arrangements that are intended to provide imputation benefits to Australian taxpayers in respect of a parcel of shares where, as a result of derivative instruments entered into as part of the arrangement, the taxpayer retains no or nominal economic exposure to the dividend and capital performance associated with that parcel of shares (TA 2020/5). **See item 4.**

Override royalties: ruling

The Commissioner has issued a final ruling in relation to income (called in the ruling "override royalties") which is derived by a non-resident and calculated by reference to the value or quantity of natural resources produced and/or sold (TR 2020/5). Such income is typically paid by the holder of a mining right to an entity that does not have an interest in the right. **See item 5.**

Remission of additional SGC

The Commissioner has issued a practice statement that sets out what ATO officers need to consider when making a decision on the remission, in whole or in part, of the additional superannuation guarantee charge (SGC) imposed under s 59(1) of the *Superannuation Guarantee (Administration) Act 1992* (Cth) where an employer fails to lodge a superannuation guarantee statement by the lodgment due date (PS LA 2020/4). The additional SGC is referred to in the practice statement as the "Part 7 penalty". **See item 6.**

Practical guidance updates

The Commissioner has amended several practical compliance guidelines. **See item 7.**

JobKeeper: ABN issues

The AAT, reversing a decision of the Commissioner, has held that an applicant for a JobKeeper payment satisfied the requirement to have an ABN on 12 March 2020 in circumstances where the applicant did not have an active ABN on that date but the Registrar of the Australian Business Register reinstated the applicant's cancelled ABN registration retrospectively to before 12 March 2020 (*Apted and FCT* [2020] AATA 5139). **See item 8.**

Unregistered entities: penalties

The Federal Court (Rangiah J) has determined the penalties to be imposed on an individual and two companies with which he was closely associated for the contravention of the prohibition in s 50-5 of the *Tax Agent Services Act 2009* (Cth) on unregistered entities providing tax agent services or BAS agent services for a fee or other reward (*Tax Practitioners Board v Hacker (No. 3)* [2020] FCA 1814). **See item 9.**

President's Report

by Peter Godber, CTA

2021 – new norms and opportunities

From regulatory reform to innovative education, there's a big year ahead for the Institute.

I hope that you have now had the chance to refresh yourselves for the year ahead.

Like many, I hoped 2021 would be a year less affected by the COVID-19 pandemic. However, from the mix of outbreaks we have seen early on this year, it looks like disruption will, to some extent, continue to be the norm in our business and personal lives for the foreseeable future. At least we are better prepared for 2021 and the adjustments we might continually need to make to do well in this environment.

It may seem a little surprising that I am authoring this President's Report in a new year. However, due to a range of factors, including the disruption of 2020 and a desire for continuity in the early part of this year, Jerome Tse continues as vice-president in 2021, and I as president. Tim Neilson and Stuart Glasgow have completed their terms on National Council and we sincerely thank them both for their very generous and extensive contributions at that level over many years.

One change that we had already implemented is the adoption of a 30 June financial reporting year for the Institute, with the first reporting period to end on 30 June 2021. We have a lot to achieve through to the end of this new reporting period. However, I am very pleased to say that the financial state of our organisation continues to be strong. We have responded well to the challenges of 2020. Given the change in our financial year end, the next AGM for The Tax Institute will probably be in or around October this year. At that time, we will report fully on our business, our strategy and our plans for 2022. So, I very much look forward to 2021 and the many things we will achieve in the time ahead.

We can look back on The Tax Summit: Project Reform with an immense sense of achievement, while knowing that there is still an uphill road to completing the work and mapping out how we keep reform opportunities alive. There are short-term and longer-term items in any major reform agenda, and we will prompt actions and more discussion accordingly. We have received great member feedback about our reform project and the benefits of participating in it, and hopefully it provides a continuing source of interest and knowledge for our members.

You will by now be familiar with the faces and talent that we have in our technical Tax Policy and Advocacy team. They are overrun with things to do at the moment, both with our reform project flow-on initiatives, and with many other areas of consultancy and advocacy in support of our members, the development of the profession, and ultimately the improvement of the tax system.

High on our agenda at the start of this year is the very significant review of the Tax Practitioners Board (TPB) and the government's response to it that was issued in late November 2020. The Tax Institute now has an important role to play. Of the 28 recommendations, many require significant further consultation and there is a sea of issues that require our input and that affect many of our members. Let me say that we welcome the report, and we congratulate Keith James, Neil Earle and everyone involved in undertaking the review.

Last year, we called for the release of the review and the Treasury's response, and it took quite some time in 2020 for it to be published. The impact on our members and the regulation of tax agents is now obvious, and you will hear much more on this from our Tax Policy and Advocacy team. Consultation is starting immediately. I believe that there are great opportunities for The Tax Institute, as a leading tax education body, to step up and play a greater role in supporting education requirements across the tax profession. Input from our members will be welcomed as we move forward to involve ourselves in, and keep you aware of, this important regulatory framework development.

In my report last December, I reminded you of the constitutional objectives of The Tax Institute, and it is a good reminder of how the key themes of tax education, research and reform are built into our mantra. We are working hard on the strategy for structured tax education into the future. The world is changing for us and we have to keep looking forward to what the students of tomorrow will want and how we deliver our formal education in a modern, technically efficient and attractive manner. You will hear more about that this year. The opportunities for us to provide a broad menu of topics in tax education across sectors are evolving. We have a leading role to play and we must be bold about what we can offer, to whom, and why.

Back to our informal knowledge sharing and ongoing CPD, it looks like 2021 might look a lot like late 2020. We are approaching face-to-face events with due caution, but we are well prepared to offer a mix of events, some face-to-face, many online, some a mix of both, during 2021. We are working hard on mapping out this year in response to what we now see as continuing disruption to the business of events. However, we are well prepared, and we will deliver knowledge and education to our members at a high level in whatever environment we find ourselves.

It will be another year full of new developments for the tax professional, including regulatory reform and, as always, technical topics — new ones and some that seem to never go away. Our whole Institute team is already busy and looking forward to supporting you, our members, in every way possible in 2021.

CEO's Report

by Giles Hurst

Starting 2021 on a positive note

A new year brings new opportunity and good news for the Institute.

Welcome to a new year — one I think we've all stepped into with a sigh of relief.

I hope that, since my last report to you, you have had an opportunity to rest and refresh. You deserve that and more after proving your mettle so thoroughly last year. When the going gets tough, the tax profession really does get going.

2020 was an endurance test for our profession. The stroke of midnight between 31 December 2020 and 1 January 2021 certainly felt like crossing some kind of finish line, puffing and panting. And despite lingering challenges, for a majority of us there is now light at the end of the tunnel, getting closer every day.

So, as we embark on a new — hopefully brighter and kinder — year, I'd like to begin as I aim to continue: with good news.

There is good news for our profession as we continue our work towards genuine reform in our tax system. The Tax Summit: Project Reform brought the brightest minds of the profession together to determine priorities for change and yielded considerable insight. 2021 promises further progress, as we expect to submit *The case for change* paper to regulators as a catalyst for meaningful and lasting change.

You will also be glad to hear that our face-to-face events are set to get back on track this year, albeit slowly and with due caution. Last year, our swift shift to virtual events allowed us to remain connected and continue to offer professional development opportunities. The events surpassed that purpose and in fact became valuable tools to bring together speakers and delegates from all around the country in a way we never really had before. With continuing disruption in this space, online events are here to stay for the foreseeable future.

However, there is a certain magic to gathering with like-minded colleagues and experts in-person. While many events will continue to be conducted online, our team is working diligently on a gradual return to select face-to-face events or hybrid events in 2021. Keep an eye out for these opportunities to connect in-person and rest assured that, when we invite you to a face-to-face event, we do so with the safety of our speakers, delegates, volunteers and staff always front of mind.

We also have the good fortune to welcome new members into the fold and welcome back those we have known for a while. We have a world-class Tax Policy and Advocacy team providing guidance and leadership and look forward to the launch of a new website which will catapult us to the forefront of the digital world.

As Teddy Roosevelt once said, "Far and away the best prize that life has to offer is the chance to work hard at work worth doing." That's a prize we've certainly won.

Of course, we all know that 1 January is not a magical reset button, as much as it might feel like it sometimes, or we might hope it could be. The challenges of COVID-19 have not disappeared with 2020. In fact, as I write this, our Sydney office is closed for the safety of our staff and will remain so until I am confident that opening our doors again is in everyone's best interests. And on a broader level, our profession will continue to shoulder the work of interpreting and implementing stimulus policies to keep Australian businesses and families going – those challenges are not going to disappear.

Despite any of these future hurdles, 2021 does have immense potential — not because of the date on the calendar, but because of the people we choose to share it with. Community and collaboration allowed us to navigate the challenges of 2020 and will allow for the successes of 2021. So be sure to connect to your colleagues through The Tax Institute this year.

Looking forward to a busy, bright and productive year with you all.

Senior Tax Counsel's Report

by Robert Deutsch, CTA

Justifying "justified trust"

What is justified trust, why is it important and what is it designed to achieve? These simple questions deserve answers and this short piece tries to address these matters.

This month, I thought I might have a go at trying to explain, in lay terms, a concept used by the tax office. The concept "justified trust" is used by the ATO to explain to the public at large why it can have confidence that large public and large private companies are paying the appropriate amount of tax.

To explain by reference to individuals, if we took a random sample of 300 people who each earned $100,000 and came to the conclusion that the average tax paid was $5,000 per person, it would be a cause for considerable alarm since the tax paid on $100,000 gross income should be in the order of $24,000 per person. Of course, that does not mean that every person must pay that amount of tax — deductions, offsets and other tax concessions need to be taken into account. But it would be extraordinary if, through a random sample, the level of deductions and offsets etc was that high. To put it another way, there could be no justified trust that the amount paid by that cohort of individuals was appropriate.

Of course, the justified trust program is not generally applied to individuals. It applies to large public companies and has more recently been extended to the Top 500 private groups (for example, this includes those groups with a turnover in excess of $350m). It is also far more focused on the affairs and the specific circumstances of each taxpayer.

How does the tax office ensure justified trust?

Random sampling of the kind described above is part of the process but the ATO does look for a more systems-based approach which provides confidence that companies have appropriate processes in place to ensure that they are paying an appropriate amount of tax. This includes, in particular, a high level of assurance that the board of directors has adopted, both in theory and in practice, appropriate policies to ensure that decisions about tax are being made at the very highest levels of board administration. There must also be some concrete substantial evidence that tax matters have been properly and duly considered and applied on a timely basis. Some considered explanation of the difference between tax and accounting income must also be provided.

Essentially, what the ATO is trying to do is to strengthen public confidence that the top end is paying the right amount of tax. The other related initiative that reinforces that confidence is the tax gap analysis which has shown of late that the difference between the tax collected and that which should be collected from public companies is not substantial and has been narrowing over recent years.

The justified trust program is in its relatively early stage of development but, as outlined above, it is gradually being expanded to cover other sectors beyond large public companies and large private groups.

Tax News – the details

by TaxCounsel Pty Ltd

December – what happened in tax?

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

Government initiatives

1. Temporary full expensing amendments

The *Treasury Laws Amendment (2020 Measures No. 6) Act 2020*, which became law on 17 December 2020, amended the temporary full expensing concession provisions and the backing business investment provisions in the income tax law to provide greater flexibility in accessing the concessions.

Temporary full expensing allows eligible businesses with an aggregated turnover of less than $5b in an income year to deduct the full cost of eligible depreciating assets that are first held, and first used or installed ready for use for a taxable purpose, between 2020-21 budget time and 30 June 2022. Businesses are also able to deduct the full cost of improvements to these assets and to existing eligible depreciating assets made during this period.

The backing business incentive allows businesses with an aggregated turnover of less than $500m in an income year to temporarily deduct capital allowances for depreciating assets at an accelerated rate.

More particularly, the amendments that have been made by the amending Act:

- provide an alternative mechanism for working out whether the $5b threshold applies is met for the temporary full expensing concession; and
- allow entities to opt out of temporary full expensing and the backing business investment incentives on an asset-by-asset basis.

In addition, the amending Act clarifies the intended operation of temporary full expensing by ensuring that a balancing adjustment event occurs if a depreciating asset has its decline in value worked out under the temporary full expensing provisions and, in a later income year, the asset no longer meets the test regarding its use or its location in Australia.

2. Tax Practitioners Board review

On 27 November 2020, the government released the final report, and its response, to the independent review of the Tax Practitioners Board (TPB).

When releasing the report, the Assistant Treasurer said that the review looked at the effectiveness of the TPB and the *Tax Agent Services Act 2009* (Cth) to ensure that tax agent services are provided to the public in accordance with appropriate professional and ethical standards.

The final report made 28 recommendations and the government supports 20 of the recommendations in full, in part or in principle.

Additional consultation is to be undertaken before implementing some of the review recommendations to assist the government to further develop options, ensuring the best outcome for tax professionals and taxpayers who rely on their services.

Among the proposed changes are those which will:

- provide greater independence of the TPB from the ATO;
- provide a reduction in red tape;
- ensure that education and experience requirements are set at the right level for tax practitioners to provide community confidence in the tax profession; and
- bolster eligibility requirements to ensure that only those individuals and entities that meet high standards of ethical and professional behaviour can obtain tax practitioner registration.

It may be noted that the *Treasury Laws Amendment (2020 Measures No. 6) Act 2020*, referred to in item 1, also made some amendments to the *Tax Agent Services Act 2009.* One of these amendments provides that the TPB is not required to terminate a registration on a surrender notice if the Board decides to commence an investigation within 30 days after receiving the surrender notice. This is intended to ensure that a tax agent, BAS agent or tax (financial) adviser cannot frustrate a potential investigation by seeking termination of their registration first.

The Commissioner's perspective

3. Commissioner's discretion to retain tax refunds

The Commissioner has issued a draft practice statement in relation to the changes that were made by the *Treasury Laws Amendment (Combating Illegal Phoenixing) Act 2020* to extend the Commissioner's discretion to retain a tax refund (PS LA 2020/D2).

The changes extended the Commissioner's retention discretion where a taxpayer has an outstanding notification (other than a notification under the business activity statement (BAS) or petroleum resource rent tax (PRRT) provisions) that:

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

Although the law does not limit the application of the extension to the discretion, the draft practice statement recognises that the Commissioner's exercise of the extended discretion will not be taken lightly. In particular, the exercise of the discretion will be considered in circumstances where taxpayers are identified as engaging in high-risk behaviour (including those engaging in illegal phoenix activity).

PS LA 2020/D2 provides guidance to ATO officers on when they may exercise the Commissioner's discretion to retain a taxpayer's refund. However, the draft practice statement does not apply to the exercise of the Commissioner's discretion to retain a taxpayer's running balance account 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.

Guidance on the exercise of the discretion to retain a taxpayer's refund where a notification under the BAS and PRRT provisions is outstanding, or where the Commissioner requires verification of information contained in a notification, is contained in PS LA 2011/22 and PS LA 2012/6.

4. Taxpayer alert: imputation benefits

The Commissioner has issued a taxpayer alert in relation to arrangements that are intended to provide imputation benefits to Australian taxpayers in respect of a parcel of shares where, as a result of derivative instruments entered into as part of the arrangement, the taxpayer retains no or nominal economic exposure to the dividend and capital performance associated with that parcel of shares (TA 2020/5).

The arrangements involve an Australian taxpayer who already holds an existing long position in a portfolio of Australian shares. The taxpayer acquires additional parcels of Australian shares (or interests in shares) and, on the same day or about the same time, enters into derivative instruments (that are a short position) in relation to those additional shares.

While the derivative instruments themselves may differ, typically these arrangements result in the taxpayer having no or nominal economic exposure to both the dividend and capital performance associated with those additional shares.

Due to the taxpayer's existing holding of Australian shares, the taxpayer calculates the delta of their overall net position to be greater than 0.3. That is, the taxpayer relies on an existing long position of Australian shares to purport to meet the substantive integrity rules (in Div 1A of former Pt IIIAA of the *Income Tax Assessment Act 1936* (Cth) (ITAA36)) in relation to holding shares at risk for the purposes of claiming franking credits. This results in the taxpayer claiming franking credits in respect of both the existing Australian shares and the additional parcel of shares.

Setting aside the original holding of Australian shares, these arrangements result in the taxpayer holding the additional parcel of Australian shares at no or nominal risk, such that the franking credits are generally the only return of significance relating to the additional Australian shares acquired.

The concerns raised in the alert are the issues of whether:

- the taxpayer is a qualified person in relation to the relevant dividends on the additional parcel of shares;
- the Commissioner should make a determination pursuant to s 177EA ITAA36 in respect of the arrangements, in particular, to deny the imputation benefits received in respect of the additional parcel of shares; and
- the promoter penalty laws would apply to promoters of the arrangement.

In addition, the Commissioner has similar concerns over these arrangements where Australian taxpayers hold Australian shares indirectly through attribution managed investment trusts.

5. Override royalties: ruling

The Commissioner has issued a final ruling in relation to income (called in the ruling "override royalties") which is derived by a non-resident and calculated by reference to the value or quantity of natural resources produced and/or sold (TR 2020/5). Such income is typically paid by the holder of a mining right to an entity that does not have an interest in the right.

The ruling sets out:

- when a payment, that is income, is calculated, in whole or in part, by reference to the value or quantity of natural resources produced in Australia for the purposes of the definition of "natural resource income" in s 6CA(1) ITAA36;
- how the income from real property articles in Australia's tax treaties apply to override royalties; and
- the circumstances in which an Australian resident payer of override royalties is required to withhold an amount from an override royalty payment under s 12-325 of Sch 1 to the *Taxation Administration Act 1953* (Cth).

6. Remission of additional SGC

The Commissioner has issued a practice statement that sets out what ATO officers need to consider when making a decision on the remission, in whole or in part, of the additional superannuation guarantee charge (SGC) imposed under s 59(1) of the *Superannuation Guarantee (Administration) Act 1992* (Cth) (SGAA92) where an employer fails to lodge a superannuation guarantee (SG) statement by the lodgment due date (PS LA 2020/4). The additional SGC is referred to in the practice statement as the "Part 7 penalty".

The practice statement also sets out when it is appropriate to apply penalty relief.

PS LA 2020/4 points out that, between 24 May 2018 and 7 September 2020, employers were offered a one-off amnesty to disclose unpaid SG without being subject to Part 7 penalties. When legislating this amnesty, the government set clear expectations that employers who do not come forward voluntarily and only have an SGC liability identified through ATO compliance action should be subject to significant penalties. This is reflected in the remission restrictions in the amnesty legislation itself, as well as the broader policy context.

A very strict approach to penalties is to be taken where an employer could have come forward voluntarily to disclose an SG shortfall and failed to do so. The ATO will generally expect minimum penalties of 100% of the SGC where an employer did not come forward voluntarily and it took ATO compliance action for them to disclose, including for quarters where there was no legislated restriction on remission.

A Part 7 penalty is imposed under Pt 7 SGAA92 when an employer fails to provide (when required) an SG statement for a quarter or information relevant to assessing the employer's liability to pay the SGC for a quarter.

The Part 7 penalty, which is automatically imposed on an employer by law, is equal to double the SGC payable by the employer for the quarter (that is, 200% of the SGC).

If an employer's SGC assessment for a quarter is amended and a Part 7 penalty was imposed on the original SGC assessment, the Part 7 penalty assessment for the quarter must be amended. On the other hand, if a Part 7 penalty was not imposed on the original SGC assessment for a quarter (for example, because the SG statement was lodged before the legislated due date), the Part 7 penalty is not imposed for any subsequent amendments. However, in either of these cases, an administrative penalty for making a false or misleading statement may be imposed.

Although the Commissioner has the discretion to remit the Part 7 penalty, in full or in part, the Commissioner's ability to remit a Part 7 penalty imposed for a historical quarter will generally be limited.

The Part 7 penalty is automatically imposed at a rate of 200% and ATO officers, except in rare cases where an employer engages in egregious tax avoidance behaviour, should consider remitting the Part 7 penalty either in part or in full. The remission decision should take into account all of the relevant facts and indicia and a four-step penalty remission process that is set down by the practice statement must be followed.

Where a client of a practitioner is faced with a potential Part 7 penalty, the practitioner should refer to PS LA 2020/4 and ensure that any submission for remission addresses the matters referred to in the practice statement.

With the release of the practice statement, PS LA 2019/1 was withdrawn with effect from 8 September 2020.

7. Practical guidance updates

The Commissioner has amended several practical compliance guidelines.

The guidelines and brief details of the amendments are:

- PCG 2020/3 (claiming deductions for additional running expenses incurred while working from home due to COVID-19): to extend its date of effect to 30 June 2021;
- PCG 2017/4 (ATO compliance approach to taxation issues associated with cross-border related party financing arrangements and related transactions): to finalise Sch 3 of the guideline (interest-free loans between related parties) and make minor amendments; and
- PCG 2017/2 (simplified transfer pricing record-keeping options): to provide 1.79% as the maximum interest rate for small related party inbound loans for the 2021 year and as the minimum interest rate for small related party outbound loans for the 2021 year.

Recent case decisions

8. JobKeeper: ABN issues

The AAT, reversing a decision of the Commissioner, has held that an applicant for a JobKeeper payment satisfied the requirement to have an ABN on 12 March 2020 in circumstances where the applicant did not have an active ABN on that date but the Registrar of the Australian Business Register (ABR) reinstated the applicant's cancelled ABN registration retrospectively to before 12 March 2020 (*Apted and FCT*[1]).

The requirement to have an active ABN (described as an "integrity rule") in order to be eligible for a JobKeeper payment is provided for in s 11(6) of the *Coronavirus Economic Response Package (Payments and Benefits) Rules 2020* (Cth) which, so far as is relevant, provides:

> "*Integrity rule*
>
> (6) An entity is *not* entitled to a jobkeeper payment under this section unless the entity had an ABN on 12 March 2020 (or a later time allowed by the Commissioner) …"

The applicant previously had an ABN for a business that he carried on of providing property and real estate services. He decided to retire and did not accept new work after July 2018. On 28 August 2018, he cancelled his GST registration because he anticipated that he would make substantially less than $75,000 in turnover in the 2018-19 financial year as the business wound down. On 28 August 2018, he also advised the Registrar of the ABR that he had ceased his business and wished to cancel his ABN registration with effect from 4 June 2018.

The applicant's former colleagues and business associates, however, encouraged him to accept some new work which he did. On 31 March 2020, the applicant applied online to have his ABN reinstated. He was informed that his ABN was reinstated in the ABR with a date of effect of 31 March 2020. On or about 10 June 2020, the applicant contacted the ABR Registrar to discuss the date of effect of his registration. After making representations about his business history, the Registrar confirmed that the ABR was adjusted or corrected to show his ABN registration as having a date of effect of 1 July 2019 (that is, on or about the date when the applicant had resumed trading).

On 20 April 2020, the applicant applied for a JobKeeper payment and this was rejected by the Commissioner. The applicant's objection to the Commissioner's rejection was disallowed by the Commissioner and the applicant then applied to the AAT for a review of the Commissioner's objection decision.

Before the AAT the Commissioner contended that s 11(6) (see above) required that the applicant actually have an active ABN on 12 March 2020. In other words, the Commissioner argued that the words of s 11(6) contemplated a point-in-time assessment that was not affected by subsequent entries on (or adjustments to) the ABR.

In rejecting the Commissioner's contention, the AAT said that the ABN requirement in s 11(6) was effective as an integrity measure because an entity would only be entitled to an ABN if they had satisfied the Registrar that they were (relevantly) "carrying on an enterprise in Australia". In other words, s 11(6) sought to ensure the integrity of the JobKeeper payments process by reference to a proxy — the ABN registration process that is managed by the Commissioner in his capacity as Registrar.

The *A New Tax System (Australian Business Number) Act 1999* (Cth) explicitly authorises the Registrar to determine a date of effect that predates the application for registration where he is satisfied that it is appropriate to do so. A proper reading of the JobKeeper rules did not suggest that it was intended that the ABN registration be relied on for a limited purpose on a particular date. There was no reason to suppose that it was not intended to repose trust in the Registrar's determination as to the date of effect of the ABN registration (or reactivation, as the case may be) even where that date of effect is determined, ex post, to precede the date of application to the Registrar.

Although not necessary to do so, the AAT also held that, if (contrary to the AAT's view) the applicant did not have an ABN on 12 March 2020, the Commissioner's exercise of the discretion to allow a later date for the purposes of s 11(6) was a decision that is reviewable by the AAT.

The Commissioner has issued an interim decision impact statement in relation to the AAT's decision in which he states that the decision is inconsistent with his view in respect of all key issues considered by the tribunal. The Commissioner has filed an appeal in respect of the decision to the Full Federal Court and has made an application for an expedited hearing in recognition of the importance of resolving the issues considered by the tribunal as soon as possible.

9. Unregistered entities: penalties

The Federal Court (Rangiah J) has determined the penalties to be imposed on an individual and two companies with which he was closely associated for the contravention of the prohibition in s 50-5 of the *Tax Agent Services Act 2009* (Cth) (TASA09) on unregistered entities providing tax agent services or BAS agent services for a fee or other reward (*Tax Practitioners Board v Hacker (No. 3)*[2]).

In an earlier decision, Rangiah J considered the question of whether there had been relevant contraventions. In that judgment, his Honour rejected several arguments advanced on behalf of the defendants (*Tax Practitioners Board v Hacker*[3]). One of these arguments was that both the individual and the company could not contravene the prohibition in respect of the same taxation service. His Honour said that the language and legislative scheme of s 50-5(1) TASA09 demonstrated that, when an unregistered individual employee, agent or director of a company provides a tax agent service for a fee or reward for or on behalf of an unregistered company which also charges a fee or receives a reward for that service, both the individual and the company may contravene the provision. It would not be the same offence because the individual and the company will have each breached their separate obligations to be registered.

In another earlier judgment, Rangiah J held that the defendants were guilty of contempt of court by breeching undertakings that had been given by them to the court (*Tax Practitioners Board v Hacker (No. 2)*[4]).

In relation to the penalties to be imposed for the contraventions of the prohibition in s 50-5 TASA09, Rangiah J made a number of general observations, including:

– the principal object of imposing pecuniary penalties is to ensure compliance with the law by deterring future contraventions;
– the court must put a price on contravention which is sufficiently high to deter repetition of the conduct by the respondent and other would-be contraveners;
– the task of the court in assessing a penalty is one of "instinctive synthesis", arriving at a single result through a weighing of all relevant factors, rather than starting from a predetermined figure and making adjustments for each separate factor;
– where there are multiple contraventions of the same provision, in some circumstances the "course of conduct" principle may be applied to ensure that the offender is not punished more than once for essentially the same criminality. However, that phrase should not simplistically be adopted to transfer multiple contraventions into one contravention, or, necessarily, to impose one penalty by reference to one maximum amount; the task is to evaluate the conduct and its course and assess what penalty is, or penalties are, appropriate for the contraventions; and
– the totality principle operates as a "final check" to ensure that the penalties to be imposed on a wrongdoer, considered as a whole, are "just and appropriate".

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References

1 [2020] AATA 5139.
2 [2020] FCA 1814.
3 [2020] FCA 1047.
4 [2020] FCA 1048.

Tax Tips

by TaxCounsel Pty Ltd

Construction issues

All tax issues at the most basic level depend on the construction of the relevant legislation. Recent court decisions provide some insights on this issue.

Background

In a judgment handed down last year, Steward J[1] said:[2]

> "[T]he tax legislation of the Commonwealth is oppressively complex."

And in *N & M Martin Holdings Pty Ltd v FCT*,[3] his Honour stated that the means adopted by parliament to achieve the object of the provisions there under consideration (Subdiv 115-C of the *Income Tax Assessment Act 1997* (Cth) (ITAA97)) was "highly complex; perhaps unnecessarily so".

It would be difficult to mount a successful case against the veracity of the observations of Steward J, no matter what standard of proof were applied. Indeed, the first quotation could be slightly revised with increased accuracy to reflect the fact that the tax law is not only oppressively complex but, as time goes on, is becoming increasingly so, whether one is considering income tax, CGT, FBT, GST or the *Taxation Administration Act 1953* (Cth) (TAA53).

The complexity, of course, has a substantial impact on the work of tax advisers for a number of reasons. First, a tax adviser must provide advice to clients in a timely fashion. While there will be situations where the position is clear, there will be many others where it is not. In those situations, the tax adviser will seek to establish, if possible, what the correct position is. Failing that, the tax adviser will be seeking to ensure that a view is adopted that meets the "reasonably arguable" threshold for the purposes of the administrative penalty provisions.

In the quest for answers, the tax adviser will need to apply the principles of statutory construction that have been developed by the courts and other aids to construction that are relevant, including the relevant explanatory memorandum and any other authoritative guidance. Binding tax rulings are, of course, to be taken into account. Also, court decisions and decisions of the AAT will be relevant. But even court decisions may raise their own difficulties, particularly where a decision has been made by a Full Court, with various views being expressed by the members of the court to arrive at the same ultimate conclusion. The problems in this regard that the decision of the Full High Court in *Hepples v FCT*[4] gave rise to and which are embedded in tax lore will not be easily forgotten, even though the provisions involved were replaced many years ago.

The issue of statutory construction is a very large topic. This article briefly considers several recent decisions of the courts in tax cases in which various aspects of statutory construction were considered.

The challenge

In *Melbourne Apartment Project Pty Ltd (as Trustee for Melbourne Apartment Project) v FCT*,[5] Kerr J said that the challenge of statutory construction lies in the nature of language and his Honour referred to the observation of Justice Felix Frankfurter in "Some reflections on the reading of statutes"[6] that:

> "The difficulty is that the legislative ideas which laws embody are both explicit and immanent. And so the bottom problem is: what is below the surface of the words and yet fairly a part of them?"

General approach

In *Paule v FCT*,[7] Thawley J said:

> "It is to be accepted, as the applicants submitted, that the Court should start with the text of the statute and have regard to the context and purpose of the statute at the 'first stage and not at some later stage', citing *SZTAL v Minister for Immigration & Border Protection*[8]."

His Honour said that legislative history and extrinsic materials cannot displace the meaning of the statute or be used to contradict the statutory language[9] and went on to quote the following passage from the decision of the High Court in *Consolidated Media Holdings*:

> "'This Court has stated on many occasions that the task of statutory construction must begin with a consideration of the [statutory] text'[10]. So must the task of statutory construction end. The statutory text must be considered in its context. That context includes legislative history and extrinsic materials. Understanding context has utility if, and in so far as, it assists in fixing the meaning of the statutory text. Legislative history and extrinsic materials cannot displace the meaning of the statutory text. Nor is their examination an end in itself."

The applicants in *Paule* also referred to s 15AA of the *Acts Interpretation Act 1901* (Cth):[11]

> "I accept that, where competing constructions are open, the interpretation that would best achieve the purpose or object of the statute (whether that purpose is expressly stated in the statute or implied) is to be preferred to each other interpretation. Before this principle operates, there must be more than one construction open. Assuming there is, it is necessary to identify the purpose or object."

Each word to be given effect to

In *Auctus Resources Pty Ltd v FCT*,[12] Steward J said that:

> "… if the Commissioner is correct in his broad interpretation of s. 8AAZN [TAA53], current s. 172A(2) [ITAA36] would be rendered otiose — a result which would directly conflict with the well-established principle of statutory construction articulated in *Project Blue Sky Inc v. Australian Broadcasting Authority*[13]."

To similar effect, Croft J said, in *North West Melbourne Recycling Pty Ltd v Commissioner of State Revenue*,[14] that it is a trite rule of statutory construction that effect must be given to every provision in a statute, and that a construction of legislation which fails to give any operation to a provision will give way to one that does.

Consistent meaning for same word

In the *Melbourne Apartment Project* case, Kerr J said that it was a fundamental rule of construction that any document should be construed, as far as possible, to give the same meaning to the same words whenever those words occur in that document, and that that applied especially to an Act of parliament and with especial force to words contained in the same section of an Act. His Honour said that this "fundamental rule" is merely a presumption of statutory construction that is readily rebuttable.

Deeming provision

The tax laws frequently have "deeming" provisions to ensure that they have an intended operation. In the context of income tax, the provisions of Div 7A of the *Income Tax Assessment Act 1936* (ITAA36) are well known. Those provisions provide that a private company is to be taken, in the circumstances provided for in the Division, to pay a dividend to an entity at the end of an income year where there has been a payment to, a loan to or the forgiveness of a debt owed by a shareholder or an associate of a shareholder.

A recent decision of the UK Supreme Court provides some useful guidance on the construction of a deeming provision. That decision is *Fowler v Commissioners for Her Majesty's Revenue and Customs*.[15] Lord Briggs (giving the judgment of the court) said:

> "There are useful but not conclusive dicta in reported authorities about the way in which, in general, statutory deeming provisions ought to be interpreted and applied. They are not conclusive because they may fairly be said to point in different directions, even if not actually contradictory. The relevant dicta are mainly collected in a summary by Lord Walker in *DCC Holdings (UK) Ltd v Revenue and Customs Comrs*[16]. They include the following guidance, which has remained consistent over many years:
>
> (1) The extent of the fiction created by a deeming provision is primarily a matter of construction of the statute in which it appears.
>
> (2) For that purpose the court should ascertain, if it can, the purposes for which and the persons between whom the statutory fiction is to be resorted to, and then apply the deeming provision that far, but not where it would produce effects clearly outside those purposes.
>
> (3) But those purposes may be difficult to ascertain, and Parliament may not find it easy to prescribe with precision the intended limits of the artificial assumption which the deeming provision requires to be made.
>
> (4) A deeming provision should not be applied so far as to produce unjust, absurd or anomalous results, unless the court is compelled to do so by clear language.
>
> (5) But the court should not shrink from applying the fiction created by the deeming provision to the consequences which would inevitably flow from the fiction being real. As Lord Asquith memorably put it in *East End Dwellings Co Ltd v Finsbury Borough Council*[17];
>
> 'The statute says that you must imagine a certain state of affairs; it does not say that having done so, you must cause or permit your imagination to boggle when it comes to the inevitable corollaries of that state of affairs'."

Exempting or relieving provisions

In *Eichmann v FCT*,[18] McKerracher, Steward and Stewart JJ in a joint judgment emphasised the approach that should be adopted in the construction of exempting or relieving provisions in the tax law, in that case, the relevant provisions being those contained in Div 152 ITAA97 which provide for the CGT small business concessions.

Their Honours said:[19]

> "*Secondly*, contrary to the Commissioner's submissions, in our view the provisions conferring small business relief, being Div. 152 of Pt. 3-3 of the *1997 Act*, should be construed beneficially rather than restrictively in order to promote the purpose of the concessions conferred by that Division: … The beneficial nature of this relief was described in the Explanatory Memorandum to the *New Business Tax System (Capital Gains Tax) Bill 1999* (Cth.) which, when enacted, inserted Div. 152 into the *1997 Act* …
>
> It follows that because s. 152-40(1)(a) is beneficial in nature, 'its language should be construed so as to give the most complete remedy which is consistent "with the actual language employed" and to which its words "are fairly open"'[20]. In that respect, a beneficial construction of legislation may, in our view, legitimately influence constructional choices in a given case which arise from the use of generalised language to describe a necessary connection between two things; here those two things are the use of an asset and the carrying on of a business.
>
> *Thirdly*, the language used in s. 152-40(1)(a) relevantly requires one to ascertain three matters. One must determine the use of a particular asset; one must then determine the course of the carrying on of a business; and then one must see whether the asset was used in the course of the carrying on of that business. These inquiries involve issues of fact and degree. But because s. 152-40 should be construed beneficially, no narrow approach to the consideration of these issues should be applied. We also observe that, for these purposes, the legislature has not used language which might confine these inquiries. It has not, although it could have, referred to the 'ordinary' course of a business or to the 'day to day' course of a business; it has not used the words 'direct' or 'integral' to qualify the word 'in'. It is sufficient if the asset is used at some point in the course of the carrying on of an identified business."

Acts Interpretation Act

It must always be kept in mind, when considering the meaning and effect of a provision of a Commonwealth Act, that the *Acts Interpretation Act 1901* may be relevant in particular circumstances. For example, that Act contains provisions which have the following headings:

- every section a substantive enactment (s 12);
- material that is part of an Act (s 13);
- construction of Acts to be subject to Constitution (s 15A);
- interpretation best achieving Act's purpose or object (s 15AA);
- use of extrinsic material in the interpretation of an Act (s 15AB);
- changes to style not to affect meaning (s 15AC). The ITAA97 in fact contains a corresponding specific provision (s 1-3);[21]
- examples (s 15AD);

– parts of speech and grammatical forms (s 18A);
– rules as to gender and number (s 23); and
– rules relating to distance, time and age (Pt 8).

The Act also contains a number of rules that apply to the construction of particular expressions in Commonwealth Acts.

The *Acts Interpretation Act 1901* rules apply unless there is a contrary intention.[22]

TaxCounsel Pty Ltd

References

1 Then of the Federal Court. His Honour was appointed to the High Court in December 2020.

2 *Auctus Resources Pty Ltd v FCT* [2020] FCA 1096 per Steward J at [84].

3 [2020] FCA 1186.

4 [1991] HCA 39. See also *Hepples v FCT (No. 2)* [1992] HCA 3.

5 [2019] FCA 2118 at [57].

6 (1947) 47 *Columbia Law Review* 527 at 533.

7 [2019] FCA 394 at [49]-[52].

8 [2017] HCA 34 at [14].

9 See *FCT v Consolidated Media Holdings Ltd* [2012] HCA 55 at [39], and *Barry R Liggins Pty Ltd v Comptroller-General of Customs* (1991) 32 FCR 112 at 120.

10 Citing *Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue* [2009] HCA 41 at [47].

11 [2019] FCA 394 at [52].

12 [2020] FCA 1096 at [72].

13 (1998) 194 CLR 355 at 382.

14 [2017] VSC 647.

15 [2020] UKSC 22 at [27].

16 [2011] 1 WLR 44 at [37]-[39], collected from *Inland Revenue Comrs v Metrolands (Property Finance) Ltd* [1981] 1 WLR 637, *Marshall v Kerr* [1995] 1 AC 148, and *Jenks v Dickinson* [1997] STC 853.

17 [1952] AC 109 at [133].

18 [2020] FCAFC 155.

19 [2020] FCAFC 155 at [38], [40] and [41].

20 *Khoury v Government Insurance Office of New South Wales* [1984] HCA 55 per Mason, Brennan, Deane and Dawson JJ at [29].

21 S 1-3 ITAA97 has been considered in, for example, *Keycorp Ltd v FCT* [2007] FCA 41 and *FCT v BHP Billiton Finance Ltd* [2010] FCA 25; [2010] FCAFC 25.

22 S 2(2) of the *Acts Interpretation Act 1901*. There was, for example, a contrary intention in the use of the word "may" in former s 46(3) ITAA36, so s 33 of the *Acts Interpretation Act 1901* did not apply: *Finance Facilities Pty Ltd v FCT* [1971] HCA 12.

Mid Market Focus

by Marcus Polovineo, HLB Mann Judd

R&D: a year in review

The following article highlights important R&D tax incentive developments that occurred during the 2020 calendar year.

2020 was certainly a year for the history books. The COVID-19 pandemic that took hold in 2020 resulted in significant economic impacts in Australia, ultimately triggering Australia's first technical recession since 1991. This resulted in the announcement of various stimulus measures at both state and federal levels of government.

As we emerge from the COVID-19 pandemic, incentivising innovation and skills development in Australia will undoubtedly be a focus for a strong economic recovery.

With economic recovery in mind, the R&D tax incentive remains a relevant and important tool in promoting this outcome. This has already been acknowledged by the inclusion of various R&D amendments in the Treasury Laws Amendment (A Tax Plan for the COVID-19 Economic Recovery) Bill 2020 (the COVID-19 Recovery Bill).

In addition to the changes included in the COVID-19 Recovery Bill, 2020 marked another year of discussion regarding both the eligibility criteria and the operation of the R&D tax incentive program. Despite this, the primary eligibility criteria and guidance remained relatively unchanged.

There were, however, various developments throughout the year that advisers should be aware of.

R&D: a recap on recent changes

As part of the 2018-19 Australian federal Budget, the government announced that it would seek to increase the integrity of the R&D tax incentive program and focus on rewarding entities with higher proportionate R&D expenditure. This was proposed to be achieved through the introduction of a new four-tiered R&D intensity measure.

The Bill to implement the 2018-19 R&D Budget measures was introduced into parliament, but ultimately lapsed.[1] The Bill was subsequently re-introduced in December 2019 in almost identical form with regard to the proposed R&D changes.[2] Most significantly, the changes included in the re-introduced Bill were proposed to apply for the 2020 tax year. However, at the conclusion of the 2020 financial year, the Bill had not been passed.

The resulting uncertainty, and possible requirement to amend tax returns if the Bill was passed, was of great concern to advisers and claimants alike.

Thankfully, the COVID-19 Recovery Bill introduced and passed in October 2020, resolving any uncertainty by replacing the earlier Bill and legislating that the modified changes would now apply from the first income year commencing on or after 1 July 2021.

COVID-19 Recovery Bill

The COVID-19 Recovery Bill was introduced into parliament on 7 October 2020 and received swift assent on 14 October 2020.

The Bill included various changes to the operation of the R&D tax incentive, being primarily:

- increasing the R&D expenditure threshold from $100m to $150m and making the threshold a permanent feature of the law;
- for the refundable offset (ie a turnover of less than $20m): linking the R&D tax offset for refundable claimants to the claimant's corporate tax rate — effectively making the rate 18.5 percentage points above the claimant corporate tax rate (to reflect the reductions in corporate tax rate);
- for the non-refundable offset (ie a turnover of greater than $20m): basing the offset available on the "R&D intensity" of the claimant entity through the inclusion of two "tiers":

Tier	R&D intensity range	Intensity premium
1	Notional deductions representing up to and including 2% of total expenses	8.5 percentage points
2	Notional deductions representing over 2% of total expenses	16.5 percentage points

- extending the general anti-avoidance rules in the tax law to R&D tax offsets directly;
- making the rate at which the offset is recouped more accurate in situations where the offset would otherwise result in an additional or double benefit; and
- making the rate at which deductible balancing adjustment amounts incorporate the R&D tax incentive more accurate.

These changes, particularly the simplification of the originally proposed four-tier R&D intensity measure, reflect a more practical and accessible change to the R&D rules.

Importantly, the Bill did not make any fundamental change to the existing eligibility criteria.

In addition to the assent of the COVID-19 Recovery Bill in 2020, there were various Administrative Appeals Tribunal cases between claimants and Innovation Science Australia (ISA) during the year which offer critical insights into understanding both the interpretation of the R&D eligibility requirements and the key risk areas that claimants and advisers alike should be well versed in.

Coal of Queensland

Background

In *Coal of Queensland Pty Ltd and Innovation and Science Australia (Taxation)*,[3] the claimant held exploration permits covering an area of central Queensland known to contain unexploited coal deposits. It was understood that the features of these deposits made extraction prohibitively expensive. The claimant sought to develop new processes to overcome the geographical features thought to make the process unviable.

R&D analysis

The AAT found in favour of ISA. The claimant has appealed to the Federal Court of Australia.

It was asserted by ISA that the claimed activities were not eligible R&D activities on multiple grounds, including that:

- the outcomes were not determined by applying a systematic progression of work, based on principles of established science, proceeding from hypothesis to experiment, observation and evaluation leading to logical conclusions;
- the activities were not conducted for the purpose of generating new knowledge; and
- the claimed core R&D activities fell within the scope of an exclusion in s 355-25(2) of the *Income Tax Assessment Act 1997* (Cth) (ITAA97), being the exclusion extending to "prospecting, exploring or drilling for minerals".

There are various comments included in the reasons for decision in this case that have broad relevance when considering the eligibility of R&D claims.

With regard to documentation, it was observed that:[4]

> "… there are no R&D plans or documentation to demonstrate the activities were carried out by applying a systematic progression of work based on principles of established science; or that they proceeded from the purported hypothesis to experiment, observation and evaluation, leading to logical conclusions."

It therefore remains critical that claimants maintain clear documentation, not just detailing the work done, but also addressing the specific R&D plan and process to be followed in accordance with the principles of established science.

The claimant employed external consultants to perform various tests and analysis. Many claimants might feel that this level of substantiation offers a high level of contemporaneous support for the R&D undertaken. This is likely only true to a limited extent; in particular, to the extent that this documentation forms a clear part of a contemporaneously documented R&D plan outlining a systematic progression of work.

Further, it was observed that the activities:[5]

> "… were all generic exploration activities undertaken in the initial exploration stages which a company with a mining tenement would undertake in order to ascertain the location, quality and size of the coal resources so it can progress to a point of being able to mine the coal."

Accordingly, it was determined that the activities were not core R&D activities and all came within the exclusion in s 355-25(2)(b) ITAA97.

It is evident that the "fatal blow" in this case was ineligibility as a result of the specific exclusion for "prospecting, exploring or drilling for minerals" in s 355-25(2)(b) ITAA97. However, even without the implication of this exclusion, the claimant would have likely been unsuccessful, both as a result of the generic nature of the activities and also as a result of the lack of contemporaneous documentation available.

Havilah Resources

Background

In *Havilah Resources Ltd and Innovation and Science Australia (Taxation)*,[6] the claimant controlled various mining tenements in South Australia.

The claimant included R&D activities for multiple tenements, relating to:

- new processes for the removal of excess groundwater;
- new processes for proposed tailings storage; and
- various hydrogeological and geotechnical investigations.

R&D analysis

The AAT found in favour of ISA in this case. Included in the reasons for decision were multiple eligibility issues with the respective claimed activities.

It was concluded that specific activities did not satisfy the definition of core R&D activities. It was observed in this regard that:[7]

> "Information derived from a routine investigation of hydrogeological conditions is not an outcome that can only be determined by applying a systematic progression of work that proceeds from hypothesis and leads to logical conclusions. In this case, the outcome was determined by a process of routine investigation."

Further, the activities associated with the testing and analysis of groundwater and the development of a hydrological model were found to be activities associated with complying with statutory requirements or standards and were ineligible as a result of the specific exclusion in s 355-25(2)(f) ITAA97.

Of particular note with regard to documentation, it was observed that:[8]

> "The lack of documentation evidencing an hypothesis creates a real evidentiary difficulty for Havilah because it is required to establish a systematic progression of work that proceeds from hypothesis to experiment in a scientific way. One would expect documentation recording the systematic progression of the activities undertaken."

These comments highlight the importance of contemporaneous documentation directly addressing the hypothesis being tested. It is probable that a significant number of claimants might informally establish the relevant hypothesis at the time of performing relevant experiments but may not commit this to writing until a later date. This potentially adds a significant level of risk regarding R&D eligibility.

Finally, some registered activities were found to fall under the mineral exploration exclusion in s 355-25(2)(b) ITAA97. The AAT considered the contents of the taxpayer's quarterly reports and concluded that there was a purpose of locating gold deposits, even though the registrations did not necessarily include the specific reference to "deposits".

Other observations and developments

Both the *Coal of Queensland* and *Havilah Resources* cases add further to understanding the requirements for satisfying the core R&D eligibility criteria.

Both cases also serve as a reminder that advisers must be mindful of the activities specifically excluded from being eligible R&D activities. These include activities associated with complying with statutory requirements or standards, as well as activities associated with prospecting, exploring or drilling for minerals.

Comments included in the reasons for decision in *Havilah Resources* are a clear reminder of the threshold that triggers these exclusions. This includes that:[9]

> "Even if the claimed activities were carried out for such a dual purpose, the exclusion would be engaged. The test is not whether the activity is solely or even primarily carried out to comply with statutory requirements or standards; the test is whether the activity is 'associated with' complying."

Importantly, the most broadly applicable observations from these cases relates to the documentation requirements for R&D eligibility. Documentation requirements have long been an area of concern for R&D, particularly as these requirements are not clearly articulated in the R&D legislation. Increasingly, however, and as is further evidenced in these two cases, it is clear that, in order to evidence the required systematic progression of work that proceeds from hypothesis to experiment in a scientific way, contemporaneous documentation should be considered as a necessity.

Particularly from *Havilah Resources*, it could be interpreted that, without being able to evidence a clearly established hypothesis at the outset of the R&D activities, it would be difficult, if not impossible, to establish how a systematic progression of work in a scientific way could have been undertaken.

Advisers must be focused on assisting their clients to ensure that their R&D activities are documented throughout the period of the R&D activity. In particular, making it clear that any hypothesis being addressed is established and documented from the outset of the R&D activities.

This is especially salient as it was recently published that a taxpayer had commenced proceedings against their R&D adviser in relation to the R&D advice and services that were provided.[10] The proceedings included that:

> "It [the R&D adviser] would have advised the applicants as to the proper manner in which the applicants could have planned, documented and conducted activities in subsequent years so that such activities would comprise eligible R&D activity in respect of which valid claims for R&D tax incentives could then have been made."

This should serve as a further reminder to advisers to not only make it explicitly clear to their clients of the R&D eligibility criteria, but also to advise in detail on the documentation requirements for best ensuring R&D eligibility for both current and any future R&D claims.

Conclusion

The R&D incentive is likely to remain, at least in the short term, as an important policy that offers significant benefit for many taxpayers. The recent cases discussed above highlight that advisers and claimants should take a cautious approach when it comes to maintaining R&D documentation. While there is likely to be ongoing discussion surrounding the amount of documentation required to support an R&D claim, there is little doubt that the best possible position is achieved by ensuring that the R&D process is clearly and contemporaneously documented.

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7 [2020] AATA 933 at [77].

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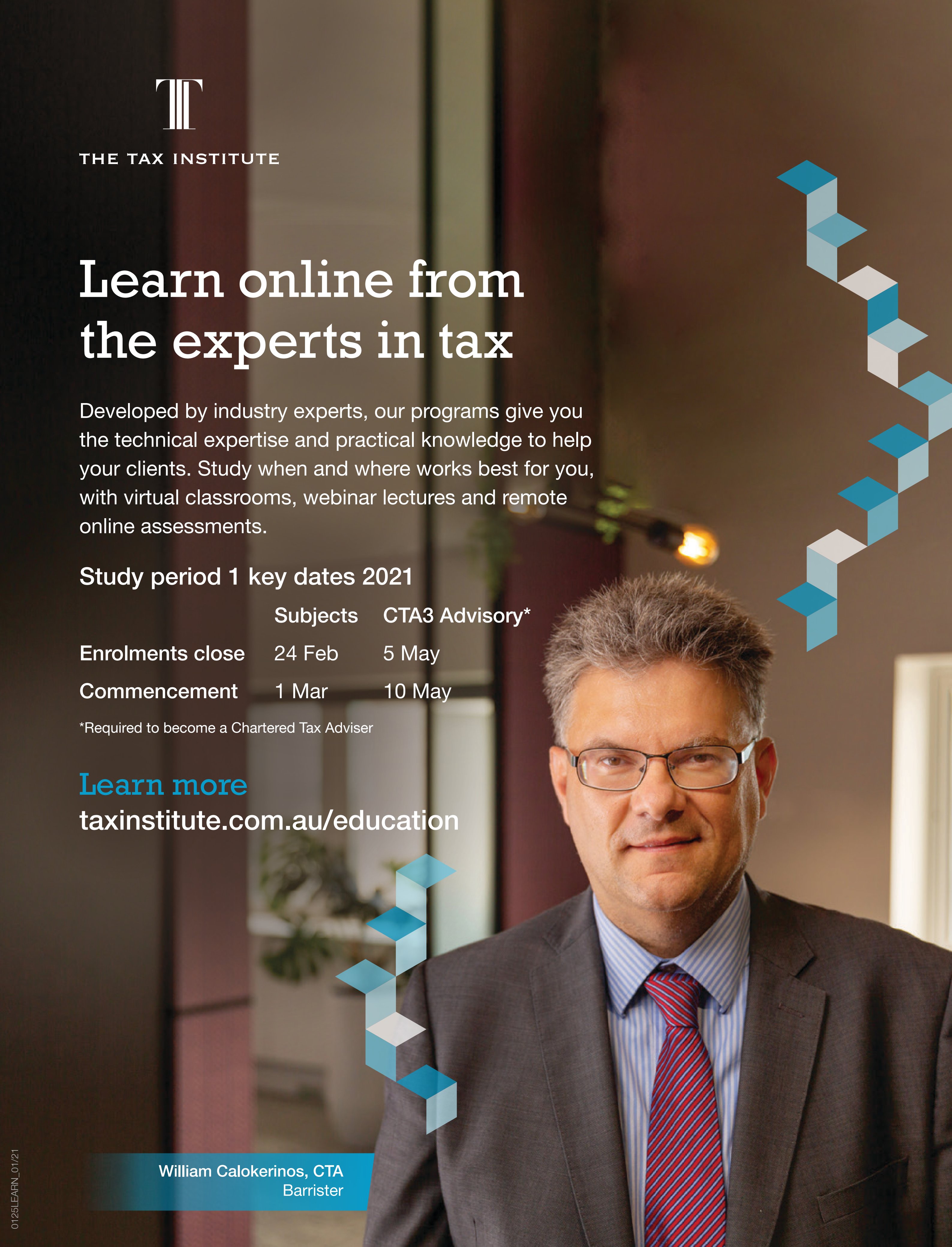
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How study will enable continued career success

The Tax Institute's CTA2A Advanced 2020 study period two dux shares her thoughts on the most valuable aspect of studying at the Institute.

Paula Bennett, Partner, Markel Tax (UK), NSW

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

I am a UK chartered accountant, a UK Chartered Tax Adviser, a trust and estate practitioner, and have an Advanced Diploma in international tax. I have spent over 20 years working in tax in the UK, beginning my tax career in 1998 advising small businesses and private clients. In 2002, I moved into the owner-managed business sector, with a particular specialism in business succession and equity reward. It was during that role that I made partner. My next step was using all of my tax skills to provide tax support to accountants and their clients. I was a partner in BDO LLP in London, where I led the national tax support for professionals market. In 2011, I founded an award-winning tax practice which I sold when I relocated to Australia.

During my tax career to date, I have given 600+ tax lectures and webinars, written eight editions of *Tolley's tax planning for owner-managed businesses*, written countless tax articles, and been interviewed on tax matters for TV and radio.

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

Being able to understand and apply the Australian tax rules; in particular, the complexities around the various small business CGT concessions, the use of trusts in business structuring and superannuation.

What are your areas of new confidence?

With my deep knowledge of UK tax, this subject has given me a sound understanding of the Australian tax rules which are ostensibly similar to the UK but, on further analysis, are remarkably different.

What was the reason for undertaking CTA2A with the Institute?

So that I can advise my clients on Australian tax matters. This subject is part of the course to obtain the qualification to become a licensed adviser in Australia.

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

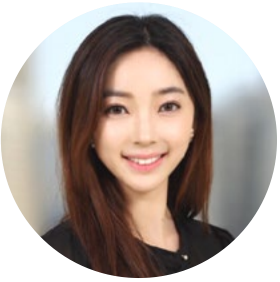
I am currently studying CTA2B and will then study Australian commercial law. I enjoy working in tax and I am always taking the opportunity to expand my knowledge. As a member of The Tax Institute, I regularly use its valuable resources to develop my knowledge.

What are the challenges of juggling study and work?

Finding time to study while working and making time for the family is always tough. I stick to my planned study time and always made sure I have time to get down to the beach with the family.

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

Studying with The Tax Institute is a positive experience. The program is very structured, and if you follow the recommended timetable and do the required research, you should be prepared for exam day!



Member Profile

This month's column features Amy Liu, CTA, from HWL Ebsworth, New South Wales.

Member since

2018

Areas of specialty

Cross-border investments, mergers and acquisitions, corporate structuring, private equity and real estate transactions, with a specific focus on GST.

What made you choose tax as a career and join The Tax Institute?

I picked tax law as an elective at university as I thought it was the perfect combination of commerce and law subjects. As I began my career at Deloitte, it seemed to me that tax was fundamental to every transaction in the economy. I find tax intellectually stimulating as you frequently have to use logic to solve complex problems for clients. I also enjoy the fact that, because tax is constantly changing as it adapts to government policies and the global economy, you are expected to come up with innovative and practical advice for clients.

How is your membership beneficial to your practice and clients?

The materials on The Tax Institute website offer invaluable insights on both the technical and practical aspects of tax law, and I often use these materials when preparing tax advice. The Tax Institute is also an amazing community that allows you to network with other tax practitioners through its conventions, seminars and CPD units. In 2020, I had the wonderful experience of participating in the Institute's NSW Emerging Leaders Program and presenting at a number of Monthly Morning Tax Clubs.

What is your most memorable career achievement to date?

My most memorable career achievement is making the transition from a GST lawyer to a broad-based tax lawyer. Both experiences offered me an extensive skill set and helped me to become a well-rounded tax adviser. I have utilised this to create a positive impact in the client's businesses, whether it is resolving a tax dispute, fostering a business expansion, or setting up employee incentive plans. As a testament to my efforts, in 2020, I had the great honour of being nominated as a finalist in both the *Lawyers Weekly* 30 Under 30 awards (Taxation category) and The Tax Institute's Tax Adviser of the Year Awards (Emerging Tax Star category).

What do you see being the main challenges for tax practitioners this year?

COVID-19 has changed the way society and businesses operate. I believe the challenge this year is for practitioners to grasp the implications of COVID-19 on businesses and the economy, and to be prepared for the uncertainties that these implications bring in an environment where clients increasingly rely on us for certainty. To do this, practitioners will need to consider both the technical and practical business implications of the tax advice provided.

What do you see as the key attributes of an effective leader in the tax profession?

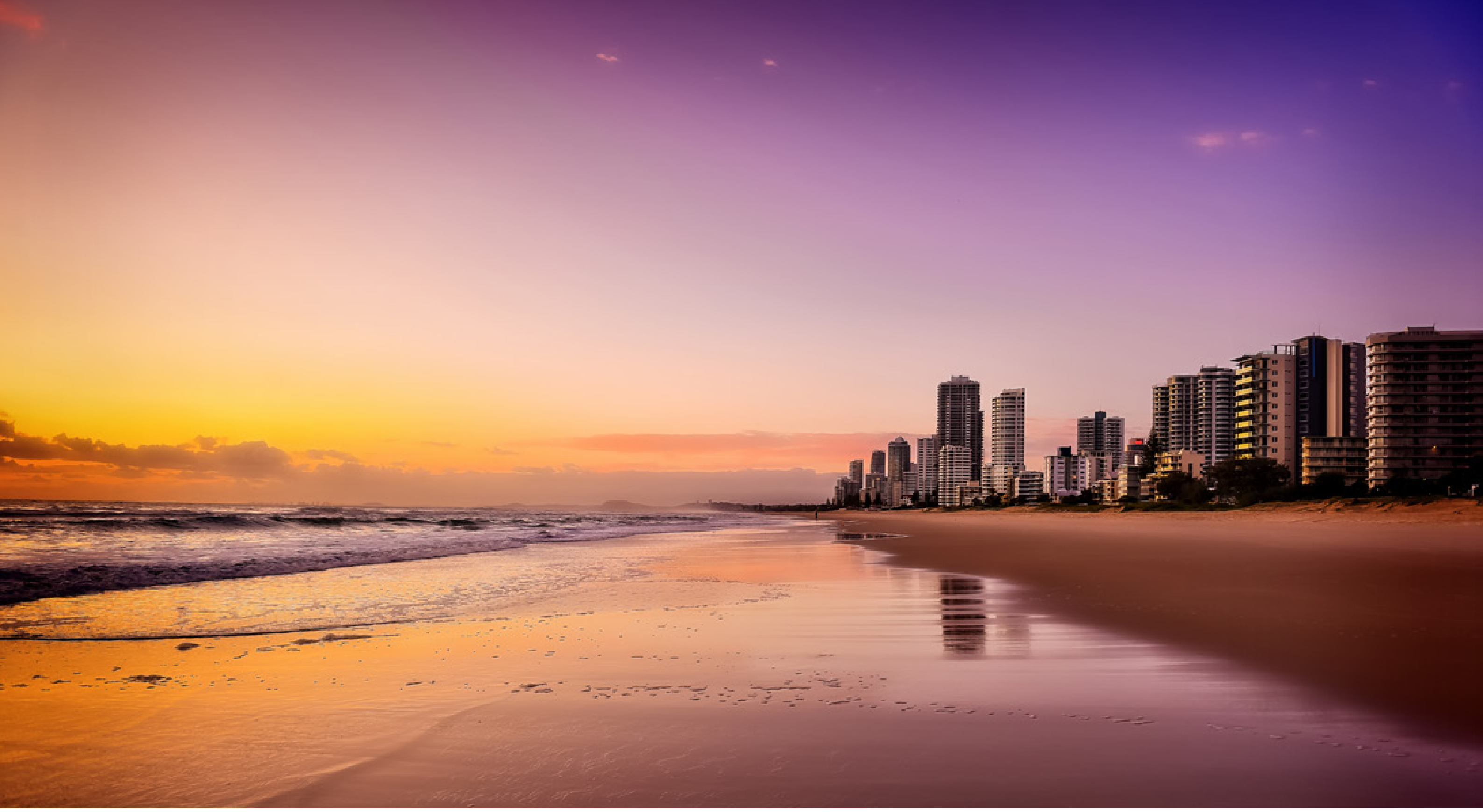
Effective leadership is universal across all professions — an effective leader is someone who trusts your abilities (sometimes more than you trust yourself) and provides the utmost support for the team's growth. I have been fortunate to work with various leaders and mentors in my career, including in my current role, and this has had a profound impact on my career development. Leaders in the tax profession should help their team to see how tax fits into the broader transaction and the bigger picture.

Do you have any advice for young professionals just beginning their career in tax?

Plan ahead! Understand what is expected of you during each stage of your career and what is required to achieve the next steps, set out your goals, and monitor yourself so you can meet them. Don't walk in a forest without a map! You must have complete faith in yourself and your abilities to succeed; understand that all of your past skills and experiences will together make you a well-rounded adviser.

What does work–life balance mean to you and what are your interests outside of work, how do you relax?

I believe work should be part of your life, and when you embrace work as a sense of personal growth and lifelong learning, you automatically balance it with any other aspects of your life. I love reading — it allows me to relax and enter into a meditative state especially when I am engrossed in a self-development book.



Tax reform: taking stock and next steps

by Andrew Mills, CTA (Life), Director, Tax Policy and Technical, and Robyn Jacobson, CTA, Senior Advocate, The Tax Institute

This article reminds members that one of the main objectives of The Tax Institute is to advocate for improvements to the tax system. The focus that has been given to holistic tax reform since mid-2020 — comprising the series of keynote speaker events, focus sessions, roundtables and The Tax Summit: Project Reform, together with the development of the document *The case for change* — has been designed to encourage debate on what are the best features of a tax system and to call governments to action. The release of *The case for change* will be the basis for continuing to pursue the cause of genuine tax reform for the benefit of Australia and for our members and their clients.

Why tax reform?

A tax system is designed to raise the money that governments need to provide the services demanded by society. This means that imposts by governments can take many forms, be it user pays or more generic and traditional revenue raising.

A *good* tax system, on the other hand, not only raises the right amount of revenue, but is also conscious of the impact that taxes have on economic activity. A tax system that efficiently stimulates economic growth and productivity[1] is to be preferred to one that has no regard for the impact on economic activity. Tax systems are traditionally gauged on the basis of three accepted fundamental principles: efficiency, equity and simplicity.

Efficiency

The OECD[2] seeks to rank various taxes according to the relative harm taxes might inflict on economic growth. The conclusion, in terms of efficiency and efficacy, is that the most harmful type of taxes for economic growth are corporate taxes, followed by personal income taxes, and then consumption taxes, with recurrent taxes on immovable residential property being the least harmful. Accordingly, taxes on immovable residential land impose the lowest cost on economic growth. This conclusion is similar to that recently described in the report commissioned by the New South Wales Government into federal financial relations (the Thodey report).[3] That report notes that land tax is efficient and one that could be more broadly based is to be preferred as a substitute for the highly inefficient stamp duty.

Further, while the Thodey report notes the relative efficiency of the GST, it also notes that there are major risks to its resilience[4] and that it has failed to be the growth tax it was designed to be because of the relatively narrow base. That is, the proportion of household expenditure that is subject to GST is shrinking and this trend is likely to continue with demographic changes as well as technological change.

It is also well documented that Australia has a comparatively high reliance on corporate taxes compared to other jurisdictions. In the OECD's *Revenue statistics 2020*,[5] Australia ranks fourth highest when it comes to the proportion of tax raised from companies. (The first three countries are Chile, Colombia and Mexico — not the countries we generally compare ourselves to on financial metrics.) Australia ranks equal second highest on the proportion of revenue from personal income tax and third lowest on consumption taxes. One must ask, are we so significantly out of step for any good reason? Do we know something other countries don't or have we been left behind? Noting that our national productivity growth has been extraordinarily low over the last 20 years, we should ask to what extent is this attributable to the current mix of taxes. How much is the current tax system impeding productivity and economic growth?

To many, the solution is obvious.

While some would argue that the only necessary and almost completely unavoidable tax is one based on land and its use,[6] that approach would be challenged by perceptions of failing at least one of the accepted fundamental principles of a good tax system: equity, efficiency and simplicity. A tax focused solely on the returns from the use of land could be simply designed and clearly satisfies the accepted wisdom of what is an efficient tax. However, it is likely to struggle to be designed in a way that meets existing concepts of fairness.[7]

The right mix of taxes would reduce reliance on the known inefficient taxes and increase the proportion of revenue raised by efficient taxes. This is true economic reform — reform which enhances productivity and creates employment.

Equity

While a shift away from taxing income to relying more on consumption taxes and a land-based tax may be desirable from an efficiency point of view, it is important to factor in fairness.

Equity and fairness lead to a more cohesive society. A system that is fair, and can been explained and perceived as fair, improves confidence that tax is being paid appropriately by the right contributors. The focus in recent years about multinational corporates not paying "the right amount of tax" illustrates this. Media reports often overlooked the fact that one-third of listed companies actually make real economic loss in any one year or that significant accumulated losses were legitimately applied against otherwise taxable incomes, creating the misleading impression that one-third of corporates don't pay any tax.[8] The truth is that the corporates were fully compliant with the law and paid what was due in most cases.[9] However, what the law required to be paid and how that amount should be determined had not kept pace with community expectations. Politicians (some of whom were apparently "outraged" by certain behaviours) were those responsible for ensuring that the legislation kept pace with those changing expectations.

Accordingly, it is important that tax laws are consistent with community expectations of fairness. That it has apparently ceased to be so is a failure of successive governments to invest in ongoing maintenance of the system. While apparently somewhat mundane, it is clear what happens when that maintenance is neglected.

Australia prides itself on being a society of equals where everyone gets a "fair go". It is unsurprising, therefore, that a system that maintains an appropriate level of progressiveness on income (and wealth distribution) will gain acceptance and support from the community. The importance of ensuring that the social security (ie transfer) system is playing its part in maintaining that fairness is critical and should not be overlooked in any debate regarding the fairness of the system.

However, when considering the appropriate fairness settings in a tax and transfer system, not all taxes are as equitable as they may superficially seem. The International Monetary Fund, in its work "Tax policy for developing countries", has said:[10]

> "Another concern in the choice between taxing income and taxing consumption involves their relative impact on equity. Taxing consumption has traditionally been thought to be inherently more regressive (that is, harder on the poor than the rich) than taxing income. Doubt has been cast on this belief as well. Theoretical and practical considerations suggest that the equity concerns about the traditional form of taxing consumption are probably overstated and that, for developing countries, attempts to address these concerns by such initiatives as graduated consumption taxes would be ineffective and administratively impractical."

As noted in an article[11] in the August 2020 issue of this journal, what superficially can seem regressive might actually be progressive. Thus, the differential treatment of food, depending on whether it is classified as a pre-prepared meal, may actually mean that lower socio-economic sections of society are spending a higher proportion of their income on GST than was previously understood and that some higher socio-economic sections of society may not be paying GST on what may be considered "luxury" items.

Similarly, recent work by Treasury[12] suggests that payroll tax has little effect on the employment decision.

A tax reform process must include better education of the real impact of taxes on different sections of society and expose for debate what is truly progressive and what is not.

Such education and debate must also address the real incidence of taxes: the way in which certain taxes impact on not only the "payers" of the tax, but also on the consumers, employers, employees and other businesses that interact with the payers.

Perhaps one of the starkest discussions that ran as a theme across a number of The Tax Summit: Project Reform sessions was the impact of the interaction of the tax and transfer systems on working parents and the high effective marginal tax rates that they — usually working mothers — face. This is one of the most unfair features of our current system and could fall under the heading of "gender equity" in our tax system. Primary carers can face a net cost of working an additional day once effective marginal tax rates are added to the cost of childcare itself. This should be regarded as one of the most fundamental failures of our system. The fact that it seems to be acknowledged but little is done about it is a further indictment on the way in which society responds to such failures. It is the role of bodies like The Tax Institute to prosecute the changes necessary to rectify this shameful situation.

Also raised during The Tax Summit: Project Reform discourse was intergenerational equity. This is an important issue, not only because inequities exist between different age groups at different times — and there may be good reason for that — but also because little work seems to have been done and minimal debate has occurred about what taxes are borne and benefits received over the course of a lifetime. Further, this issue is exacerbated by the fact that there is a risk of that equation changing through policy decisions that may not have regard to the longitudinal impact. Thorough research is necessary to have an informed debate about the right tax settings across a lifetime and to ensure that certainty is built into those settings.

Finally, equity must also consider the treatment of different types of income earned — known as "horizontal equity". Often what is called out in this part of the debate is the differing treatment of, say, the taxation of savings to the taxation of labour income. While valid, the debate on horizontal equity should be widened to include the taxation of the same income in the hands of different entities and whether that is an appropriate setting. Currently, small business income is taxed in a variety of ways depending on whether the chosen business vehicle is a sole trader, partnership, limited partnership, trust or company. That such differences can exist creates complexity and leaves open significant planning opportunities which undermines confidence in the equity of the tax system.

Simplicity

The third main feature of a good tax system is simplicity.

Simplicity generally promotes cost efficiency which provides an environment for greater investment and builds trust in the system.

The complexity of the current system is reflected in the multiple laws and the detailed rules which are often overlaid on already complex rules. While the Board of Taxation recommended, and the government implemented, a significant reduction in the size of the tax laws in the mid-2000s, the laws have since grown again and now exceed 10,000 pages.

Complexity reduces the ease of doing business and deters investment, both domestic investment as well as foreign direct investment.

The most telling statistic of the complexity in the Australian tax system is the estimated cost of meeting obligations to register, calculate and pay tax liabilities. The estimated compliance costs of some $40 billion per annum is a dead weight cost on business and Australians. It represents more than 10 times the cost of running the Australian Taxation Office. It represents significant red tape and is a drag on economic activity. That means reduced economic welfare for Australians with lower investment, resulting in fewer employment opportunities.

Additionally, a complex system reduces the level of trust in the system and is connected to perceptions of the fairness in the system. Because the system is complex and seems impenetrable — other than to the cognoscenti — it has the appearance of being capable of manipulation by those fortunate to be advised by that cognoscenti, irrespective of the truth of that.

A feature of simplicity (and one that is often called out separately) is sustainability and stability of a system. A system designed with these features is flexible and minimises the need for constant tinkering. Fewer changes foster certainty, confidence and trust. We have seen what happens when a system is not designed for the long term or is designed in a way that is inflexible to changing economic or societal circumstances and imperatives — it has resulted in our current inefficient, inequitable and complex tax system.

Another perspective of certainty is that a system should be clearly understood by society, which requires a level of transparency. But other aspects are equally important — the need for our system to be integrated into other systems given the openness of our economy and the considerable trade and flow of capital, as well as being positioned to create the best kind of jobs. Or, to express it as the Prime Minister did early last year — it's about creating investment and jobs.

> *"A system that is not designed for the long term … has resulted in our current inefficient, inequitable and complex tax system."*

How does the current system measure up?

Efficiency

Various reports have pointed out that Australia relies on a number of high economic cost taxes. At a state level, examples include the various duties, whether on real property or other transfer (eg cars) duties, and insurance duties. At a federal level, there is a high reliance on corporate taxes. All of these taxes have an "excess marginal burden" or the value destroyed for the dollar of revenue raised — the Thodey report sets this out most recently but it has been a theme of previous tax reviews, including the Henry review[13] in 2009.

Equity

The incidence of high effective marginal tax rates on some sections of society has been referred to above and discussed during the course of The Tax Summit: Project Reform event series, backed up by the work done by Ann Kayis-Kumar (UNSW), Miranda Stewart (University of Melbourne) and others, and reflected in publications by the Grattan Institute, among others.

Importantly, this work shows that the tax system does not sit alone but interacts with other systems (transfer/social security); people often forget that these were once highly integrated, with many benefits being delivered through the tax system. This is less so today and may well be part of the reason for what is now a very disjointed and incoherent system.

Similarly, the retirement system must not only integrate with other parts of the tax and transfer system, but it must also satisfy community expectations of fairness and equity. There was considerable (and perhaps surprising) agreement among experts in this area during the course of The Tax Summit: Project Reform event series that the current design of the taxation of superannuation is too generous. The fact that the taxation is levied at concessional rates on contributions and income of the funds during the accumulation phase for members, yet fund income and benefits during retirement phase are completely exempt, means that concessions are significant and their affordability in the context of the whole system is questionable.

The government's recent *Retirement income review* noted:[14]

> "Contributions and earnings tax concessions together were estimated to cost a total of $41.55 billion in revenue forgone terms in 2018-19 (Chart 4A-6). Of this, $18.3 billion was employer contributions tax concessions (both compulsory and salary sacrifice) and $22.1 billion was earnings tax concessions. Only $1.1 billion was personal contributions tax concessions, reflecting that less than 10 per cent of personal contributions are concessional."

To some extent, the tax concessions drive the complexity in the design of the tax rules as integrity measures are built in. It is instructive that the changes to superannuation in the mid-2000s that introduced many of the current concessions (before substantial modification in 2016) were originally described as "Simpler Super" but, by the time they passed parliament, the initiatives had been renamed "Better Super".

Simplicity

Australian tax law (which exceeds 10,000 pages) is often highly intricate, and much of it applies only to a small proportion of the taxpayer population. This has been referred to above, as have the other features, which give rise to a poor score for the tax system on these criteria.

The ATO speaks of "papering over the complexity" in the system. While there is much to be admired in an administrator proposing to use technology to hide the complexity in the system, it means that the general population will not be aware of the unnecessary complexity that exists in the tax system. Rather than paper over complexity, it might be better to address the fundamental complexity so that it is not necessary to use some of the revenue collected in simplifying the user experience. If the system is simplified, less will then need to be spent trying to create the appearance of simplicity.

Trust and transparency

The lack of trust manifests itself in many ways. The lack of trust in the efficacy of the system exists because of the complexity. This emanates from a suspicion of large/multinational corporates and the perception that, if you can afford to pay for "smart tax lawyers and accountants", you can avoid paying your fair share of tax.

A lack of trust between the administrator and the taxpayer which is reflected in audit approaches and efforts adds to the compliance costs imposed on taxpayers. Nonetheless, despite that apparent lack of trust between the administrator and taxpayers in relation to particular dealings, there is a valuable commodity in our system: the relatively high(er) trust in the ATO as administrator, which helps foster the relatively high levels of voluntary compliance that Australia enjoys.

Levels of reform

The system as a whole

Considering the whole system, reform is about the choice of taxes, taking into account the principles above. It is also about the mix of taxes.

Putting aside single tax solutions for the reasons outlined above, we are left with choosing which taxes to put into the mix and what weighting should be given to each of those taxes. Obviously, land tax and consumption taxes should be given greater weight than is currently the case as they are the more efficient taxes. However, we are unlikely to move away from some form of tax on income and profits/gains, so it is important that they, too, be in the mix.

Can the balance be shifted away from taxes on income and profits/gains which are less economically efficient in favour of GST and land tax? Can other taxes be designed so they are more economically efficient? It seems that payroll tax might fall into this category. Similarly, income tax could be made more efficient through changes to thresholds and rates. It is a matter of to what extent, but the answer should be a resounding "yes".

Can we repeal some of the smaller, nuisance taxes? Some of the insurance duties are clearly ripe for abolition. Similarly, the excise regime on alcohol could either be scrapped or rationalised.

Can the superannuation laws be rewritten in a way that is both able to be applied by the average practitioner and comprehensible to the majority of superannuation fund members? I would defy most politicians to describe the intricate and complex superannuation rules that they have created in any level of detail.

There are other examples.

Whatever choices are made, a clear eye will need to be kept on the impact on various sections of the community to ensure that any impacts are considered and dealt with appropriately. This is addressed below.

The design of the system

As we drill down to the next level, the question is how to design each of the taxes so that they have the greatest effect with the least economic impost.

This is more challenging, and vested interests will attempt to ensure that the system continues to work for them. I say this because there are clearly anomalies in the way the current system works that provide perceived benefits for some.

The work that The Tax Institute's volunteers have done and much of the discussion throughout The Tax Summit: Project Reform event series have been focused on this. Some examples of questions that have arisen include:

– Why do we choose to have a GST that taxes less than 50% of consumption?
– Why do we have so many different thresholds for small business?
– Why do we have a two-tier company tax rate that creates so many problems — including definitional aspects, imputation problems and concerns at the borderline between large and small companies?
– Why do we have TOFA at all?
– Why did we choose the most unique and complicated consolidation regime in the world?
– Why do our international tax rules still throw up anomalies (eg *Burton*[15] and *Greensill*[16])? Are those rules coherent?
– Are the current CGT discount settings too generous?
– Why do we tax businesses differently depending on the particular legal structure chosen? Why do we encourage complicated structures because of those very differences?
– Should imputation continue to be a feature of our tax system?
– Why do we have so many different definitions of "employee'"? Why do we use the concept of "employee" at all in tax? Should we instead use the concept of "worker"?
– Why are there so many different withholding regimes and yet we have large chunks of economic activity that are neither subject to withholding nor reporting?
– Why do we have such a strange, outdated and complicated FBT system?
– Why do we allow grants to be redesigned to be tax incentives? For example, R&D.
– Why do we have a CGT that is so overly prescriptive yet only deals with half the balance sheet?
– Could the SGC regime be designed to operate more effectively to assist employers meet their superannuation obligations?
– Where is the optimal taxing point for superannuation amounts: on entry, during the investment phase or on exit?
– Why is there an age limit on making personal superannuation contributions?
– Why do individuals need to satisfy a work test to make personal superannuation contributions after age 64?
– Why do we have more than 10,000 pages of tax laws?

The list goes on.

Next steps

The Tax Institute will soon be publishing the document on tax reform which represents the culmination of the work of many committees and participants over the course of 2020. That document is *The case for change*, and it will be shared with politicians on both sides of politics and at both state and federal levels of government. It makes the case that not only is reform of the tax and transfer systems needed, but also that change is long overdue and must happen holistically.

While it will be up to governments to make changes through legislative amendments, it is our fervent belief that the ongoing prosecution of the case for change — for meaningful tax reform — is crucial to Australia's future prosperity and cohesiveness as a nation. The Tax Institute will continue to call and advocate for meaningful tax reform into the future, backed by the comprehensive work done by so many of our members and staff. Our economic future depends on successful tax reform.

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Tax and estate planning in 2021: where are we at?

by Matthew Burgess, CTA, Director, View Legal

In light of ongoing changes to the taxation regime and the expanding wealth of Australia's ageing population, there has for many years been a growing need for estate planning to utilise appropriate structuring. Estate planning related areas have largely been outliers from radical simultaneous rule overhauls. Since 2018, this historical position appears to have changed with a range of announcements, possibly permanently. Subsequent years have seen evolution in a number of areas, including trust vesting, trust splitting, testamentary trusts, excepted trust income and family trusts. One year on, however, the question needs to be asked: what has been the impact? With the post-baby boomer intergenerational wealth transfer wave gathering pace, the ongoing developments create significant risk for advisers and their customers in the tax and estate planning arena.

Introduction

In light of ongoing changes to the taxation regime and the expanding wealth of Australia's ageing population, there has for many years been a growing need for estate planning to utilise appropriate structuring.

This time last year, an article in this journal argued that 2018 had seen more changes in key estate planning areas in that calendar year than in each of the previous 30 years combined — and yet, 2019 had seen somewhat of a stagnation in relation to a number of key issues.[1] In particular, the article explored potentially important shifts in approaches across a range of issues, including the following areas:

– trust splitting;
– testamentary trusts and excepted trust income;
– the ongoing saga that is arguably the highest profile estate planning exercise in Australia's recent history (involving Lang Hancock, Gina Rinehart and her children);[2]
– the application of the so-called "safe harbour rule" under the small business restructure roll-over rules in Subdiv 328-G of the *Income Tax Assessment Act 1997* (Cth) (ITAA97); and
– the use of (binding) financial agreements.

Twelve months on, this article examines the status of each of the above areas (particularly trust splitting and excepted trust income where there have been important developments), while also exploring the following key estate planning related developments in 2020:

– the ability to structure testamentary trusts to minimise the risk that assets will be attacked on the relationship breakdown of a beneficiary;
– the latest guidance from the High Court in relation to the deeming rules that can apply to assets otherwise registered as owned as a joint tenancy;
– the use of enduring powers of attorney to manage superannuation death benefit nominations; and
– the impact of lost trust deeds of an inter vivos discretionary trust.

Trust splitting

In July 2018, the ATO released its views on trust splitting in TD 2018/D3.

As explored in previous articles in this journal,[3] there were a range of concerns with TD 2018/D3 for all tax and trust advisers. These issues were only partially addressed by the final ruling that was released in December 2019 as TD 2019/14 — a close to Christmas release date that continues what some advisers suggest is an apparent tradition of the "last ATO officer out the door has to issue an attack on trusts and then turn off the lights".

Critically, TD 2018/D3 assumed a single factual matrix which is very specific, and it lists a number of line items that may, or may not, be a part of a trust splitting arrangement.

Many trust splitting arrangements involve a change of trustee in relation to specific assets and few (or indeed none) of the other features listed in TD 2018/D3 (for instance, no changes to the appointors, right of indemnity or range of beneficiaries).

Given the extended delays in finalising TD 2018/D3, there must be a legitimate question as to its correctness in relation to the one example included in the draft. This is particularly the case since the ATO conveniently:

– ignores both High Court and Full Federal Court authority in decisions such as *FCT v Commercial Nominees of Australia Ltd*[4] and *FCT v Clark*[5] when making conclusions about trust resettlements; and
– makes unsubstantiated and unexplained assumptions about how a trustee may or may not act following a trust split.

Interestingly, the ATO does specifically explain its reasoning in relation to the above two points (and a range of other industry concerns) in a related publication to TD 2019/14, namely, its trust splitting *Public advice and guidance compendium*.[6] In particular, the ATO confirms its view (among the 39 "question and answers") that, in relation to the above two points:

– the decisions in *Commercial Nominees* and *Clark* considered whether a trust comes to an end and all of the assets of the pre-existing trust are settled on terms of a new trust. The question of whether a particular trust split arrangement causes a CGT event to happen in respect of the assets vested in the separate trustee is conceptually a different issue. As such, these decisions are of limited assistance when determining the tax implications of a trust split; and

- the observations about the expected outcome of a challenge by an aggrieved beneficiary are invoked as a convenient "check" on the conclusion otherwise reached as to the effect of the arrangement (namely, the creation of a new trust over assets transferred to the new trustee).

Ignoring the arguably questionable reasoning set out above, more positively, TD 2019/14 does include two key changes that address other serious issues that many specialists in this area had raised with regard to TD 2018/D3:

- a second example has been included which suggests how the ATO believes that a form of trust split may be able to be implemented, without causing a resettlement; and
- the ATO has appeared to effectively abandon its previous attempt to make TD 2019/14 retrospective by acknowledging that its view of the potential CGT implications of the arrangement discussed in this determination may have been subject to conjecture prior to the publication of TD 2018/D3 on 11 July 2018. The Commissioner will not devote compliance resources to apply the views expressed in this determination to arrangements entered into before this date.

The second example included in TD 2019/14 essentially confirms that a trust split will not be a CGT resettlement, so long as:

- if each trustee keeps separate accounts in respect of the assets that they hold, the results are consolidated for the entire trust fund and a single tax return is prepared for the trust as a whole;
- there is no attempt to apply for a separate tax file number;
- there is no amendment of beneficiary classes;
- there is no narrowing of the right of trustee indemnity (ie each trustee must continue to have recourse to all of the assets of the trust to satisfy its right of indemnity);
- there are no changes to the trustee who remains in control of assets not subject to the trust split; and
- the trustees of each "split" trust must still act jointly in relation to issues such as choosing an accountant, incurring joint expenses, amending the trust deed, and determining an earlier vesting date.

Based on the second example in TD 2019/14, all other aspects of a trust split are permissible, for example:

- amending the trust deed to allow the trust split to occur (assuming there is an adequate power of variation);
- appointing a new trustee (and replacing the previous trustee) to certain assets that are to be subject to the trust split;
- changing the appointor or principal in relation to the assets the subject of the trust split; and
- updating third party records (eg the land titles office, share registries etc) in relation to the change of trusteeship.

Certainly, proceeding with a trust splitting, even if it corresponds exactly with the second example in TD 2019/14, will not of itself necessarily provide a complete solution in relation to the estate and succession planning objectives.

While there are a range of additional complementary steps that may need to be taken, arguably, one of most prevalent is the simultaneous implementation of so-called "gift and loan back" arrangements.[7]

While a detailed analysis of the gift and loan back strategy in the context of a trust splitting is outside the scope of this article, briefly:

- there is the establishing of a new trust;
- the relevant split trust makes a gift of a sum of money to the new trust equal to the market value of the assets of the split trust;
- the trustee of the new trust then makes a loan of the gifted sum of money to the split trust; and
- the trustee of the new trust secures the loan by taking a charge for the sum of money over the assets of the split trust.

> *"... the ATO has appeared to effectively abandon its previous attempt to make TD 2019/14 retrospective."*

2018 federal Budget attack on excepted trust income

The announcement in the 2018 federal Budget[8] that "the concessional tax rates available for minors receiving income from testamentary trusts will be limited to income derived from assets that are transferred from the deceased estate or the proceeds of the disposal or investment of those assets" was, for many, a surprise.

Thus, as flagged in last year's article,[1] advisers in the estate planning industry should likely continue to be concerned about what the government means by suggesting that the mischief to be addressed is that "some taxpayers are able to inappropriately obtain the benefit of [a] lower tax rate by injecting assets unrelated to the deceased estate into the testamentary trust".

With the unexplained retrospective effect from 1 July 2019, the new rules are set out in s 102AG(2) ITAA36 (with a new subs (2AA)) and were crafted as follows with the one (very key) change to the rules as compared to what was originally proposed shown by the mark up below:[9]

> "(2AA) For the purposes of paragraph (2)(a), assessable income of a trust estate is of a kind covered by this subsection if:
>
> (a) the assessable income is derived by the trustee of the trust estate from property; and
>
> (b) the property satisfies any of the following requirements:
>
> (i) the property was transferred to the trustee of the trust estate to benefit the beneficiary from the estate of the deceased person concerned, as a result of the will, codicil, intestacy or order of a court mentioned in paragraph (2)(a);

(ii) the property~~, in the opinion of the Commissioner,~~ represents accumulations of income or capital from property that satisfies the requirement in subparagraph (i);

(iii) the property~~, in the opinion of the Commissioner,~~ represents accumulations of income or capital from property that satisfies the requirement in subparagraph (ii), or (because of a previous operation of this subparagraph) the requirement in this subparagraph."

Thankfully, the somewhat bizarre approach (given that our tax system is founded on the concept of self-assessment) originally to make two-thirds of the rules turn on the "Commissioner's opinion" was removed in the final version of the enacted legislation.

In an area that already has substantial compliance costs, if the hardwiring of subjective tests into the law had been implemented, it would have guaranteed further significant costs to taxpayers and, indeed, would have been likely to lead to increased administrative issues for the Commissioner.

The combination of the final legislation, explanatory memorandum (EM) to the Bill that became the *Treasury Laws Amendment (2019 Measures No. 3) Act 2020*,[10] and subsequent ATO observations in the publication QC 16509[11] make it clear that, at least from the perspective of the revenue authorities, the style of assets of a testamentary trust that are able to generate excepted trust income will be narrower than was previously the case.

Three specific examples, sourced from the EM and QC 16509, are set out below in relation to:

- a distribution from a family trust to a testamentary trust;
- the reinvestment of testamentary trust income; and
- acquiring an asset of a testamentary trust with funds sourced from an estate, a family trust distribution and borrowings.

A distribution from a family trust to a testamentary trust

On 1 July 2019, testamentary trust ABC is established under a will of which a minor is a beneficiary.

Pursuant to the will, $100,000 is transferred to the trustee from the estate of the deceased.

Shortly after the testamentary trust is established, a related family trust makes a capital distribution of $1,000,000 to the testamentary trust. The resulting $1,100,000 is invested in ASX-listed shares on the same day. Dividend income of $110,000 is derived for the 2019-20 income year.

The net income of the trust is $110,000 and the minor is presently entitled to 50% of the amount of net income. The minor's share of the net income of the trust is $55,000. $50,000 is attributable to assets unrelated to the deceased estate and is not excepted trust income. $5,000 is excepted trust income on the basis that it is assessable income of the trust estate that resulted from a testamentary trust, derived from property transferred from the deceased estate.

Reinvestment of testamentary trust income

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

For the 2020-21 income year, that investment derives income of $5,500, and the minor is presently entitled to the entire amount. $5,000 is attributable to assets unrelated to the deceased estate and is not excepted trust income. $500 is excepted trust income on the basis that it is assessable income of the trust estate that resulted from a testamentary trust, derived from income that was previously excepted trust income.

Acquiring an asset of a testamentary trust with funds sourced from an estate, a family trust distribution and borrowings

Johnston Trust is a testamentary trust established under a will into which $500,000 is transferred from the deceased estate on 22 August 2019.

A trustee of a family trust then makes a capital distribution of $500,000 to Johnston Trust.

The trustee of Johnston Trust borrows $1m from a bank and purchases a rental property for $1.9m.

The remaining $100,000 is used as working capital for the rental property. In the 2019-20 income year, the trustee of Johnston Trust receives $50,000 of net rental income.

The net income of the trust for that year is $50,000.

Michael, who is under 18 years old, is made presently entitled to 50% of the $50,000 net income, being $25,000. Michael's excepted income is $6,250.

This amount is the extent to which the $25,000 of income resulted from the $500,000 transferred from the deceased estate (worked out as $500,000 ÷ $2m × $25,000).

The remaining $18,750 of income is attributable to assets unrelated to the deceased estate and is not excepted income.

Superannuation death benefit payments

When introducing the changes to the way in which the excepted trust income rules are to operate, the EM confirmed that the new measures were believed to have a "small unquantifiable gain to revenue over the forward estimates period".[12] This admission (leaving aside the obvious question of why the changes were in fact needed in the first place) may indirectly provide comfort for willmakers wanting superannuation death benefits to pass to a testamentary trust.

In particular, there have been concerns that the rules do not address how assets (such as a superannuation death benefit) that are acquired by a testamentary trust as a consequence of the willmaker's death, but are not directly from the willmaker personally, will be treated.

Aside from the asset protection benefits offered by testamentary trusts, the issues from a tax planning perspective in relation to superannuation death benefit payments are critical. This is because, if superannuation death benefits are not caught by the new rules, future income distributions sourced from the capital contribution to the testamentary trust to an infant beneficiary will be treated as excepted trust income.

Arguably, the rules in relation to superannuation death benefit payments are not as clear as they could be. That said, the preferred interpretation appears to be that, so long as a death benefit is paid to the legal personal representative of an estate before passing to a testamentary trust, this should be sufficient to ensure that any income later derived will be excepted trust income.

In contrast, if a death benefit passes directly from a superannuation fund to a legal personal representative in their capacity as the trustee of a testamentary trust, there is a material risk that the death benefit will be deemed to be "injected" into the testamentary trust in a manner that is caught by the new rules. This is because the payment would not strictly pass via the estate of the deceased willmaker.

Practically, most specialist holistic estate planning advisers tend to recommend against death benefit payments being made directly to any type of trust. This is due to the potential difficulties with meeting the legislative requirement for a superannuation death benefit payment to only be made to dependants or to the legal personal representative.

Accessing excepted trust income in relation to superannuation death benefits

The conservative view is that the reference to "legal personal representative" in relation to the legislative requirement for a superannuation death benefit payment to only be made to dependants or to the legal personal representative, is of the estate, not a testamentary trust established under the estate. Adopting the conservative interpretation should therefore, counterintuitively, help to ensure that superannuation death benefits can be the source of future concessional excepted trust income distributions.

Furthermore, superannuation death benefits have been a longstanding and arguably significant source of excepted trust income distributions for those utilising testamentary trusts as part of a holistic estate plan.

Removing the ability for superannuation death benefits to continue to be a source of excepted trust income would fundamentally contradict the admission in the EM that the new measures will have a small unquantifiable gain to revenue.

Tracing will be key

Particularly where there are tax dependants who are potential beneficiaries of a testamentary trust, there has been a recognised need to ensure a "tracing" of superannuation death benefit proceeds paid to a deceased estate.

The new rules are likely to further heighten the need for methodical tracing in relation to superannuation death benefits, as highlighted by the examples from the EM and QC 16509 outlined above.

For example, assuming that the original death benefit can be used to validly create excepted trust income, and given the likelihood that the death benefit payment will be converted into other assets, there will be a need to demonstrate that the source of funds for those assets was the death benefit. In turn, future income will need to be traced to the original death benefit payment in order to be able to be treated as excepted trust income.

Testamentary trusts and family law

Previous articles in this journal have explored numerous aspects of the ability for the Family Court to "look through" trust structures and attack the underlying assets.[13]

Testamentary trusts are, however, one form of trust where there have been a limited number of reported decisions. At least anecdotally, some believe that this is because the Family Court is less inclined to consider that assets held via testamentary trusts are exposed to division on a property settlement.

The decision in *Bernard & Bernard*[14] seems to add weight to this line of reasoning, assuming that the testamentary trust is properly structured and administered appropriately. In this case, a testamentary trust was set up under the will of the husband's father, who died three years before the husband and wife separated.

Broadly, the testamentary trust (which was named after the husband) was structured as follows:

- the husband was the primary beneficiary;
- the appointor was a third party and, although not disclosed in the case, may have been a trusted adviser;
- the husband's sister was the sole trustee; and
- the range of beneficiaries was relatively "standard", although not limited to the bloodline of the willmaker in that the husband's wife was a potential beneficiary.

There was also a second testamentary trust for the husband's sister, structured on mirror terms.

While the (notorious) family law decision in *Kennon v Spry*[15] was mentioned by the court, it was largely only to observe that the *Spry* situation was entirely different to the facts of this case, other than for the fact that there was a trust in existence.

In holding that the assets of the husband's testamentary trust did not form part of the matrimonial pool, the court mentioned the following key aspects of the trust:

- the husband was not the settlor (rather, his father was);
- the husband was not the trustee;
- the trustee retained complete and unfettered discretion to administer the trust;
- the husband was not the appointor;
- while the husband was a primary beneficiary, this of itself created no legal title to the property of the trust; and
- there was nothing to support a suggestion that the testamentary trust may be a sham.

The court also confirmed that the trustees of each of the two testamentary trusts had been scrupulous in their dealings and in their promulgation of resolutions, in ensuring the accumulation of funds to carry out the activities of the trustee, in the holding of meetings and in the filing of tax returns, and in their distinct roles as trustee and beneficiary. Indeed, the court stated that "rarely [does it] see a family law matter where tax returns and disclosure is so up-to-date and thorough, as has been in this matter".

While the testamentary trust assets were still considered a financial resource, this meant that they could only be factored into the final property settlement in an indirect manner.

Joint tenancy and partnership assets

As is well understood by specialist advisers, assets that are owned as a joint tenancy (as opposed to tenants in common) pass automatically to surviving owners on the death of a joint tenant. However, for tax purposes, joint tenancy assets are deemed to be owned as tenants in common, in equal shares.[16] This means that the conversion from one ownership mode to the other has no tax consequences. It also means that the death of a joint tenant owner will cause a tax event.

Importantly, from an estate planning perspective, even where title records indicate that an asset is owned as joint tenants, if it is a partnership asset, it will be deemed to be effectively owned as tenants in common. If this deeming rule applies, the death of a partner essentially causes the value of their interest to pass under their estate plan, and not automatically by survivorship (as is the case generally with assets owned as joint tenants) to the other owners.

The decision of the High Court in *Commissioner of State Revenue v Rojoda Pty Ltd*[17] further highlights the way in which these rules operate. Interestingly, the High Court's decision reversed a decision of the Court of Appeal, which in turn had reversed a decision of the State Administrative Tribunal.

The High Court decision relevantly confirmed that:

- Australian Partnership Acts, like the 1890 United Kingdom counterpart, reflect the equitable principle that, subject to the terms of any partnership deed, partners hold legal rights to the partnership property on trust for all of the partners;
- this means that, if property is acquired as partnership property (even if this is done in the name only of one partner), it will be held on trust for the partnership;
- furthermore, the legal estate or interest in land which is partnership property devolves not according to the general rules of law but "in trust so far as necessary for the persons beneficially interested in the land";
- the rules in this area do not create any new trust in relation to land. Rather, they give statutory recognition to the equitable principle that legal title to partnership property is held on trust for all partners;
- this means that each partner will have a non-specific interest in relation to all of the partnership freehold titles (as well as all of the current assets of the partnership), with a right, on dissolution, to compel the sale of the freehold titles in order to realise a fund from which, at the conclusion of the winding-up of the partnership, a vested share can be claimed;
- in this case, a deed where a partner confirmed that they held freehold titles of a partnership on trust for each former partner or their successors created a fixed trust. This is because the confirmation in the deed extinguished the unique equitable rights of the partners in the landholdings and instead created new fixed trusts; and
- the creation of the fixed trusts over land had adverse (and unexpected) stamp duty (ie the declaration of a trust) and tax (ie CGT event E1, being the creation of a trust) consequences.

As flagged in the High Court decision, the Partnership Acts in most states codify the rules in this regard.[18] These rules generally state that, unless the contrary intention appears, property bought with money belonging to the partnership is deemed to have been bought on account of the partnership and is considered partnership property.

The rules in this area were perhaps best explained historically in the case of *Spence v FCT*.[19] In this case, it was relevantly held:

> "It is … a mistake to say she got it simply by virtue of her joint tenancy. The legal estate devolved in accordance with the joint tenancy. To that extent the maxim which was mentioned — 'ius accrescendi inter mercatores locum non habet' — does not apply.[20] But it is applicable in equity; partners who hold as joint tenants in law hold beneficially as tenants in common. That is an old rule. It is more exactly stated today in terms of the Partnership Acts:[21] the legal estate devolves according to its nature and tenure but in trust so far as necessary for the persons beneficially interested; and as between partners land which is partnership property is to be treated as personal estate."

The "old rule" reference in the quote above comes from cases such as *Lake v Craddock*.[22]

Binding death benefit nominations and incapacity

Re Narumon Pty Ltd[23] was a widely reported superannuation death benefit case[24] which, in essence, considered the key issues that arise in relation to binding death benefit nominations (BDBNs).

While the case allowed an enduring power of attorney (EPA) to be used to refresh a BDBN, there are many aspects that meant this outcome was not necessarily the "standard" position.

In a factual matrix where the member of a self-managed superannuation fund (SMSF) had made a lapsing BDBN and then lost capacity, the key BDBN-related issues revolved around attempts to both "refresh" the lapsed BDBN and create a new BDBN to remedy the member's error of purporting to nominate a non-*Superannuation Industry (Supervision) Act 1993* (SIS) dependant in the BDBN.

In summary, the court confirmed:

- the provisions of the trust deed for a superannuation fund are critical to the outcome of whether an attorney may validly make a BDBN, noting that practically for industry or retail funds, interested parties must contact the trustee to access the relevant trust instrument;
- the persons nominated under the BDBN need to be SIS dependants in order to be entitled to receive any part of a death benefit;
- depending on the deed, it may be that the nomination of a non-dependant will not invalidate the balance of the BDBN;
- it will be much easier (and hopefully avoid court proceedings) if the deed and the EPA grant the attorney the right to sign a BDBN;
- in this case, there was no such power in the deed or in the EPA. However, the power of attorney legislation (in Queensland) was held to give the power to refresh

the stale BDBN. That said, the Queensland legislation is unique in this regard and the position is likely different in other states.

- it is critical, however, that there is a conflict of interest clause in the EPA if the attorney is to be nominated under a new BDBN, which is not standard in government EPA forms in any states (including Queensland). This is because, unless a conflict of interest clause is included in an EPA, it is likely impossible for anything other than a "refreshing" of a BDBN to be done, and even a refreshing of a previous BDBN may not in fact be possible; and
- while the Superannuation Complaints Tribunal decision D07-08\030[25] (in which it was also accepted that an EPA can permit an attorney to complete and sign a BDBN) was mentioned, it was also noted that this decision did not provide any detailed discussion.

It should be noted that, in case there has ever been any doubt, estate planning is more than a will. Here, the SMSF death benefit was more than 95% of the deceased's entire wealth.

Despite the above conclusion, there is at least one more recent case (by an inferior court) that reached the opposite conclusion.

The relevant case is *SM*.[26] Importantly, the court stated that it did not need to comment on whether an attorney can make a BDBN for the issues in question in the case, which in turn meant that the comments were not binding on other courts. That said, the court confirmed that, in its view, a BDBN is often a testamentary act and therefore cannot be delegated.

In particular, the court concluded that a BDBN is a testamentary disposition where the member of a superannuation fund has a present equitable entitlement to the money and the BDBN was not made further to a contractual right.

Having said this, in later cases, superior courts have largely ignored the reasoning and conclusions in *SM*.[26]

The decision in *Re SB; Ex parte AC*[27] provides further confirmation of the view that (subject to the terms of the relevant documents) an attorney can make a BDBN. In particular, the case confirms:

- the key question ultimately is: is a non-lapsing nomination a revocable disposition of property intended to take effect at death (ie akin to a will)? The court confirmed that the answer to this question is "no";
- as confirmed in *Re Narumon Pty Ltd*,[28] although the making of a BDBN under a superannuation fund has the effect of dealing with the payment of benefits following death, it is not a testamentary act, and so is not captured, by analogy, by the restriction against delegating to an attorney the making of a will;
- in *McFadden v Public Trustee for Victoria*,[29] it was also confirmed that the right to nominate a beneficiary was not a testamentary act; rather, it was the exercise of a contractual right;
- similarly, in *Re Application by Police Association of South Australia*,[30] it was confirmed that a BDBN is merely a right in the nature of a power of appointment; and
- thus, ultimately, the execution of a non-lapsing nomination is not a testamentary act. Rather, it is an act pursuant to a contract between the trustee and the member. The interest that a member has in a trust fund terminates on their death, and the nomination does not dispose of property but, by the exercise of a contractual right, directs the trustee on how the death benefit should be dealt with.

Therefore, a member's attorney will generally have the right to complete a BDBN for a principal, unless otherwise prohibited by the terms of the trust deed or attorney documentation.

Lost trust deeds

A previous article in this journal explored a range of issues in relation to the topic of lost trust deeds.[31] Briefly, the article explained that, where a trust's rules are uncertain due to the loss of the original deed, there is a threshold issue of a likely breach of the trustee's duty to ascertain the terms of the trust. This can, in turn, have a significant impact on the trustee's future ability to administer the trust, particularly from a tax perspective. The article set out a number of reported decisions that provide guidance as to what steps can be taken by trustees who are unable to locate an original, wet-signed trust instrument.

In *Sutton v NRS(J) Pty Ltd*,[32] the trustee provided the court with what appeared to be a full photocopy of a trust deed, dated on establishment in 1972. At all times, all relevant parties had acted on the assumption that the photocopy was indeed a true and full copy of the original deed (which had been misplaced).

A financier for the trust, operating under the "know your customer" policy, mandated production of the original trust instrument for sighting to ensure that the trust's constituent documents were in order.

As the trustee was unable to produce the original deed, an application to court was made, with part of the evidence including a further photocopy of the deed that was located with the law firm which originally drafted the trust deed.

In summary, the court confirmed:

- generally, in the absence of evidence to the contrary, it can be presumed from the taking of the action that the formalities have been complied with, that is, a presumption of regularity may apply to the effect that, where an act is done which can be done legally only after the performance of some prior act, proof of the later act carries with it a presumption of the due performance of the prior act;[33]
- in this case, however, there was no need to prove by inference that any formality had been complied with — the photocopy of the deed was signed and the evidence established directly that the parties concerned had always acted on the basis that it set out the terms of the trust;
- in this type of situation, it was held that the court should assist those responsible for the administration of the trust by ensuring that they can continue to administer it as if the photocopied deed was the trust's constituting document; and
- the way that this was achieved was for the court to formally order that the trustees of the trust were justified

in administering the trust on the basis that the photocopy of the deed that was annexed to the court order was a true copy of the original trust deed.

Conclusion

In modern estate planning, significant complexities from the interaction between the legislation relating to tax, trusts, bankruptcy, family law and superannuation have been omnipresent.

To coin a related estate planning phrase, rumours of the death of key tax and estate planning strategies such as trust splitting, testamentary trusts and superannuation have been somewhat exaggerated.[34]

While the level of ongoing income tax flexibility in a number of key areas will undoubtedly be lessened by changes from 2020, the reality is that there are still significant advantages from an income tax planning perspective despite the changes — not least of which because, with proper tracing and accounting, testamentary trusts should still be a legitimate source of excepted trust income distributions.

Furthermore, there are fundamental reasons why most people value the key structuring issues explored in this article, other than simply accessing the excepted trust income regime. For example, asset protection, limited liability, flexibility in asset management and access to the 50% CGT discount afforded to all forms of trusts.

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Commissioner's appeal in FCT v Glencore Investment Pty Ltd

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The decision of the Full Federal Court in *FCT v Glencore Investment Pty Ltd* reinforces the importance of facts and evidence, including lay and expert witnesses, for both taxpayers and the Commissioner in transfer pricing cases. The opportunity for the Commissioner to reconstruct international agreements to support transfer pricing adjustments appears to have been narrowed. However, it will be necessary to see how far that extends to transactions to which Subdiv 815-B ITAA97 could apply. The reduced reliance on the OECD guidelines is also of interest. A clear message is that transfer pricing is not an exact science and that there will not generally be one perfect price. Rather, there will be an acceptable range. Regardless, the need for taxpayers to document and validate their positions remains unchanged and cannot be overstated.

There is always a flurry when a new transfer pricing judgment arrives. Things were no different when the Full Federal Court handed down judgment in *FCT v Glencore Investment Pty Ltd*[1] (*Glencore*) in November 2020. The decision provides significant insights into how former Div 13 of the *Income Tax Assessment Act 1936* (ITAA36) (Cth) and Subdiv 815-A of the *Income Tax Assessment Act 1997* (ITAA97) (Cth) should be applied. It will also be relevant in interpreting Subdiv 815-B ITAA97, and the "associated enterprises article" contained in most double tax agreements.

In their majority judgment, Middleton and Steward JJ (the majority), were of the view that Davies J, at first instance, found for the taxpayer because, in essence, "her Honour preferred the evidence of Mr. Wilson to that of Mr. Ingelbinck" (at [105]). I make this point because I think that it is a telling statement. As much as transfer pricing cases involve significant technical issues, they inevitably turn on the evidence. In particular, which expert is preferred by the court.

The *Glencore* decision reinforces that taxpayers need to do everything possible not to fall into a transfer pricing dispute. The costs of running these disputes and the uncertainties in terms of outcome are significant. Avoiding such disputes requires up-front attention to the terms of international agreements with related parties and evidence to support the terms of the international agreements as being at arm's length.

As always with transfer pricing disputes, evidence was key. However, it was different this time, in that it was the Commissioner's evidence that was found lacking. For example, the Commissioner argued that the taxpayer should have been provided a quid pro quo for agreeing to the increased pricing arrangements and that the 23% deduction rate was wrong. The court found these positions problematic as the Commissioner did not provide evidence as to what the quid pro quo might have been (at [217]) or what the rate should have been, and did not challenge the accuracy of the range of rates relied on by the taxpayer (at [111]).

What does that mean for taxpayers? As a general proposition, not a lot, in that the taxpayer is still required to prove that the relevant arrangements are on arm's length terms. However, without contrary evidence presented by the Commissioner, the taxpayer's position cannot be said to have been disputed and, therefore, becomes more readily acceptable. In any event, we can expect that the Commissioner, taking *Glencore* as a learning experience, will probably lead all relevant evidence in future cases.

This article reviews the decision and sets out some guiding principles in terms of both technical and evidentiary issues.

The facts

Cobar Management Pty Ltd (CM) sold copper concentrate mined in Australia to a Swiss related entity, Glencore International AG (GI). Prior to February 2007, the sale price was based on the price for refined copper determined by reference to the London Metal Exchange (LME) reduced by discounts for agreed benchmarks for treatment costs and refining costs (TCRC) (original pricing) (original agreement). These pricing arrangements were restructured in February 2007 to reflect the copper reference price on the LME over one of three quotational periods selected by GI, with a fixed 23% deduction off of the copper reference price (price sharing) (new pricing) (new agreement). Effectively, the consideration moved from benchmark pricing to price sharing. This reduced both the risk profile of CM and its profitability.

The Commissioner raised transfer pricing adjustments under Div 13 ITAA36 and Subdiv 815-A ITAA97, arguing that the original pricing was arm's length in nature and that an independent producer would not have agreed to the new pricing.

At first instance, Davies J found for the taxpayer. With the exception of a minor issue relating to freight charges, the Full Federal Court dismissed the Commissioner's appeal with a judgment given by the majority and a separate judgment delivered by Thawley J. Although the three judgments in this matter essentially find in favour of the taxpayer, each takes a different approach on certain issues in reaching that position.

Both parties have now lodged applications for special leave to appeal to the High Court.

The evidence

The taxpayer relied on one lay witness and one expert witness. The Commissioner relied on two expert witnesses. However, in the Full Federal Court, the second of the Commissioner's expert witnesses, whose expertise was challenged in the first hearing, was not referenced in argument.

Mr Kelly, the taxpayer's lay witness, gave evidence about the mine and the risks that CM would have been exposed to if it had been transacting with an arm's length party.

Mr Wilson, the taxpayer's expert witness, gave evidence that the adoption of a price-sharing clause was "a matter of commercial judgment having regard to the particular risk appetite and cost pressures facing a particular mine". He opined that price sharing was a recognised pricing methodology, the normal range for price sharing was 21% to 26%, and it was reasonable to adopt the new pricing as the copper price was expected to undergo steep decline for an uncertain period. He concluded the new pricing arrangement was commercial and prudent.

Mr Ingelbink, the Commissioner's key expert witness, gave evidence that an independent seller would not have agreed to the new pricing as it favoured the position of the buyer to the detriment of the seller. He stated that an independent party would not have agreed to the new pricing without quid pro quo and that the switch to price sharing was "irresponsible".

The issues

The issues arising from the matters before the court, which are considered in more detail below, include:

- whether the Commissioner can reconstruct the arrangement because the terms of the agreement were ones which might not reasonably be expected between independent parties dealing with each other at arm's length;
- the role of the *Transfer pricing guidelines for multinational enterprises and tax administrations*[2] (the guidelines);
- the Commissioner's characterisation of the reconstructed hypothetical agreement as the original agreement;
- the principles relevant to determining whether the consideration was within an arm's length range;
- the probative value of comparables that are not identical; and
- the role of experts in transfer pricing disputes.

Reconstruction of the arrangement

To effect the transfer pricing adjustment, the Commissioner adjusted the pricing formula to restore the original pricing. A key issue before the court was whether this was a reconstruction permitted by Div 13 ITAA36 or Subdiv 815-A ITAA97.

Davies J held that the agreement could not be reconstructed as neither Div 13 nor Subdiv 815-A authorised the Commissioner to ascertain the consideration that might reasonably be expected to have been paid by reference to a pricing formula that did not include price sharing or quotational period optionality with back pricing.

The basis for this finding of Davies J was that the guidelines (at paras 1.36 to 1.39) applied to require the arm's length test to be determined by reference to the "transaction actually undertaken by the associated enterprises as it has been structured by them", unless the transaction differs from its form, or, when viewed in totality, differs "from those which would have been adopted by independent enterprises behaving in a commercially rational manner and the actual structure practically impedes the tax administration from determining an appropriate transfer price".

The majority were "hesitant" to comment on the exceptions referred to in the guidelines because of the generalised and opaque language and because, ultimately, the guidelines are guidelines, not directions (at [153]). Thawley J stated that the guidelines are not a "sure way" to understand the operation of Div 13 (at [277]) and that, in relation to Subdiv 815-A, he does not read them to limit the two situations as being the only exceptions (at [294]).

The majority held that the guidelines were irrelevant because the Commissioner had not reconstructed the arrangement. Rather, the Commissioner had applied Subdiv 815-A and Div 13 to the transaction actually undertaken, as all he had changed was the consideration payable. The majority stated that the Commissioner could substitute a different price which he considers to be the "arm's length consideration", including a different formula or other methodology, for the ascertainment of the arm's length consideration (at [154]).

However, their Honours did state (arguably in obiter) that there is no authority to substitute different terms of a contract if those terms do not define the consideration received (at [155]). Identifying when a term relates directly or indirectly to pricing will not always be clear cut and needs to be decided on a case-by-case basis. It was noted that the extent to which the Commissioner can substitute different conditions, under Subdiv 815-A, if he considers that those conditions differ from those which might be expected to operate between independent enterprises "is a question for another day" (at [156]). It is this issue that will generate uncertainty for transactions that are subject to Subdiv 815-B ITAA97.

Thawley J agreed that price sharing and quotational period adjustments were part of the methodology for determining price (at [268]). However, his Honour took a more holistic approach, applying a different interpretation of the reasons of Allsop CJ in *Chevron Australia Holdings Pty Ltd v FCT*[3] ([at 278]). His Honour held that it was necessary to identify terms in the international agreement which affect consideration (which is broader than price) that might reasonably have been expected, in an agreement between independent parties, dealing at arm's length, and to determine the consideration which might reasonably be expected for the supply of property to be determined by reference to "an agreement" with those terms (at [270]). Thawley J disagreed that Subdiv 815-A requires a distinction between terms which define price and those which do not (at [297]).

Ultimately, Thawley J found that the taxpayer had established that the terms of the agreement were ones which might reasonably be expected between independent parties, in the position of CM and GI, dealing with each other at arm's length, and that the consideration for the supply of copper concentrate under an agreement with those terms was within an arm's length range.

Clearly, there is tension between the three judgments on this issue. It will be interesting to see whether the High Court grants special leave to appeal and, if so, whether the reconstruction test will be clarified. However, given that the decision relates to provisions that now have limited application, it might be thought prudent for the issue to be considered in the context of a decision relating to Subdiv 815-B.

> *"As much as transfer pricing cases involve significant technical issues, they inevitably turn on the evidence. In particular, which expert is preferred by the court."*

Commissioner's reliance on original agreement

The essence of the Commissioner's argument on appeal was that the original agreement was of an arm's length nature. In the Commissioner's submission, risk benefits were irrelevant to CM and CI because no evidence was led by the taxpayers about risk. As such, because the price increase was not offset by any contemplated risk reduction or other benefit, CM was worse off by agreeing to the new price:[4]

> "Why, it was asked, would a party in the position of C.M.P.L. have agreed to such a debilitating change of terms? It simply was not what an independent party dealing at arm's length with a buyer of copper concentrate would ever have agreed to."

The question is not whether they should they have agreed to amend the contract (the majority at [165]). Rather, it is whether the new agreement fell within that range of hypothetical contracts for the sale of copper concentrate which independent parties dealing at arm's length with each other might reasonably be expected to have entered into. Thawley J agreed with the majority, noting that the argument hinted at a Pt IVA ITAA36 approach (at [272]).

From a general perspective, this confirms that taxpayers do not have to disprove the case put by the Commissioner. Rather, taxpayers are required to prove that their pricing falls within a range of arm's length outcomes.

One of the grounds for special leave to appeal to the High Court is that the Full Court ought to have held that the taxpayer's failure to adduce evidence of the risk reduction arising from the new pricing was fatal to discharging its burden of proof under s 14ZZO of the *Taxation Administration Act 1953* (Cth).

Further, the Commissioner has submitted to the High Court that the Full Court erred in finding that the taxpayer could succeed on the basis that there were a range of arm's length terms which independent parties might have been expected to agree. The Commissioner maintains that the taxpayer should be required to prove, to the standard of "reasonable probability", the expected terms that would have existed, had the dealing been at arm's length.

Factors to consider when determining arm's length consideration

When determining arm's length consideration, it is necessary to establish what the taxpayer, or a person in the position of the taxpayer, would be expected to give by way of consideration in respect of the acquisition of the property to a party independent from it.[5]

Much has been said about whether this requires the "utter disembodiment" of the actual parties.[6] No rigid rule exists. However, the majority identified a number of considerations that are relevant (at [177] to [187]).

When identifying a hypothetical seller, they need to be identified only by reference to those attributes or features which can affect the consideration which is receivable. Subjective factors, such as financial soundness are not relevant.[7] Objective factors include, for example in the context of the *Glencore* facts, the means of production at the actual mine, the levels of production, the costs of production, the size of the mine, and the objective circumstances of the copper concentrate market as at February 2007. It also includes the fact that the entity was a wholly owned subsidiary of a multinational group, although it does not necessarily have to be considered by reference to the fact it was a member of a specific group, such as the Glencore Group.

The hypothetical seller does not reflect any considerations that are the product of the non-arm's length relationship and the broader Glencore Group. It was stated that this included any policy formed about the issue of risk when selling to GI (at [180]):

> "It follows that the taxpayer's failure to lead evidence about C.M.P.L.'s appetite for risk taking is not fatal. Nor is the failure to lead evidence about the Glencore Group's policy about risk taking (if any). Whilst such a policy, if it existed, might have been relevant, it was also, for the reasons given below, open to the taxpayer to discharge its onus on this issue through the opinions of Mr. Wilson."

There is considerable discussion in the *Glencore* judgments about the relevance of risk. The Commissioner is strongly of the view that the taxpayer should have been required to prove its attitude to risk and how that impacted its pricing decisions. The majority did not agree and said, rather, that the taxpayer was entitled to support the appropriateness of the new pricing by reference to what an independent party might have done to address risk in the objective circumstances of the copper concentrate market at that time in selling to an independent party. It could legitimately adopt a more conservative approach to risk, so long as it was commercially rational to do so, and it is what an independent party dealing at arm's length might reasonably be expected to have done. In other words, the issue is not how the taxpayer's approach to risk drove its decisions, but what an arm's length party would have done.

Similarly, it was noted that the mere fact that a mistake is made in terms of forecasting outcomes does not preclude an arm's length price or of itself necessarily reveal any unreasonableness in the formation of a judgment as to appropriate risk management. Mistakes happen in arm's length and non-arm's length deals (at [162]). An arm's length party could equally have made that error. You cannot determine whether a forecast was reasonable by reference to whether it proved correct. Rather, you look at what approach unrelated parties would take to forecast the matters subject to forecast.

Finally, there is likely to be more than one price which is an arm's length price and taxpayers are under no obligation to choose a pricing methodology which pursues profitability in Australia at the expense of prudence. There is no obligation to "maximise" profitability at the expense of all else (at [182]).

Applying these principles, the majority concluded that the new price was arm's length, based on:

- 23% being the midpoint of the range from the survey of offtake agreements with price-sharing formulas;
- the quotation period optionality clause was arm's length, as evidenced by a third-party contract containing a materially identical quotation period optionality clause, and there being no persuasive evidence to displace this evidence; and
- the taxpayer's expert evidence that the formula was rational and commercial.

The majority ultimately rejected the Commissioner's submission that an entity in the position of CM would not have traded earnings for risk. Thawley J agreed.

The majority noted that, even if Mr Ingelbinck's approach represented a position that arm's length parties might reasonably be expected to have adopted, that did not negate that the new pricing was also an arm's length outcome. In other words, there generally is not one arm's length price. As long as the taxpayer selects one of a range of arm's length prices on a pragmatic basis using the information available at the time, they satisfy the test.

One of Mr Ingelbinck's concerns with the new pricing was that CM received no discernible quid pro quo. The majority found it problematic that the type of quid pro quo which was justified was never identified or quantified. The Commissioner submitted that the onus was on the taxpayer to show that it had received the correct quid pro quo. This was rejected.

Third party contracts that can be differentiated

The taxpayer relied on a number of contracts entered into by independent parties to demonstrate that the terms of the new agreement were arm's length in nature. The Commissioner challenged the relevance of these agreements for various reasons (depending on the contract), including the tonnage involved being too small or because they involved different grades of copper.

The majority acknowledged the differences but concluded that this did not mean the contracts should be ignored or rejected. They held that the differences identified by the Commissioner reduced the probative value of these agreements but did not negate them entirely. The agreements demonstrated that price sharing of 23% was not out of the market (at [193]).

The role of experts

In relation to the examination of contracts entered into by other parties, the majority noted that a lay witness, rather than an expert witness, is probably best placed to give evidence on why contracts are comparable (at [100]). This is because they would be best placed to explain the third-party agreements. It was suggested that the expert witness could then take that lay evidence into account when preparing their expert report and concluding whether pricing was arm's length.

This reinforces the need to ensure that consideration is given to gathering supporting evidence at the time transactions are entered into.

Subdivision 815-B

Subdivision 815-B ITAA97 applies to income years commencing on or after 1 July 2013 and includes provisions which enable the Commissioner to substitute the terms that independent entities in comparable circumstances would have agreed to.

Glencore does not directly deal with Subdiv 815-B. However, the principles in *Glencore* will be relevant to any review of an international transaction between non-independent parties in order to determine whether Subdiv 815-B applies to require a transfer pricing adjustment, in particular, the discussion in relation to terms relevant to establishing an appropriate hypothetical agreement. The Federal Court's comments about the importance of the actual contract between the related parties as the starting point for the transfer pricing analysis may suggest that, contrary to the Commissioner's view, Subdiv 815-B does not include a broad reconstruction power.

Practical implications

As is evident from the above discussion, there are a number of technical issues that the Federal Court dealt with in *Glencore*, some of which remain unresolved, particularly given the different approaches taken by the respective judges. However, I would suggest that, from a practical perspective, not much has changed. Transfer pricing issues continue to be all about the facts, the evidence and the credibility of the competing witnesses.

This decision reinforces that you should:

- consider your overall transfer pricing position when entering into international agreements with related parties, not just the pricing. Ask yourself if there are particular terms agreed to that you might not expect to see between parties acting on arm's length terms and, if so, how this effects the pricing;
- if there is a third-party market, gather contemporaneous evidence from that market to support the contractual terms and the price;
- if third-party market evidence is not available, gather contemporaneous evidence of contracts between the taxpayer and unrelated parties and, if possible, contracts between other parties. If contracts can't be located, look for industry reports and behaviour and document how they support your international agreements as being on arm's length terms;

- document why transactions are rational and commercial;
- consider who could be lay witnesses to support your positions and obtain a contemporaneous statement from them about the processes relevant to the creation of the agreement and matters relevant to agreeing terms and pricing; and
- if the risk factors are sufficient, identify experts to support your commercial position at the time you make it. Why? The decision makes it clear that you do not use hindsight to justify/attack a position. There will be greater credibility in reports that are prepared using current projections and untainted by future events.

Disputes cannot always be avoided. However, this attention to evidence to support positions will reduce the risk of dispute and enable a more comprehensive and credible defence to be mounted if a dispute does arise.

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References

1 [2020] FCAFC 187.

2 OECD, *Transfer pricing guidelines for multinational enterprises and tax administrations*, July 1995.

3 [2017] FCAFC 62.

4 [2020] FCAFC 187 at [165].

5 *Chevron Australia Holdings Pty Ltd v FCT* [2017] FCAFC 62 at [43].

6 See, for example, *Chevron Australia Holdings Pty Ltd v FCT* [2017] FCAFC 62 at [45]

7 *SNF (Australia) Pty Ltd v FCT* [2010] FCA 635.

Superannuation

by Daniel Butler, CTA, and
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Proportioning rule: key to many super strategies

The proportioning rule is used to calculate the tax-free and taxable components of a superannuation benefit. Having a sound understanding of this rule is key to many superannuation strategies.

Overview

The proportioning rule provides that the tax-free and taxable components of a superannuation benefit are taken to be paid in the same proportion as the tax-free and taxable components of the member's superannuation interest from which the benefit came. This means that, when paying a superannuation benefit, a member cannot decide whether that benefit is paid from the tax-free or taxable component. Instead, the tax-free and taxable components of the superannuation benefit will be reflective of the tax-free and taxable components of the member's particular superannuation interest. Thus, a member cannot simply select or "cherry pick" the tax-free component to pay less tax.

Terminology

In this article, we refer to the following terms as they are used in s 307-125 of the *Income Tax Assessment Act 1997* (Cth):

- superannuation interest: refers to a member's accumulation or pension interest as appropriate;
- superannuation benefit: refers to a payment from a superannuation fund to a member, either as a lump sum or a pension payment;
- tax-free component: this generally includes all non-concessional contributions made after 30 June 2007 that are not included in the fund's assessable income and the "crystallised segment" that broadly includes numerous tax-free components that existed prior to 30 June 2007; and
- taxable component: this generally includes concessional contributions and earnings and any capital appreciation from investments in the fund. Broadly, this is the total value of a member's superannuation interest less the value of the tax-free component.

Note that these terms may have other meanings in other legislation. However, this article is primarily focused on the meaning of the terms from a taxation and superannuation law perspective.

Superannuation interest

In a self-managed superannuation fund context, a member can only have one accumulation interest. However, each pension that is commenced will form its own superannuation interest. When a member decides to commence a pension, the tax-free and taxable components will be locked at that time.

The time to determine the tax-free and taxable components of a superannuation benefit differ depending on whether a lump sum or pension is provided. In summary, these proportions are determined at the following times:

- lump sum payment: just before the benefit is paid; and
- pension payment: on the date the pension commences.

To illustrate how this works in respect of pensions, consider the following example.

Accumulation interest

For an accumulation interest, the tax-free component is likely to remain static, while the taxable component can fluctuate with investment markets and earnings (or losses) accrue, in some cases on a daily basis.

Let's assume that Ben has an accumulation interest valued at $200,000, with a $100,000 tax-free component (ie 50% tax-free). If Ben's accumulation account increases in value to $400,000, the tax-free component remains at $100,000 (therefore, the account is now 25% tax-free). On the other hand, if Ben's accumulation interest decreases to $80,000, his tax-free component is now $80,000 (ie 100% tax-free).

Pension interest

When a pension is commenced, the tax-free and taxable components are locked in at that time. Thus, each payment will reflect the tax-free and taxable components of the accumulation interest.

Referring to Ben's example above, if Ben commences a pension when it is valued at $200,000, with a $100,000 tax-free component, each pension payment will be 50% tax-free. Note that this proportion does not subsequently change despite increases or decreases in the value of the assets supporting that pension.

However, it is worthwhile noting that, if the pension assets increase over time, the tax-free component effectively grows in amount (but not in proportion). Conversely, if the pension assets decrease over time, the tax-free amount can decrease in amount (note, for example, that the tax-free amount in Ben's accumulation account decreased from $100,000 to $80,000).

Timing and value

Accordingly, the following general rules should be noted:

- where assets are going to increase in value, the tax-free component is maximised by commencing a pension sooner rather than later (locking in the tax-free component to grow proportionately); and

- where assets are going to decrease in value, the tax-free component is maximised by commencing a pension later rather than sooner (allowing the decrease in assets to erode the taxable component).

Conclusion

Making sure you get the timing right and monitoring the value of your accumulation and pension interests can make a significant difference. In a nutshell, understanding the proportioning rule is key to maximising your superannuation strategies.

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Alternative Assets Insights

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Non-concessional MIT income

The finalised ATO guidance on non-concessional MIT income addresses various aspects of the recently introduced stapled structure legislation.

On 18 November 2020, the ATO issued its finalised guidance in the form of LCR 2020/2 on the concept of "non-concessional MIT income". Non-concessional managed investment trust (MIT) income fund payments made by an MIT to non-residents from 1 July 2019 are subject to a withholding tax rate of 30% unless transitional rules apply.

LCR 2020/2 addresses various aspects of the new stapled structure law as it relates to non-concessional MIT income, including:

- MIT cross-staple arrangements, including the meaning of "arrangement" and "facility";
- MIT cross-staple arrangement income and the transitional rules;
- the integrity rules, particularly in relation to concessional cross-staple rent;
- MIT trading trust income;
- MIT residential housing income; and
- MIT agricultural income.

The final law companion ruling has been updated from its predecessor, LCR 2019/D2, which was released on 26 June 2019. Although the guidance remains largely unchanged, there are some changes that will assist taxpayers when applying the law. However, not all issues and scenarios have been addressed and significant uncertainty remains.

The authors' key observations in relation to LCR 2020/2 are set out below.

Eligible investment business and the meaning of "rent"

As part of the consultation on LCR 2019/D2, a number of submissions were made to remove the commentary included in the draft law companion ruling in relation to the definition of "rent" and "investing in land primarily for the purpose of deriving rent" on the basis that they are longstanding principles that have much broader application than the provisions of the stapled structure law, and that the purpose of a law companion ruling is to provide insights into the practical implications or detail of recently enacted law.

Notwithstanding the submissions made, the final law companion ruling still contains the commentary regarding "rent" and "investing in land primarily for the purpose of deriving rent". However, some clarifications have been made.

Investing in land

LCR 2019/D2 highlighted several factors that the ATO considered relevant when determining whether the trustee is investing in land for the purpose, or primarily for the purpose, of deriving rent. However, the factors did not highlight the importance of the test time in order to assess the intention of the trustee, which is critical.

Following submissions, LCR 2020/2 helpfully confirms that a relevant factor includes consideration of the intended holding period for the asset and any strategy for its disposal, and that this must be assessed at the time of acquisition (and continually). This clarification is now consistent with the intention of Div 6C of the *Income Tax Assessment Act 1936* (Cth) and the position historically applied by the ATO and industry in relation to the application of Div 6C.

Amounts of rent attributable to movable property

Under the view expressed in LCR 2019/D2, there was a risk that moveable property and items not characterised as fixtures could not comprise part of a facility, notwithstanding that they would form part of the definition of "eligible investment business" for the purposes of Div 6C.

LCR 2020/2 clarifies that moveable property will not necessarily be excluded from forming part of a facility.

Payment in substitution for rent

LCR 2020/2 makes a distinction between an amount paid in "substitution" for rent as opposed to in "satisfaction" of rent. In another helpful change from the draft, the final law companion ruling clarifies that, where a periodic amount of rent is satisfied by a means of payment other than cash that is specifically provided for under the lease agreement, that payment in kind may still be a payment in the nature of rent (ie it is not an amount in substitution for rent).

Concept of facility

The transitional provisions in respect of MIT cross-staple arrangement income can apply to the "acquisition, creation or lease of a facility" that occurred or was entered into before 27 March 2018. As such, the concept of what constitutes a facility is critical to the application of the transitional provisions to existing structures.

The ATO's view on what constitutes a facility has been refined and clarified in LCR 2020/2. While this is a positive change, uncertainties still exist which means that taxpayers may need to approach the ATO on a case-by-case basis to obtain certainty in relation to their specific circumstances.

Concept of ultimate facility removed

LCR 2019/D2 introduced a new concept of "facility", and also "ultimate facility". In particular, the draft law companion ruling suggested that, notwithstanding that facilities are part of an integrated system or network which may be considered a broader facility, they may be considered as discrete and separate facilities for the purposes of the stapled structure law. This created significant uncertainty as to what constitutes a facility for the purposes of the transitional provisions and whether a facility as a whole is eligible to be an economic infrastructure facility.

LCR 2020/2 has removed all references to "ultimate facility". The ATO has acknowledged that, as the term "ultimate facility" was neither legislated, nor referenced in the explanatory memorandum to the applicable law, it would lead to confusion when determining what the facility is. This is a positive clarification for taxpayers.

Enhancements to existing facilities

In another welcome change, LCR 2020/2 confirms that it is possible that subsequent works which expand or alter a facility may still form part of the existing facility, provided that the works do not substantially alter the functions of the facility.

Expanded commentary on economic infrastructure facilities

LCR 2020/2 has provided further detailed commentary on what constitutes an economic infrastructure facility for the purposes of applying the law, which is helpful for taxpayers in identifying whether they will be an economic infrastructure facility and eligible for the 15-year transitional period.

However, a new paragraph (para 208) has been inserted advising that taxpayers should not assume that, merely because an asset (or a collection of assets) forms part of an identified facility, all assets forming part of the facility will constitute a single economic infrastructure facility. The final law companion ruling provides that regard must still be had to all of the relevant facts and circumstances relevant to the identification of a "facility" and an "economic infrastructure facility".

Notwithstanding that the concept of "ultimate facility" has been removed, new para 208 could still impact taxpayers who may have anticipated the entirety of their assets to be a single facility which meets the "economic infrastructure facility" definition. This approach may lead to two transitional periods for the single "facility" (ie 15 years for the economic infrastructure facility component, and seven years for other parts of the facility). This may result in an additional tax cost for certain investors and a heavy compliance burden on taxpayers to "reasonably apportion" cross-staple income.

Concessional cross-staple rent cap

LCR 2019/D2 did not provide any additional guidance on what would constitute an "objective method" for determining the annual rent under a lease but, rather, reproduced comments from the explanatory memorandum to the law.

LCR 2020/2 provides helpful guidance on what an objective method is. However, the commentary still raises a number of questions and uncertainties. In particular, there is no additional guidance on what "associated documents" are for the purposes of determining whether an objective method exists, and it is still not clear as to when a method is objective.

Based on the level of detail, it seems that the ATO's preference will be to ensure that taxpayers seek ATO guidance on their specific rent clauses, which will allow the ATO to administer the transitional rules on a case-by-case basis.

Changes to existing arrangements

LCR 2020/2 does not provide any additional guidance on when changes made to a cross-staple arrangement may result in a new arrangement and therefore not qualify for access to the transitional provisions.

In the Compendium to LCR 2020/2, the ATO indicates that whether changes made to a cross-staple arrangement are so substantial as to risk the continuing existence of a transitional cross-staple arrangement will be dependent on the specific facts and circumstances. The lack of additional guidance will create additional uncertainty for taxpayers. It is clear from the ATO commentary that, where changes are made to arrangements or to the terms of the arrangements, the ATO expects that taxpayers would engage with it to obtain certainty.

The takeaway

LCR 2020/2 contains a number of helpful clarifications which will assist taxpayers when applying the law. However, there is still significant uncertainty when applying the law.

In the Compendium to LCR 2020/2, the ATO indicated in a number of its responses that the final law companion ruling could not address all possible circumstances. Although the principles outlined in LCR 2020/2 provide general guidance, the ATO invites taxpayers to engage with it to discuss their specific circumstances. In this regard, taxpayers will need to approach the ATO to obtain any certainty on the application of the law and, in particular, what constitutes a "facility" and if that facility in its entirety is an "economic infrastructure facility".

We recommend that impacted taxpayers reassess their positions and consider possible next steps.

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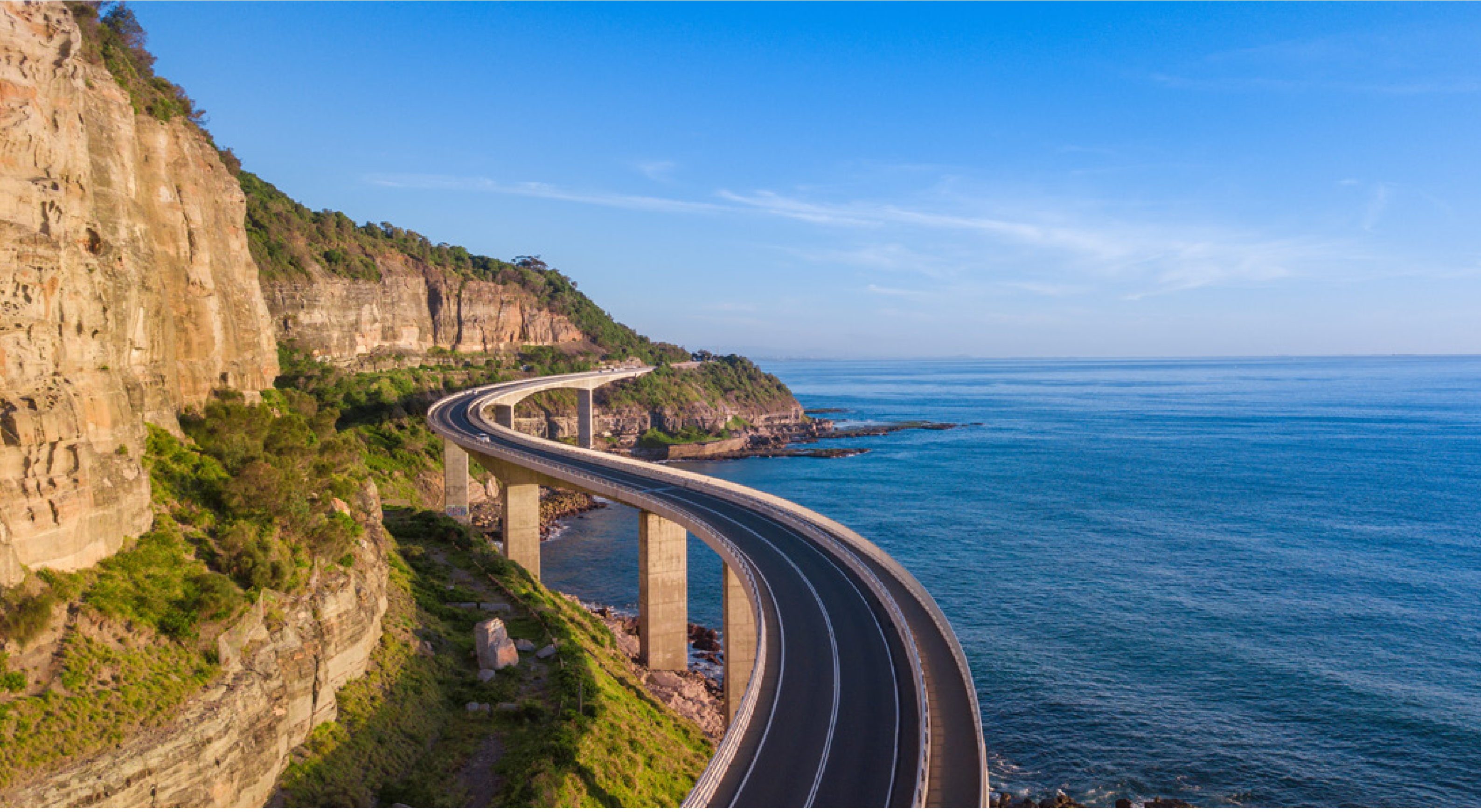

Successful Succession

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

Testamentary gifts and specific entitlements of tax-exempt entities

Masterly streaming of a capital gain to a charity beneficiary under a will reduced the estate's capital gains tax to $0.

This "story" is about Helen and her generous testamentary charitable gift.

Helen died in early 2019. She was 92 years old, she had never married, and she did not have children. She lived her entire life in Victoria and died in Victoria.

Under her will, she left her $15m estate to six relatives and friends, as well as a hospital where she had spent a lot of time in the final years of her life.

The hospital was not-for-profit, was run and registered as a charity, and was endorsed as a deductible gift recipient under item 1 of the table in s 30-15 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97). The hospital was also endorsed to access the GST concession and income tax exemption.

The charitable purposes of the hospital within the meaning of the *Charities Act 2013* (Cth) were "providing relief of sickness, suffering and distress to the general public by providing health care facilities and services".

Helen's estate comprised of cash and a large property on the outskirts of Melbourne, which had recently been rezoned as general residential land capable of subdivision.

The property had been Helen's home. She had purchased a parcel of land in 1955 (parcel A), inherited a parcel of land in 1969 when her brother died (parcel B), and acquired a further parcel by adverse possession from the local council in 1992 (parcel C).

Parcel A made up about 63% of the size of the property and Helen's home was on it. Parcel B was about 31% of the total property and adjoined parcel A. Parcels A and B had road frontage. The size of parcels A and B was about 3 hectares.

Parcel C was a long skinny block abutting parcels A and B at the very back of the block, without street frontage. It made up about 6% of the property.

Accordingly, parcels A and B were pre-CGT assets and parcel C was a post-CGT asset. Parcel C was valued at $30,000 at the time of acquisition in 1992.

The property is unlikely to have ever been income-producing.

At the date of Helen's death, the property was valued at $10m.

The valuers were asked to apportion the value between the parcels and their advice was as follows:

> Parcel A: 20,000 m^2 (2 hectares), with dwelling — $7m (ie 70% of the total value);
>
> Parcel B: 10,000 m^2 — $2.85m (ie 28.5% of the total value); and
>
> Parcel C: 2,000 m^2 — $150,000 (ie 1.5% of the total value).

In mid-2020, the executor, to whom probate had been granted in late 2019, sold the property for $13m, with settlement of the sale at the end of 2020.

The proceeds of sale were apportioned between the three parcels along the same percentages as set out by the valuer.

What tax was payable by the executor?

Parcel A: CGT main residence exemption

The executor applied the CGT main residence exemption available under s 118-195 ITAA97 which applies to the dwelling[1] and the surrounding 2 hectares of land (including the land under the dwelling) which are used for personal or domestic purposes (not income-producing purposes).[2]

The executor was able to choose which 2 hectares the exemption applied to, so long as the dwelling remained on that block. The executor chose the 2 hectares with the more appealing outlook and valuable street frontage to be the subject of the exemption,[3] and this was reflected in the valuation provided by the valuer. The legislation does not require the 2 hectares to all be on the one title or on the same title as the dwelling.

The exemption was available because the property was sold and settled within two years from Helen's date of death.[4] Therefore, no CGT was payable on parcel A.

Parcel B: pre-CGT asset

As parcel B was a pre-CGT asset, ie acquired by Helen before 20 September 1985, the executor is taken to have acquired parcel B at the market value at the date of Helen's death,[5] ie $2.85m. The difference between the sale price for parcel B ($3.705m, ie 28.5% of the total sale price) and this cost base ($2.85m) was roughly $855,000 (not taking into account sale costs and other expenses which increase the cost base).

This gain since the date of death was subject to CGT.

The executor acquired this parcel 12 months before entering into the contract of sale and, therefore, this gain qualified for the 50% CGT discount.

Consequently, approximately $425,000 remained taxable for Helen's estate.

Parcel C

Parcel C was a post-CGT asset, with a cost base of roughly $30,000 (not taking into account costs and any expenses incurred in relation to this block since 1992, such as lawn mowing, rates, fire levy, sale costs etc). In other words, the executor inherited Helen's cost base.

The sale price attributed to parcel C was $195,000 (ie 1.5% of $13m). Accordingly, the capital gain was roughly $165,000.

Similarly to parcel B, the executor qualified for the CGT discount on this parcel, but the estate still faced tax on approximately $80,000.

The predicted tax payable on both parcels B and C by the estate was approximately $200,000.

Tax-exempt beneficiary

The executor wanted to take advantage of the tax-exempt status of the hospital for the benefit of all of the beneficiaries of Helen's estate.

The executor took a conservative approach and applied for a private ruling from the ATO to shore up her position. The ATO returned a positive ruling.

The ATO was asked:

> "Is the Trustee permitted by Subdivision 115-C of the *Income Tax Assessment Act 1997* (ITAA 1997) to confer specific entitlement upon the Hospital in respect of the capital gain referable to the sale of the Property?"

The ATO answered in the affirmative:

> "Yes. As the two conditions in subsection 115-228(1) of the ITAA 1997 will be satisfied, the Trustee can confer specific entitlement upon the Hospital in respect of the full capital gain made on the sale of the Property.
>
> The Trustee has the power under the will to stream capital gains to beneficiaries for tax purposes …
>
> The capital gains do not exceed [the hospital's] share of the residue of the estate.
>
> The Trustee is in the process of winding up the estate and will determine that [the hospital's] share of the estate (or part of it) is referable to 100% of the capital gain from the sale of the Property.
>
> The Trustee will make a record of its determination by payment of an amount attributable to the relevant capital gain by 31 August 2021."

Here is how it happened.

The executor made the hospital specifically entitled to the entire capital gain so as to make the hospital the taxpayer for the capital gain[6] and not the executor of Helen's estate. In other words, all of the taxable gain from the two parcels was streamed to the hospital,[7] and as it was a tax-exempt entity, the hospital paid no tax on it.

The other beneficiaries were paid the estate cash and the proceeds of sale of parcel A and the other proceeds from parcel B.

Although, there was no specific streaming power in the will, the will did contain a power to appropriate any asset or part of an asset towards the satisfaction of any beneficiary's full or partial entitlement. As the hospital was a residuary beneficiary, the executor was able to appropriate the funds representing the capital gain from the sale of parcels B and C to satisfy the hospital's entitlements under the will.

The power to appropriate assets towards the satisfaction of a beneficiary's entitlement is also present in the legislation of each state and territory, except South Australia.[8] There is also a similar common law power to appropriate[9] in all jurisdictions in Australia, including South Australia.

The specific entitlement was determined via a written resolution prepared after the proceeds of sale were received from the purchaser,[10] and before 31 August 2021 (ie following the year in which the gain arose). The resolution was signed by the executor. The resolution stated that the funds attributable to that gain (before the discounts are applied) were not required for estate administration any longer and would be paid to the hospital in the next 30 days.

This resolution gave effect to the s 115-228 ITAA97 requirements for creating a specific entitlement to a capital gain by setting out:

- the proposed time frame for receipt of the net financial benefits "referable to the capital gain"; and
- the specific character of the amount referable to the capital gain in the records of the estate no later than two months after the end of the income year.

The resolution complied with the definition of "financial benefit" in s 974-160 ITAA97 in that the hospital was made entitled to something of "economic value", and the net financial benefit was the amount that the hospital would actually receive after the deduction of costs (and any losses). In this case, the net financial benefit for the capital gain in each of parcel B and parcel C was the amount of the capital gain before application of the CGT discount (ie $855,000 and $165,000, respectively). The resolution precisely recorded that the relevant capital gain satisfied the hospital's entitlement under the will.

The outcome of the private ruling was that each beneficiary's share was enlarged as the estate was not liable to pay any CGT on the sale of Helen's property.

Conclusion

Although this positive outcome spins on its own facts and merits, and for that reason the private ruling cannot be relied on even in similar situations, these facts do arise quite frequently. Many generous willmakers leave the residue, or a part of the residue, of their estate to a charity, and many estates are comprised of CGT assets.

A private ruling should be applied for in each instance, but taxpayers now have a better idea about the way in which the Commissioner might decide in similar circumstances.

In this case, the executor also had time on her side as she had over eight months from the date of sale to obtain the private binding ruling and create the hospital's specific entitlement. Executors or administrators with settlements occurring towards the end of the financial year or close to 31 August will need to have their wits about them and be prepared early.

It is the duty of estate representatives to maximise the estate for the benefit of the beneficiaries. Availing herself of this tax advice and the private ruling was an intelligent and responsible executor.

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References

1 Defined in s 118-115(1) ITAA97.
2 S 118-120 ITAA97.
3 See TD 1999/67.
4 S 118-195(1) ITAA97.
5 Item 4 of the table in s 128-15(4) ITAA97.
6 Subdiv 115-C, ss 115-215(3), 115-225 and 115-227 ITAA97.
7 The gain did not exceed the hospital's entitlements under the will.
8 S 46 of the *Administration and Probate Act 1958* (Vic); s 46 of the *Trustee Act 1925* (ACT); s 81 of the *Administration and Probate Act 1969* (NT); s 46 of the *Trustee Act 1925* (NSW); s 33 of the *Trusts Act 1973* (Qld); s 40 of the *Administration and Probate Act 1935* (Tas); s 30 of the *Trustees Act 1962* (WA).
9 *In the Will of Hinsch* [1896] NSWLawRp 6; *In the Estate of Mack* (1956) 73 WN (NSW) 218; *Wiblen v Feros; Estate of Feros (dec'd)* (1998) 44 NSWLR 158.
10 S 115-228 ITAA97.

Events Calendar

February/March 2021

EVENT	DATE	CPD
Queensland		
2021 Private Business Tax Retreat – face-to-face	25/2/21	12
Western Australia		
2021 WA Tax Forum	18/3/21	12
National/Online		
2021 Private Business Tax Retreat – online	25/2/21	12
2021 Superannuation Intensive Series – online/workshop	24/3/21	14

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

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