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The Tax Institute

Taxation in Australia

Design of a sustainable superannuation system
The Tax Institute

High Court decides FCT v Carter
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Insights from the Institute

Regular columns

Tax News – at a glance

by TaxCounsel Pty Ltd

June – what happened in tax?

The following points highlight important federal tax developments that occurred during June 2022. A selection of the developments is considered in more detail in the "Tax News – the details" column on page 6 (at the item number indicated).

Non-commercial losses safe harbour

The Commissioner has released a draft practical compliance guideline that outlines a safe harbour that will allow an individual taxpayer with a non-commercial business loss for an income year that would otherwise have to be carried forward, to manage their tax affairs as if the Commissioner had exercised the discretion to allow the losses to be deducted in the income year (PCG 2022/D2). **See item 1.**

Car limits

For 2022–23, the depreciation car limit is $64,741 and the luxury car tax thresholds are $84,916 (fuel-efficient vehicles) and $71,849 (other vehicles). **See item 2.**

Disclosure of information

The New South Wales Court of Appeal has by majority (Gleeson JA and Basten AJA; Macfarlan JA dissenting) allowed an appeal by the Commonwealth from a decision of Ball J and held that a notice to produce documents issued to the Commonwealth in proceedings brought to seek to recover moneys paid to the Commissioner by another entity should be set aside (*Commonwealth of Australia v Kupang Resources Pty Ltd (ACN 098 773 785)* [2022] NSWCA 77). **See item 3.**

Freezing orders varied

The Federal Court (Jagot J) has varied freezing orders that were originally made in September 2019 against a Mr Huang, a non-resident who had tax debts of approximately $141m for which judgment had been entered (*DCT v Huang (No. 4)* [2022] FCA 618). **See item 4.**

Underpaid award entitlements

The AAT has held that lump sums received by two taxpayers who had been underpaid by their franchisee employers were assessable income (*Guttikonda and Sheth and FCT* [2022] AATA 1325). **See item 5.**

Increased TPB registration fees

From 1 July 2022, the tax agent and BAS agent registration and renewal of registration fees will be increased for a CPI adjustment to $731 and $146, respectively.

GST margin scheme issues

In *Landcom v FCT* ([2022] FCA 510), the Federal Court (Thawley J) considered two issues that arose out of an appeal against a decision of the Commissioner on an objection against a private ruling that was made by the Commissioner in relation to the operation of the GST margin scheme. The more important issue was how the margin scheme provisions apply where there is one contract for the disposal of several parcels of land. The other issue arose out of the fact that the vendor (which applied for the ruling) was a "state" for the purposes of both the Commonwealth Constitution and GST. The decision of Thawley J is considered in the Tax Tips column of this issue of the journal (see page 10).

Decision impact statement

The Commissioner has released a decision impact statement in relation to the High Court's decision in *FCT v Carter* ([2022] HCA 10). In that case, the High Court held that disclaimers made by default beneficiaries under a discretionary trust deed of their default interests after the end of an income year in which the default clause operated were not effective for income tax purposes. This was because the question of the "present entitlement" of a beneficiary to income of a trust for an income year must be tested and examined at the close of the year, not some reasonable period of time after the end of the year.

The decision of the High Court is an important one and its practical implications potentially extend beyond the factual situation that arose in the case. It is to be hoped that the Commissioner will issue further details of his views as to the implications of the decision.

GST fraud crackdown

The ATO-led Serious Financial Crime Taskforce launched a coordinated action on 15, 16 and 17 June in 12 locations across New South Wales, Victoria, Tasmania, South Australia, Western Australia and Queensland which saw warrants executed against 19 individuals suspected of being involved in GST fraud.

The fraud involves offenders inventing fake businesses and Australian business number applications, many in their own names, then submitting fictitious business activity statements in an attempt to gain a false GST refund.

President's Report

by Jerome Tse, CTA

The importance of authenticity

President Jerome Tse reflects on bringing your authentic self to work as organisations consider the return to offices.

As a new financial year kicks off, I hope you are keeping well, managing your workload and finding time for yourself amid obligations to your clients. At busy times like this, it's easy to get caught up in the day-to-day of work and forget to prioritise your own needs.

Last month, I had the pleasure of attending the Women in Tax National Congress. It was a wonderful chance to connect with some of our members and volunteers and set aside a day to hear a variety of thought-provoking insights.

If you're familiar with the Women in Tax National Congress, you know that we take a step back from tax technical and instead focus on the other considerations that help determine the type of workplaces and careers we create. It's a valuable reminder to look at the big picture of our careers and lives.

One of the key insights I took away from the day was the importance of being able to bring your most authentic self to work. Identifying your own values, embracing your unique perspective and lived experience, and how these things inform the work you do are just as important to forging a fulfilling career as strong technical knowledge.

Embracing authenticity at work is also key to a culture of inclusivity. The Institute has a strong focus on building a diverse and inclusive community, from our membership to volunteers and staff. At its core, this is about empowering people to bring their most authentic self to work. That goes beyond glimpses into our colleagues lives as parents, partners, friends and pet-owners during work-from-home Zoom meetings, and extends to embracing differences of culture, race, sexuality and gender – all the things that make our perspectives uniquely valuable.

We are at our best, and the organisations that we work for are at their best, when we embrace what makes us our authentic selves.

Return to offices

Increasingly, organisations are revisiting their work policies and finding a new balance between the flexibility of remote work and the culture-building that takes place in an office. For most, it seems a hybrid of remote and in-person working will become our new normal for the foreseeable future and may be here to stay for good.

We've all come to appreciate the flexibility of working from home, and the opportunities it presents to better manage a work–life balance. However, a physical presence in the office remains an important aspect of professional life for many of us, especially our younger colleagues, who can benefit immeasurably from the incidental learning that takes place in an office environment. All in all, I believe that the move to a hybrid style of work will be a positive outcome for most of us in the tax profession and related disciplines. If we can successfully negotiate the return to offices while maintaining the transparency that a closer work and home life has afforded many of us, all the better.

Focus on your wellbeing

As we navigate a return to the office, it's a good time to be aware of our own wellbeing. Mental health, burnout and self-care have all been brought into the spotlight during the COVID-19 pandemic and it's vital we don't lose sight of them now.

The Tax Institute remains cognisant of the large workload many practitioners are still dealing with. We continue to advocate for regulators and government representatives to keep this in mind when designing solutions for our tax system.

The Tax Summit 2022

Last but certainly not least, we're gearing up for the biggest event of The Tax Institute's year: The Tax Summit. We will once again be gathering at Sydney's ICC for an unforgettable few days of tax technical insights, practical professional development and networking. Stay tuned for a program coming soon. I hope to see you there in October.

Acting CEO's Report

by Joanna Price

Keep the good, leave the bad behind

Acting CEO Joanna Price discusses re-evaluating your habits and ways of working this new financial year.

With Giles only just returning from overseas, attending to personal business and representing us at a conference with various heads of other tax institutes from Europe, Canada, Asia and South Africa, I'm happy to be writing to you all as acting CEO and take this opportunity to encourage you, despite the workload July often brings, to carve out some time for yourself this month.

Like Jerome, I had the joy of attending our Women in Tax National Congress last month, getting to reconnect with our members and staff in-person. It's safe to say that there were many great takeaways for all of us, not least of all is the reminder that making time to invest in yourself with events like this is more important now than ever.

Our members tend towards the technical and analytical in their working lives. Events like the Women in Tax National Congress present an opportunity to balance that with nourishment in the form of personal and professional development.

This year, among so many other wonderful insights, motivational speaker and wellbeing habit-changer Duncan Young introduced us to the idea of "temporal landmarks". Researchers Hengchen Dai, Katherine Milkman and Jason Riis describe temporal landmarks as dates that have a significance that demarcates them from our "ordinary" days, and which separate a past period of time from the present or future. They draw a boundary between one era in our lives and another, creating new epochs and new cycles in our months/year.

For our members in the accounting profession, the beginning of a new financial year might be one of the biggest temporal landmarks on the calendar. I understand that this is a busy time, and between end of financial year concerns and preparing clients for the new financial year, it may seem that there are simply not enough hours in the day to think about anything else. But I sincerely believe that, during these busy times, it is more important than ever to carve out time for yourself.

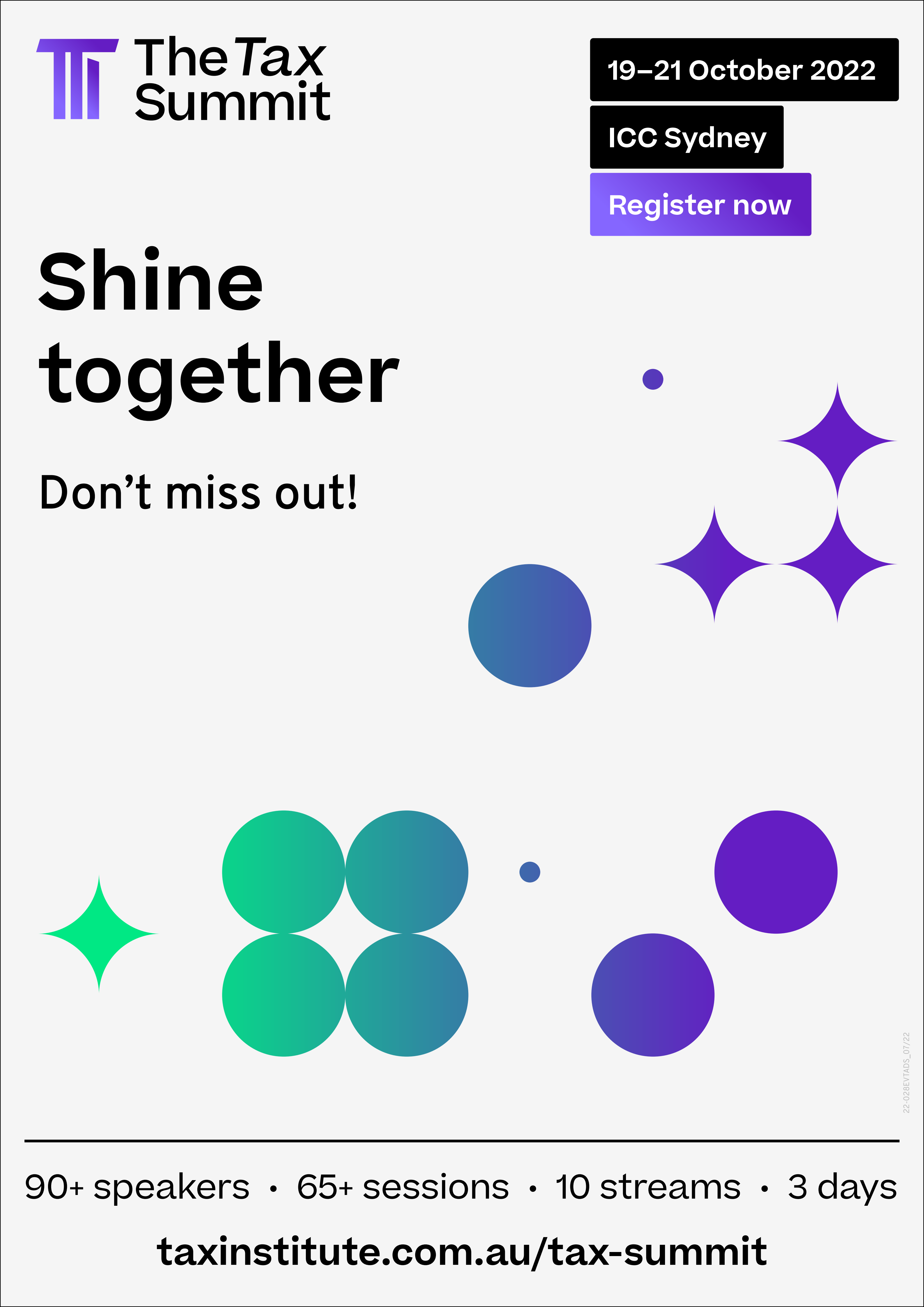
I encourage you to make some time, whether it's a whole day set aside or simply a 10-minute break where you can find it, to check in on yourself and your habits. This is a great opportunity to take advantage of the fresh start affect and re-examine the habits we've built over the past 18 months.

The shift in ways of working happened quickly, and for the most part, we were all thinking about what needed to be done to keep things ticking over, without always giving due consideration to whether we were building behaviours that serve us in the long run. Now that the effect of COVID-19 on our working lives has settled somewhat, we have the opportunity to consider if our new ways of working and the habits formed have a place now and into the future.

As Jerome pointed out in his President's Report, there are some new ways of working that we will no doubt keep — a renewed focus on wellbeing and an acceptance of real authenticity at work among them. Paying attention to our own wellbeing, keeping an eye out for the signs of burnout, and managing our time in a way that truly allows us to create balance between work and life are all habits worth keeping up.

On the other hand, the line between work and home has been blurred for many of us, and redrawing those boundaries should be a priority. I know that no longer having the daily commute — a kind of mini-temporal landmark, perhaps — was a challenge for a lot of us in the beginning and may remain a challenge even now. The habit of working through the time that would have otherwise been spent commuting, reading and shedding the work day is one that I am encouraging all of the Institute's staff and our members to lay to rest for good.

So, as we embark on a new financial year, I hope you take the time to renew the habits and connections that serve you well and rethink those that don't. And as our annual renewal period draws to a close, I hope that your connection to the Institute is one of those valuable ones you keep. We certainly value you.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Associate Tax Counsel's Report

by Amanda Donald, FTI

Post-election uncertainty

The Labor Government begins its term with an abundance of lapsed measures. In this month's column, we explore the implications for tax practitioners come 1 July 2022.

The 47th parliament is set to convene on 26 July 2022. All Bills previously before the House of Representatives have lapsed and those before the Senate will lapse on 1 July 2022. The expired Bills will need to be reintroduced and passed by both Houses. At the very earliest, this could be late July 2022 or August 2022.

The impact for practitioners

When preparing 2022 tax returns or providing tax planning advice, practitioners should be cognisant of the unenacted measures impacting the 2022 and 2023 financial years . Some lapsed measures affecting these years include:

- **skills and training boost and technology investment boost for small business:** the 2022–23 Federal Budget proposed a 120% deduction for eligible external training and digital technology expenditure for businesses with aggregated turnovers of less than $50m. The boosts were proposed to commence from 7:30pm AEDT on 29 March 2022 until 30 June 2023 (or 30 June 2024 for the technology investment boost).

  The ATO has provided guidance on how to claim deductions for the boosts for each financial year. The ATO guidance can be accessed here;
- **non-arm's length income:** from 1 July 2018, the non-arm's length income (NALI) definition was extended to include income derived from schemes relating to non-arm's length expenses. Due to the disproportionate effect of the amended rule, an administrative safe harbour was introduced until 30 June 2023. Prior to the federal election, the former government announced that it would implement legislative change to correct the unintentional application of the NALI provisions; and
- **electric car discount:** the Labor election campaign proposed to exempt electric vehicles from import tariffs and FBT where the cost of the vehicle is below the luxury car tax threshold for fuel-efficient vehicles. This election announcement was proposed to commence from 1 July 2022.

It is crucial to note that the above measures are not yet law and have no legal effect until enacted.

An opportunity for Labor

The proposed October 2022 Budget presents an opportunity for the new government to proactively, and permanently, address existing tax policies, building goodwill with the community.

Some announced measures which can improve the efficiency and fairness of the tax system if enacted include:

- **early access to superannuation for crime victims:** this was announced in December 2018 to enable victims of serious crimes to access residual compensation from their perpetrator's superannuation where the victim's compensation claim was unpaid or partly paid;
- **superannuation guarantee non-compliance:** employers late in paying or lodging superannuation guarantee (SG) statements are penalised with a Part 7 penalty and nominal interest charge. The Part 7 penalty is 200% of the original SG, even if the payment is one day late. The magnitude of the penalty is disproportionate to the level of non-compliance and deters taxpayers from rectifying identified errors;
- **permanent expansion of the instant asset write-off:** on 1 July 2022, the $1,000 instant asset write-off (IAWO) limit will re-commence. The aggregated turnover eligibility threshold imposed by the temporary full expensing regime will fall significantly from $5b to $10m or less (under the IAWO);
- **small business debt recovery action:** small businesses seeking to pause or modify ATO debt recovery when matters are under dispute can only do this through the court system. The 2021–22 Federal Budget proposed to enable eligible businesses to apply for an order of staying to the Small Business Taxation Division of the Administrative Appeals Tribunal; and
- **self-education expenses $250 threshold:** the 2021–22 Federal Budget proposed to remove the $250 non-deductible threshold for self-education expenses. This was introduced in 1975 to offset the receipt of the $250 tax concession rebate. Although the tax concession rebate ceased in 1985, the $250 threshold for self-education expenses has remained.

Where to from here?

The Tax Institute is conscious of the monumental task that the government has ahead of it. To support the government to prioritise the enactment of key tax measures, we have delivered an *Incoming government brief* directly to the Treasurer, the Hon. Dr Jim Chalmers, and the Assistant Treasurer, the Hon. Stephen Jones, as well as a number of other ministers in both Houses.

We encourage our members to view the brief here and let us know in The Tax Institute's Community your thoughts on which policies the government should prioritise.

Tax News – the details

by TaxCounsel Pty Ltd

June – what happened in tax?

The following points highlight important federal tax developments that occurred during June 2022.

Government initiatives

1. Non-commercial losses safe harbour

The Commissioner has released a draft practical compliance guideline that outlines a safe harbour that will allow an individual taxpayer with a non-commercial business loss for an income year that would otherwise have to be carried forward, to manage their tax affairs as if the Commissioner had exercised the discretion to allow the losses to be deducted in the income year (PCG 2022/D2).

One of the circumstances (specified in s 35-55(1)(a) of the *Income Tax Assessment Act 1997* (Cth) (ITAA97)) in which the Commissioner may exercise this discretion is where the business activity was or will be affected by special circumstances which are outside the control of the operators of the business activity, including drought, flood, bushfire or some other natural disaster. PCG 2022/D2 points out that, in recent years, special circumstances such as flood, bushfire and COVID-19 impacts may have caused the non-commercial loss rules to apply to a taxpayer's business. If this happens, and a taxpayer does not meet one of the other requirements for the loss to be offset against their other income, the taxpayer would need apply to the Commissioner for him to exercise the discretion to allow them to do so.

PCG 2022/D2 outlines a safe harbour that, provided the relevant conditions are satisfied, will allow a taxpayer to manage their tax affairs as if the Commissioner had exercised the discretion in s 35-55(1)(a). It does not prevent a taxpayer from applying for an exercise of the discretion in the usual way if their circumstances do not fall within the terms of the safe harbour.

For a taxpayer to qualify for the safe harbour, all of the criteria listed below must be met in an income year and the taxpayer must have made a tax profit from their business activity in the immediately preceding income year. The relevant criteria are:

- the taxpayer satisfies the income requirement in s 35-10(2E) ITAA97;
- the taxpayer made a loss from their business activity;
- the taxpayer's business activity was affected by one or more of the following events:
  - flood (including where ATO flood support was received);
  - bushfire (including where the taxpayer qualified for an ATO bushfire lodgment and payment deferral); or
  - a government-imposed lockdown, business closure and/or restriction due to COVID-19;
- the event meant that:
  - the taxpayer was not able to carry on their business activity, or was unable to carry it on to the same scale as the taxpayer usually carried on their business activity; or
  - some or all of the taxpayer's customers were not able to access the business activity, or were not able to access it in the same way as they usually did; and
- the taxpayer has not applied for a private ruling requesting that the Commissioner exercise the "special circumstances" discretion in relation to their business activity in the relevant income year.

The taxpayer must have relevant evidence to support that they are eligible for the safe harbour.

PCG 2022/D2 gives several examples, including the following:

> **Flood: not eligible to use the safe harbour**
>
> Steve runs a coffee roasting business from the garage of his home. Steve has not made a profit in recent years, including in the 2019–20 income year. Steve meets the income requirement in the 2020–21 income year.
>
> In the 2020–21 income year, the town where Steve lives was inundated with flood water and Steve closed his business for three months to undertake repairs to his garage where the business activity was conducted.
>
> Even though the flood, which would be considered to be a special circumstance, impacted Steve's business activity, Steve did not make a tax profit in the income year before the event. In this case, Steve is not eligible to apply the safe harbour. However, Steve can apply for the exercise of the Commissioner's discretion in the usual way.
>
> **COVID-19: eligible to use the safe harbour**
>
> Mary operates a food truck. Mary meets the income requirement in the 2019–20 income year. The business generated a tax profit in the 2018–19 income year. A government-imposed lockdown in response to COVID-19 meant that Mary could not operate her business from March to June 2020.
>
> In the 2019–20 income year, the business made a loss. Mary maintains evidence of the lockdown's impact on her business.
>
> In this case, Mary is eligible to use the safe harbour.

2. Car limits

For 2022–23, the depreciation car limit is $64,741 and the luxury car tax (LCT) thresholds are $84,916 (fuel-efficient vehicles) and $71,849 (other vehicles)

There is a limit on the cost that can be used to work out the depreciation of passenger vehicles (except motorcycles or similar vehicles) designed to carry a load of less than one tonne and fewer than nine passengers. The maximum value that can be used for calculating a claim is the car limit (irrespective of any amount received for a trade-in) in the year in which the car was first used or leased.

If a car is imported or sold with a GST-inclusive value above the LCT thresholds, LCT must be paid except in certain circumstances. In general, the LCT value of a car includes the value of any parts, accessories or attachments that were supplied, or imported, at the same time as the car.

Recent case decisions

3. Disclosure of information

The New South Wales Court of Appeal has by majority (Gleeson JA and Basten AJA; Macfarlan JA dissenting) allowed an appeal by the Commonwealth from a decision of Ball J and held that a notice to produce documents issued to the Commonwealth in proceedings brought to seek to recover moneys paid to the Commissioner by another entity should be set aside (*Commonwealth of Australia v Kupang Resources Pty Ltd (ACN 098 773 785)*[1]).

The respondent, Kupang Resources Pty Ltd (Kupang), brought proceedings against the Commonwealth seeking to recover moneys paid by a Mr Phillip Grimaldi to satisfy his tax debts. In earlier proceedings in the Federal Court, Mr Grimaldi had been held to have breached his fiduciary duties to Kupang, then known as Chameleon Mining NL. Kupang alleged that Mr Grimaldi paid the Commonwealth, to its knowledge, with funds obtained through breaches of fiduciary duty.

Kupang issued a notice to produce to the Commonwealth under the *Uniform Civil Procedure Rules 2005* (NSW) (UCPR) requiring production to Kupang of "protected information", relevantly, information that was "disclosed or obtained under or for the purposes of a taxation law … when it was disclosed or obtained" and "relates to the affairs of an entity", which includes an individual or body corporate (as defined in s 355-30 of Sch 1 to the *Taxation Administration Act 1953* (Cth) (TAA53)). Pursuant to s 355-25 Sch 1 TAA53, it is an offence for a taxation officer to disclose protected information to "another entity … or to a court or tribunal", subject to certain exceptions, including under s 355-50 Sch 1 TAA53 where the disclosure by a taxation officer is made in performance of the taxation officer's duties. Pursuant to s 355-75 Sch 1 TAA53, a taxation officer is not to be required to disclose "to a court or tribunal" protected information, subject to an exception where it is necessary to do so for the purpose of carrying into effect the provisions of, relevantly, a taxation law. The Commonwealth applied to the New South Wales Supreme Court to set aside the notice to produce issued by Kupang.

At first instance, Ball J dismissed the Commonwealth's application and held that r 21.10 UCPR does not require production, either directly or consequentially, to the court and therefore the Commissioner could not rely on the prohibition on compulsory disclosure of protected information to a court or tribunal contained in s 355-75 of Sch 1 TAA53. Ball J also held that the prohibition on disclosure of protected information to any entity under s 355-25 did not apply because an exception in s 355-50 applied as the disclosure would be in performance of the taxation officer's duties in defending proceedings brought by Kupang.

On appeal by the Commonwealth from the decision of Ball J, the single issue raised was whether the Commonwealth was required to produce for inspection, by a party to proceedings, documents obtained by the Commonwealth for the purposes of administering taxation laws. In allowing the appeal, the majority (Gleeson JA and Basten AJA) in a joint judgment held that:

- s 355-25 Sch 1 TAA53 was a prohibition on disclosure of protected information to "another entity … or to a court or tribunal";
- it was artificial to treat the exception to s 355-25 in s 355-50(1) or in item 1 of the table in s 355-50 Sch 1 TAA53 as satisfied in this case. The proposed disclosure, if made, would be in complying with an obligation imposed by some other statutory regime, not in performance of the taxation officer's duties, or for the purpose of administering any taxation law;
- compulsory powers to disclose otherwise than to a court or tribunal provided no exception to the prohibition in s 355-25 Sch 1 TAA53. Reading s 355-75 Sch 1 TAA53 as the sole restraint on compulsory disclosure was erroneous; and
- although in some cases a taxation officer will have the power to disclose protected information for the purpose of administering a taxation law, such as under s 355-50 Sch 1 TAA53, the only ability of a third party to obtain information by compulsion is that identified in, and limited to, the exception in s 355-75, which was not engaged in this case.

4. Freezing orders varied

The Federal Court (Jagot J) has varied freezing orders that were originally made in September 2019 against a Mr Huang, a non-resident who had tax debts of approximately $141m for which judgment had been entered (*DCT v Huang (No. 4)*[2]).

The variation effectively meant that Mr Huang was restricted from using his Australian assets to pay living expenses and legal expenses. Jagot J was satisfied that it was in the interests of justice that Mr Huang not be permitted to use his assets in Australia to pay his contemplated legal expenses in connection with proceedings he had commenced in the AAT to review the Commissioner's decision to disallow his objections to the assessments of income tax and penalties the subject of the judgment that had been entered against him.

If necessary, her Honour was also satisfied that there had been a material change in circumstances justifying the variation of the freezing orders.

On both accounts, this was primarily because:

- there was now a judgment debt owed by Mr Huang to the Deputy Commissioner of Taxation for the unpaid income tax and penalties;
- the entirety of the judgment debt remained unpaid by Mr Huang;
- following the Commissioner's disallowance of all of Mr Huang's objections to the relevant income tax assessments and administrative penalties the subject of the judgment debt, Mr Huang, on 23 December 2021, filed an application for review of the Commissioner's objection decisions in the AAT and requested that the Deputy Commissioner facilitate the use of his Australian assets to fund his legal fees and expenses in the AAT proceeding;
- the evidence persuaded her Honour that, unless the freezing orders were varied as proposed by the Deputy Commissioner, the purpose of the continuation of the freezing orders, to protect the efficacy of execution of the judgment debt against Mr Huang, would be, or involved, a real risk of being undermined;
- the evidence persuade her Honour that Mr Huang would have no difficulty in funding his proceedings in the AAT using his assets outside of Australia; and
- there was no evidence that the variation of the freezing orders would cause any prejudice to Mr Huang or any other person.

The decision of Jagot J in this case is the latest in long-running litigation in relation to the issue of freezing orders. The litigation has involved an appeal to the High Court which held that the relevant power granted to the Federal Court to make freezing orders was not constrained by a precondition that it may only be exercised if there is proof of a realistic possibility of enforcement of a judgment debt against the person's assets in each foreign jurisdiction to which the proposed order relates (*DCT v Huang*[3]).

5. Underpaid award entitlements

The AAT has held that lump sums received by two taxpayers who had been underpaid by their franchisee employers were assessable income (*Guttikonda and Sheth and FCT*[4]).

In about 2015, there were reports in the media suggesting widespread underpayment of employees working in 7-Eleven stores. To address this issue, in about September 2015, 7-Eleven established an independent panel, with an independent secretariat, to investigate claims of underpayment of wages by 7-Eleven franchisees. The taxpayers were among those who claimed to have been underpaid.

Taking the facts relevant to one taxpayer, the taxpayer was a former employee of five 7-Eleven franchisees in Australia. During the period 1 July 2006 to 30 June 2015, the taxpayer performed services in respect of 5,677.3 hours of ordinary time in the course of his employment with the franchisees.

At all times, the taxpayer was entitled to be paid wages for the hours he worked by the respective franchisees in accordance with the applicable award(s). None of the franchisees paid the taxpayer wages in accordance with the applicable award(s). In failing to pay wages to the taxpayer in accordance with the applicable award(s), the taxpayer accrued rights and a cause of action in respect of each of the amounts of wages that ought to have been paid as against each of the franchisees.

Similarly, on the taxpayer performing the work, each of the franchisees became liable to pay to the taxpayer an amount of wages equal to the difference between: (1) the amount of wages that was payable to the taxpayer under the applicable award(s); and (2) the amount of wages that was, in fact, paid to the taxpayer by the franchisees. The total of the differences was $131,673.

On 30 December 2016, the taxpayer was notified by the independent secretariat that his claim for underpayment of wages by 7-Eleven franchisees had been assessed and approved and that he was entitled to a payment of $159,078.24 which comprised $131,673.81 for "ordinary time" and $27,404.43 for "interest". The notice also stated that superannuation would be paid to the taxpayer's superannuation fund. The taxpayer executed a "Deed of Acknowledgement and Assignment" in respect of each of the franchisees.

In holding that the amounts received by each taxpayer was assessable income, the AAT said that there was an obvious nexus between the gross amounts agreed to be paid to the taxpayers and the services provided by them to their former employers. Regardless of how these payments were described, they were the product of the services provided by the taxpayers and properly characterised as income. The cases referred to by the Commissioner demonstrated that the characterisation of a payment for services rendered as income was not lost simply because the payment was in a lump sum, or payment was deferred, or made by someone other than the employer, or was expressed to be in consideration of the disposal of rights.

The AAT further held that the amounts of interest were also assessable as ordinary income.

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References

1 [2022] NSWCA 77.

2 [2022] FCA 618.

3 [2021] HCA 43.

4 [2022] AATA 1325.

Tax Tips

by TaxCounsel Pty Ltd

GST margin scheme issues

The way the GST margin scheme applies where more than one freehold interest in land is disposed of under a single contract has been considered by the Federal Court.

Background

Since its commencement on 1 July 2000, the GST legislation, in particular, the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (GSTA99), has generated a considerable amount of litigation not only between taxpayers and the Commissioner, but also, because of the nature of the tax, between the parties to a transaction, particularly conveyancing transactions such as the sale and purchase of land and the grant of options and leases over land.

One feature of the GSTA99 where there is a supply of a freehold interest in land, the sale of a stratum unit or the grant of a long-term lease is that the parties to the contract may choose that the margin scheme apply to the supply where the conditions for that scheme to apply are satisfied. The provisions that govern the operation of the margin scheme are contained in Div 75 GSTA99. Those provisions, it may be noted, have been very substantially amended since their enactment.

In *Landcom v FCT*,[1] Thawley J considered two GST issues, a constitutional issue stemming from s 114 of the Constitution and a basic issue under the GST margin scheme provisions. Thawley J decided each issue adversely to the Commissioner. This article considers the margin scheme issue.

As will be seen, Thawley J, when approaching the construction of the provisions of the GSTA99, placed some emphasis on the structure of the Act which distinguishes between what may be called the general and the specific or particular provisions. That structure manifests itself in the division of the Act into Chapters as follows: Ch 1 introduction; Ch 2 the basic rules; Ch 3 the exemptions; Ch 4 the special rules (which include the margin scheme provisions); Ch 5 miscellaneous; and Ch 6 interpreting the Act.

The relevant facts

The facts of the *Landcom* case that are relevant to the GST margin scheme issue that is considered in this article are as follows.

Landcom was the registered proprietor of a freehold interest in a number of lots of land which it intended to sell. Each lot was described in a separate certificate of title. The various lots were grouped together for the purposes of preparing two contracts of sale:

- 12 lots were grouped into "property B1" and were the subject of contract B1; and
- four lots (lots L, M, N and P (the lots)) were grouped into "property B2" and were the subject of contract B2. Lot P was separated from lots L, M and N by a train line. Lot P was connected to lot N by a private access road that was part of lot P and which led through a tunnel under the rail line.

The lots had been held by the state of New South Wales since before 1 July 2000, when the GST was introduced. The lots were previously owned by the New South Wales Land and Housing Corporation. On 1 January 2002, the lots were transferred from that corporation to Landcom pursuant to an order of the Minister made under s 17 of the *Landcom Corporation Act 2001* (NSW).

A number of the lots had been used for the purposes of farming activities, although these activities had ceased a number of decades before Landcom became the owner of the lots. The lots had also been subject to other human interventions. Lot M, for example, had an aero club for remote control plane enthusiasts, including a runway and a clubhouse.

The lots were to be sold to enable a developer to build residential premises, effectively creating a new suburb. The lots were marketed for sale by expression of interest or competitive tender process. The lots were promoted as a single piece of land as part of the same transaction on the basis that a single buyer would purchase all of the lots.

By a put and call option agreement dated 5 November 2015, Landcom granted an option to the purchaser, and the purchaser granted Landcom an option to require the purchaser, to purchase the lots comprising property B1 on the terms of contract B1, and to purchase the lots comprising property B2 on the terms of contract B2. Clause 36.3 of the contract of sale provided that the parties agreed that the "margin scheme" would be applied to work out the GST payable on any taxable supply of property under the contract.

On 26 February 2020, Landcom sent an application to the Commissioner for a private binding ruling concerning the operation of item 4 of the table in s 75-10(3) GSTA99. Where it applies, Div 75 GSTA99 allows the use of a "margin scheme" to bring taxable supplies of freehold interests in land, stratum units and long-term leases within the GST system. GST is calculated only on the "margin" for the supply. Item 4, which was relevant in the context of the *Landcom* case, applies if the following circumstances apply to the supply:

> "The supplier is the Commonwealth, a State or a Territory and has held the interest, unit or lease since before 1 July 2000, and there were no improvements on the land or premises in question as at 1 July 2000."

If those circumstances apply and an "approved valuation" as at the day specified in the table has been made, the "margin" for the supply is the amount by which the consideration for the supply exceeds the valuation (s 75-10(3) GSTA99). The relevant valuation time for item 4 is the date of the supply. Typically, therefore, where item 4 applies, there will be no margin because the consideration paid on the date of the supply would ordinarily be the market value such that there will not be any "margin".

The question of significance for Landcom was the operation of Div 75 in circumstances where four freehold interests in land were sold in one contract.[2] That question was:

> "15 … for the purposes of the application of Div 75, was there one supply of all of the lots the subject of Contract B2 or single supplies of each of Lots L, M, N and P?"

If the sale of property B2 was a single supply for the purposes of Div 75 GSTA99, any improvement on any one of the lots would be sufficient to take the supply of all of the land outside of the exception provided by item 4; any improvement on one lot would "taint" all of the lots. On the other hand, if the transaction involved separate supplies of individual freehold interests in land, some of the lots might fall within the exception and some might not.[3]

The Commissioner issued to Landcom a private ruling in which the third and fourth questions asked by Landcom (being the two questions which related to property B2)[4] were set out and answered as follows:

> "**Question 3**
>
> For the purposes of working out whether the circumstances specified in the second column of item 4 of the table in subsection 75-10(3) of the GST Act apply, will the sale of the freehold interests in the Lots comprising Property B2 pursuant to Contract B2 be a single supply?
>
> **Answer**
>
> Yes. Item 4 of the table in subsection 75-10(3) of the GST Act requires identification of the land that is the subject matter of the supply. For item 4 purposes, the supplies of the freehold interests in the Lots comprising Property B2 pursuant to Contract B2 is a single supply of land as the subject matter of the supply is the totality of Property B2.
>
> **Question 4**
>
> For the purposes of working out whether the circumstances specified in the second column of item 4 of the table in subsection 75-10(3) of the GST Act apply, will the sale of the freehold interest in each Lot comprising Property B2 pursuant to Contract B2 be a single supply?
>
> **Answer**
>
> No. Item 4 of the table in subsection 75-10(3) of the GST Act requires identification of the land that is the subject matter of the supply. For item 4 purposes, the supplies of the freehold interests in the Lots comprising Property B2 pursuant to Contract B2 is a single supply of land as the subject matter of the supply is the totality of Property B2."

On 24 August 2020, Landcom lodged an objection to the private ruling and, by an objection decision dated 24 February 2021, the Commissioner disallowed Landcom's objection. Landcom then lodged an "appeal" to the Federal Court against the Commissioner's objection decision.

The GST legislation

The provisions of Div 75 GSTA99 that are of relevance for present purposes are as follows:

> **"75-1 What this Division is about**
>
> | |
> |---|
> | This Division allows you to use a margin scheme to bring within the GST system your taxable supplies of freehold interests in land, of stratum units and of long-term leases. |
>
> **75-5 Applying the margin scheme**
>
> (1) The margin scheme applies in working out the amount of GST on a taxable supply of real property that you make by:
>
> (a) selling a freehold interest[5] in land; or
>
> (b) selling a stratum unit; or
>
> (c) granting or selling a long-term lease;
>
> if you and the recipient of the supply have agreed in writing that the margin scheme is to apply.
>
> …
>
> (2) However, the margin scheme does not apply if you acquired the entire freehold interest, stratum unit or long-term lease through a supply that was ineligible for the margin scheme.
>
> Note: If you acquired part of the interest, unit or lease through a supply that was ineligible for the margin scheme, you may have an increasing adjustment: see section 75-22.
>
> …
>
> **75-10 The amount of GST on taxable supplies**
>
> (1) If a taxable supply of real property is under the margin scheme, the amount of GST on the supply is 1/11 of the margin for the supply.
>
> (2) Subject to subsection (3) and section 75-11, the ***margin*** for the supply is the amount by which the consideration for the supply exceeds the consideration for your acquisition of the interest, unit or lease in question.
>
> (3) Subject to section 75-11, if:
>
> (a) the circumstances specified in an item in the second column of the table in this subsection apply to the supply; and

(b) an approved valuation of the freehold interest, stratum unit or long-term lease, as at the day specified in the corresponding item in the third column of the table, has been made;

the ***margin*** for the supply is the amount by which the consideration for the supply exceeds that valuation of the interest, unit or lease.

Use of valuations to work out margins

Item	When valuations may be used	Days when valuations are to be made
1	…	
2	…	
2A	…	
3	…	
4	The supplier is the Commonwealth, a State or a Territory and has held the interest, unit or lease since before 1 July 2000, and there were no improvements on the land or premises in question as at 1 July 2000.	The day on which the taxable supply takes place

…

75-16 Margins for supplies of real property acquired through several acquisitions

(1) If:

(a) you make a taxable supply of real property under the margin scheme; and

(b) the interest, unit or lease in question is one that you acquired through 2 or more acquisitions (***partial acquisitions***); and

(c) one of the following provisions (a ***margin provision***) applies in relation to such a partial acquisition, or would so apply if the partial acquisition had been an acquisition of the whole of the interest, unit or lease:

(i) section 75-10;

(ii) subsection 75-11(1), (2), (2A), (2B), (3), (4), (5), (6) or (7);

the margin provision applies, in working out the margin for the supply you make, only to the extent that the supply is connected to the partial acquisition.

(2) The application of a margin provision in relation to one of the partial acquisitions does not prevent that margin provision or a different margin provision applying in relation to another of the partial acquisitions."

Rationale of the margin scheme

Thawley J said that the margin scheme is intended to ameliorate what might otherwise be regarded as an undesirable operation of the GSTA99 on certain business activities. Two "unfairnesses" were identified by the Full Federal Court in *Brady King Pty Ltd v FCT*.[6] These were:

> "The Margin Scheme is directed towards developers. Commonly developers acquire land from private owners. Those owners are not liable for GST on the supply of land to the developer because the supply is not made in the course or furtherance of an enterprise and the owners are not registered or required to be registered under the GST Act. Because the owners are not liable for GST on their supply, application of the general scheme of the GST Act would mean that the developer, as acquirer, would not be entitled to any input tax credit on the acquisition of the land. The developer would have to pay GST on the whole value of the developed property that it supplied to the ultimate purchasers.
>
> Another potential unfairness would arise if the property the subject of supply were acquired by the taxpayer before 1 July 2000. It is a fundamental feature of the GST regime that it only taxes value added after 30 June 2000. Hence Div 75 provides an optional basis for taxpayers supplying real estate of a kind referred to in s 75-5(1)(a), s 75-5(1)(b) or s 75-5(1)(c). They can elect to pay GST on the 'margin' as defined in s 75-10(2)."

It was the second "unfairness" which was of particular relevance in the *Landcom* case.

The contentions: Landcom

Landcom's principal submission on the margin scheme issue was that s 75-5(1)(a) GSTA99 provides separate treatment for any taxable supply of real property made by selling a freehold interest in land. Even if it is possible for a supply of multiple freehold interests to be a single supply under the basic GST rules, s 75-5(1)(a) (contained in the special rules) focuses on and treats separately each supply made by selling "a freehold interest in land".

The contentions: the Commissioner

On the other hand, the Commissioner submitted that the logical and necessary starting point was identification of "the supply". The nature of "the supply" will affect whether and how the items in the table in s 75-10(3) apply because s 75-10(3) only applies if "the circumstances specified in an item in the second column of the table in the subsection *apply to the supply*": s 75-10(3)(a) (Commissioner's emphasis).

The Commissioner submitted that item 4 of the table in s 75-10(3) raised the question of whether there were improvements on the "land or premises in question" as at 1 July 2000. According to the Commissioner, given that the circumstances in item 4 have to apply to "the supply", the term "land or premises in question" refers to whatever has been supplied. According to the Commissioner, this was to be understood as a reference to the "tangible land that has been supplied" which was the entirety of the freehold interests making up what was referred to as property B2.

The decision

In rejecting the Commissioner's submissions, Thawley J made a number of points, including:

- the logical starting point for the application of Div 75 GSTA99 was s 75-5(1). Relevantly for present purposes, the question was whether there had been a "taxable supply" made "by selling a freehold interest in land". Contrary to the Commissioner's submission, s 75-10(3)(a) does not indicate that the identification of "the supply" under s 9-5 GSTA99 is the necessary starting point for the purposes of determining the application of Div 75 GSTA99;[7]
- the better construction of s 75-5(1)(a) GSTA99 was that it contained a special rule which was applicable where there had been a supply by selling a particular freehold interest in land, and the supplier and recipient had agreed that the margin scheme was to apply. Where that has occurred, the margin is calculated by reference to the particular freehold interest which was sold. It applies whether or not that particular supply, made by selling a freehold interest in land, is part of a larger supply. This construction better accorded with the ordinary meaning of the language employed in s 75-5(1) and Div 75 as a whole;[8]
- the reference to "the interest" in item 4 of the table in s 75-10(3) GSTA99 is a reference to the particular freehold interest referred to in s 75-5(1)(a) GSTA99. Contrary to the Commissioner's submission, the reference to "the land … in question" is a reference to the land to which the particular freehold interest relates, not to the "tangible land that has been supplied";[9]
- it did not matter whether the contract of sale, namely contract B2, was properly characterised for the purposes of s 9-5 GSTA99 as giving rise to a single "taxable supply" of four freehold interests in land or four taxable supplies of freehold interests in land. In either case, the margin scheme was to be applied to each freehold interest in land sold because, for the purposes of s 75-5(1)(a), there had been a supply of each freehold interest by selling each freehold interest in land. To the extent that this should be regarded as modifying the "basic rules" (which must in any event be read in the context of the GSTA99 as a whole, including the "special rules"), so much was expressly contemplated by the statutory regime. The GSTA99 contemplates that a single supply might be made up of several supplies attracting differing treatment;[10] and
- individual treatment of the relevant real property interests supplied in the manner described in s 75-5(1) better conformed to the object to which Div 75 GSTA99 was directed.[11]

The Commissioner submitted that the operation of s 75-22 GSTA99 (Increasing adjustment relating to input tax credit entitlement) was consistent with the view that a sale of multiple freehold interests can be a single supply. That section provides for an "increasing adjustment" where there is "a taxable supply of real property under the margin scheme" and part of what is being supplied was acquired in a way that was ineligible for the margin scheme. Thawley J said that the terms of s 75-22 were not directly inconsistent with the Commissioner's view, but the provision was not a strong contextual matter in favour of his view.

Thawley J said that the operation of ss 75-5, 75-16 and 75-22 GSTA99 in relation to a freehold interest in land was, in simple terms, as follows. If a particular freehold interest in land was acquired through two or more acquisitions (and amalgamated into one), and that freehold interest is sold, then:

- by reason of s 75-5(2), the margin scheme will not apply if the "entire" freehold interest was acquired through a supply that was ineligible for the margin scheme;
- if a part of the freehold interest was acquired through a supply that was ineligible for the margin scheme, the margin scheme may still apply to the sale of the freehold interest;
- s 75-16 allows the margin scheme calculation methodologies set out in ss 75-10 and 75-11(1) to (7) to be applied individually in respect of each original freehold interest which was eligible for the margin scheme; and
- s 75-22 imposes an increasing adjustment if any of the original freehold interests were ineligible for the margin scheme.[12]

His Honour said that, properly construed, s 75-22 also favoured a construction of Div 75, in its application to sales of freehold interests in land, that the legislature should be presumed to have intended to mean what it said in s 75-5(1)(a). That paragraph contemplates individual treatment under the margin scheme of "a freehold interest in land" whether or not it was sold under a contract in which other freehold interests were also sold.[13]

Thawley J said that, as Landcom submitted, the policy and context of the margin scheme set out in Div 75 (as part of the "special rules") is different from the context of the general provisions contained in the "basic rules".[14] The focus of Div 75, in so far as it applies to selling freehold interests in land, is on the sale of individual interests in land.

Thawley J then went on:

> "206 It may be accepted as the Commissioner submitted that, for the purposes of s 9-5 [taxable supplies], a practical common-sense approach should be taken to the question of whether there is a single supply and to the characterisation of that supply, having regard to relevant contractual terms and commercial reality … The recognition that the GST is a practical business tax, which informs that approach in relation to the characterisation of the relevant supply for the purposes of the 'basic rules', also informs the construction of Div 75, contained in the 'special rules'. Division 75 was introduced in part to address the position of developers who (amongst other things) acquire and dispose of freehold interests in land.

> Div 75 relevantly focuses attention on 'a freehold interest in land'. The individual treatment of freehold interests under Div 75 is practical and commercial and accords with common-sense. The Commissioner's construction of Div 75, which involves reading the singular as plural, introduces complexity and uncertainty. It gives rise to differing results depending on the manner in which freehold titles were sold and facilitates the imposition of GST on value added before 1 July 2000 where this result was not obviously intended."

Observations

It is suggested that the decision of Thawley J on the statutory construction issue is correct.

The Commissioner has, however, lodged an appeal to the Full Federal Court from the decision of Thawley J.

Where the factual situation for the purposes of applying the margin scheme is such that the decision of Thawley J on the operation of the margin scheme is relevant and the parties want the margin scheme to apply if possible, then, pending the decision of the Full Federal Court, careful attention to the drafting of the terms of the relevant contract will be needed to seek to protect each party to the contract. Indeed, attention may need to be paid to the structure of the contractual arrangements. For example, the parties could consider the possibility of entering into two separate contracts, one in relation to the sale of the parcel(s) of land in respect of which the margin scheme can be applied and the other in relation to the other parcel(s). But in that event, the contracts would usually need to be interdependent and there may be an issue of whether this may mean that any potential difficulty would not be overcome. It will need to be kept in mind that there will likely be some time before a decision on the Commissioner's appeal is handed down by the Full Federal Court.

It must always be noted that the standard form contracts for the sale and purchase of land that are in use in the various jurisdictions contain what may be called "margin scheme provisions" and that, depending on the circumstances, these may need to be modified or replaced.

TaxCounsel Pty Ltd

References

1 [2022] FCA 510.

2 This is a reference to contract B2. As to contract B1, see reference 4.

3 Note that the Commissioner was not asked to rule on any other question that might arise in relation to item 4.

4 Landcom did not object to the Commissioner's rulings on the first two questions asked by Landcom relating to property B1. In this regard, Landcom observed that contract B1 had settled and GST returns had been lodged with respect to the supply or supplies before Landcom objected.

5 This expression is not defined. It was common ground that each certificate of title gave rise to a separate freehold interest in land.

6 [2008] FCAFC 118 at [8] and [9].

7 [2022] FCA 510 at [193].

8 [2022] FCA 510 at [194].

9 [2022] FCA 510 at [196].

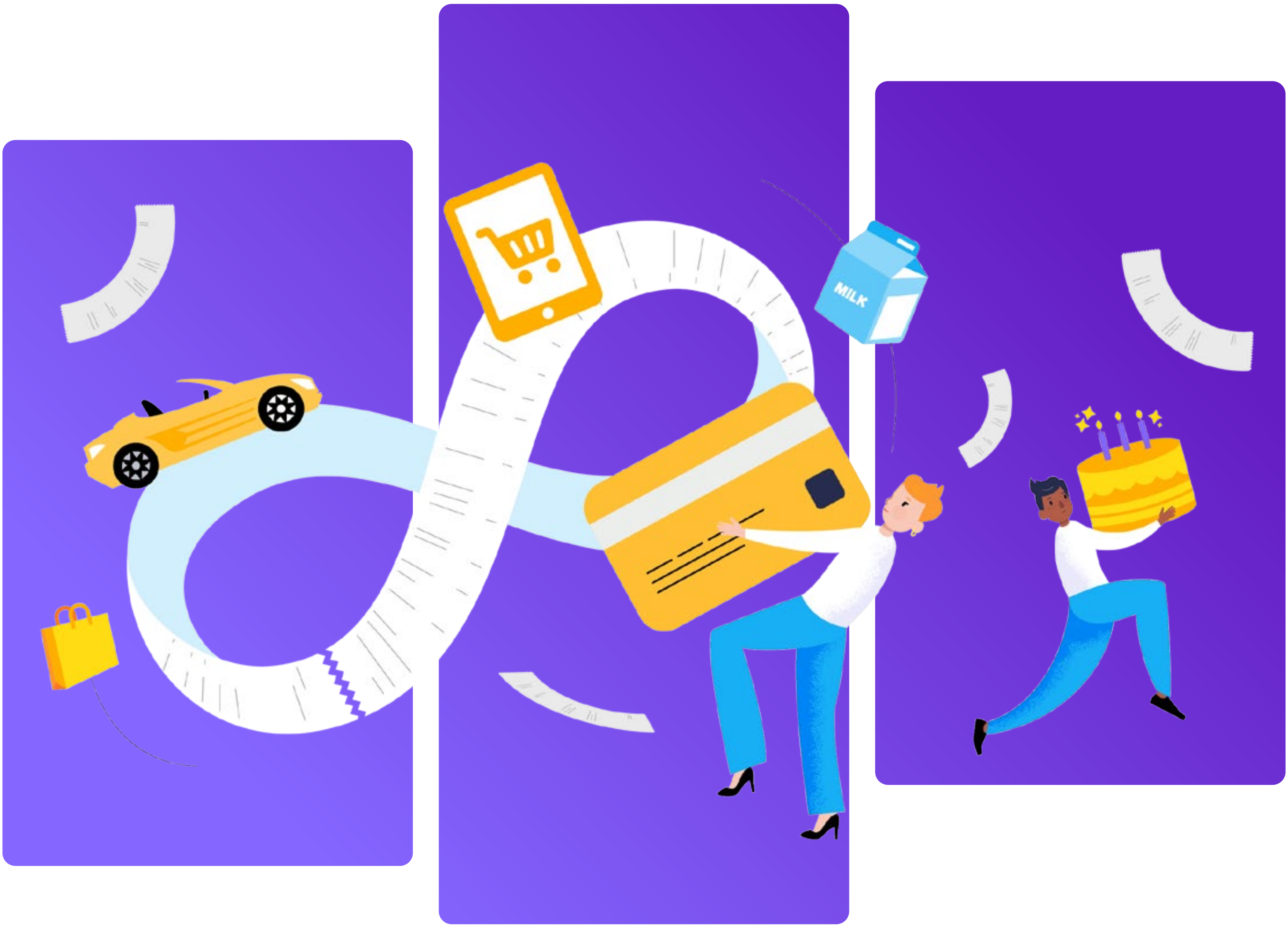
10 [2022] FCA 510 at [197].

11 [2022] FCA 510 at [198].

12 [2022] FCA 510 at [203].

13 [2022] FCA 510 at [204].

14 [2022] FCA 510 at [205].



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Higher Education

Key learnings from CommLaw 3

The dux of CommLaw 3 for Study Period 2 2021 discusses how the acquired knowledge from the subject was applied in a recent merger he was advising on.

Albert Meintjes
Senior Manager, RSM, New South Wales

Please provide a brief background of your career in tax.

I started my career in 2008 as an auditor at KPMG and transferred to KPMG's Corporate Finance division three years later. I have been working in Corporate Finance since, specialising in company valuations and providing transaction advice. Before moving to Australia in 2017, I worked in the Deloitte Corporate Finance team in Johannesburg.

I joined RSM in 2021 after four years at Pitcher Partners. Over the past five years, I have been involved in various company and asset valuations for Australian tax purposes, typically resulting from corporate transactions and restructures. I am a chartered accountant (CAANZ member) and I have BCom and BCom (Hons) degrees in accounting from the University of Johannesburg.

Why did you choose to study the CommLaw 3 subject?

I selected CommLaw 3 as an elective subject as part of the Graduate Diploma of Applied Tax Law program. Working in corporate finance, this subject was of particular interest to me as it deals with the types of property (tangible assets, intellectual property, personal property) that can be dealt with in commercial transactions.

What have you learned from the subject, and have you applied this to your role?

One of the key takeaways from the subject was gaining a more in-depth understanding of the law surrounding intellectual property and competition and consumer law. This has been particularly useful when providing transaction advice to my clients. Specifically, the *Competition and Consumer Act 2010* (Cth), the *Copyright Act 1968* (Cth), the *Trademarks Act 1995* (Cth), the *Patents Act 1990* (Cth) and the *Designs Act 2003* (Cth).

I used my knowledge from the subject recently on a merger I was advising on. We identified potential contraventions of s 50 of the *Competition and Consumer Act 2010*. Identifying potential issues early in the transaction process gave our client sufficient time to obtain legal advice and allowed us to develop an appropriate strategy for the transaction.

How did you juggle study, work and other commitments?

I wouldn't have been able to juggle all of my commitments without my wife's love and support. She also had to make sacrifices because of my studies, and it really has been a team effort. Having her support made this much easier for me and allowed me to dedicate enough time to my studies.

I allocated 10 to 14 hours of study to each subject per week and tried to leave one day free over weekends to rest and spend time with family and friends. Admittedly, finding time for studies proved much easier during COVID-19 lockdowns.

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

Now that I've completed my Graduate Diploma of Applied Tax Law, my focus will be on attending regular tax updates and staying up to date with developments as part of my continuing professional development.

What advice do you have for other tax professionals considering the Graduate Diploma of Applied Tax Law Program?

Involve your support network in your studies from the start. Whether it be your family, friends, manager at work, or a combination of all three, these are people who want to see you succeed and who will support you in achieving your goals.

Member Spotlight

Aldrin De Zilva

Member since:	**1999**
Member level:	**CTA**
Current role:	**Partner, White & Case LLP, Victoria**

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

A career in tax is dynamic, exciting and extremely rewarding. Every day I have the opportunity to collaborate with my brilliant clients and team to solve complex problems. In my view, The Tax Institute is the leading professional association in tax. In addition to providing a great opportunity to meet and network with so many talented individuals, The Tax Institute is one of the leaders in tax policy development.

How is your membership beneficial to your practice and clients?

The Tax Institute provides some fantastic technical resources and conferences which provide the opportunity to network and hear from specialists across industry, government, professional practice and the ATO on a broad range of taxation topics. The Tax Institute also provides members the forum to publicise and share ideas through publications and presentations at conferences.

What is your most memorable career achievement to date?

I have been blessed with so many memorable moments that I am incredibly proud of in my career, including: representing a client in a matter before the High Court of Australia – one of the few income tax cases prior to that case to be granted special leave by the High Court of Australia; being the lead taxation adviser on some of the largest and most complex multi-billion transactions in Australia; assisting with various tax policy reviews and initiatives over the years; and being awarded the coveted Tax Adviser of the Year Award for 2021.

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

No doubt COVID-19 will continue to pose challenges and continue to challenge our traditional ways of doing business. While taking advantage of the flexibility of remote working arrangements, we will need to continue to find ways to harness the benefits of maintaining and growing our relationships with clients and colleagues.

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

I am extremely fortunate to have worked (and to continue to work) with some of the leaders in the tax profession, including from within industry, other professional firms, the ATO and state revenue offices, state and Commonwealth Treasuries, and wonderful organisations such as The Tax Institute. The key attributes they all have in common are a passion for tax law, a desire to continue to learn, a strong work ethic and thoroughly enjoying what they do.

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

Network, network, network. Most young professionals will have a wide circle of friends and colleagues. As the continued pressures of work build, it is very easy to narrow your circle of friends. Continue to maintain and expand your network of friends.

What does it mean to have won a prestigious Tax Adviser of the Year Award for 2021 and why?

The tax community is made up of so many amazing people. Standing among them is a privilege and honour. To win an award such as this and to be considered among those that have won this award before is truly beyond anything I imagined. It is a testament to the wonderful people I am blessed to be surrounded by and my sincere gratitude is extended to my clients, current (and former) fellow team members, the tax community and my family.

Design of a sustainable superannuation system

by The Tax Institute

This chapter of the *Case for Change* paper considers the fundamental design of the superannuation system, and the best reform options to our tax system to: (1) support a sustainable superannuation and retirement system; (2) reduce unnecessary complexity and ensure greater consistency in the various superannuation caps and thresholds; and (3) encourage improved compliance by employers with the mandatory superannuation guarantee regime. There are a number of aspects of Australia's superannuation system which are inefficient and complex. Many of these issues are interrelated. Even parliamentary committees have observed that the tax treatment is complex: contributions, earnings and benefits are partially taxed and partially deductible, the result of a pragmatic attempt to reduce tax expenditures, especially those benefiting higher-income individuals, while encouraging compliance.

Overview

Successive governments have made significant changes to the taxation of superannuation, and adjusted Australia's superannuation policies in the pursuit of so-called improvements. Changes have also been made to suit the sitting government's political objectives. The superannuation rules have been tinkered with in virtually every parliamentary term since the 1980s. This has resulted in the core objectives of the system being unnecessarily overlaid with complex legislative amendments, policy changes and voluminous quantities of provisions, regulations, rulings and legislative instruments.

Key examples of the complexity include the operation of various thresholds and caps. Other overarching issues include the most appropriate taxation point in the superannuation life cycle and the operation of the superannuation guarantee (SG) charge and penalty regime.

There are three primary avenues, or 'pillars', for funding retirement in Australia:

1. superannuation – compulsory SG and voluntary superannuation;
2. private wealth – personal earnings and the accumulation of private wealth in investments held outside the superannuation system; and
3. age pension – government-funded and means-tested.

These pillars were the subject of the government's 2019 *Retirement income review*.[1] The review's final report made the following key observation:

> "The retirement income system is complex. **There is a need to improve understanding of the system.** Complexity, misconceptions and low financial literacy have resulted in people not adequately planning for their retirement or making the most of their assets when in retirement. Adding to complexity is the interaction with other systems, such as the aged care and the tax systems."

Superannuation life cycle: the taxation of contributions, earnings and benefits — historical note

Superannuation may be taxed at three key stages:

1. on contribution – when a pre-tax contribution is made by an employer or a member;
2. during the accumulation phase – tax on the fund earnings; and
3. on withdrawal – when the benefits are paid to the member who has satisfied a condition of release.

Prior to 2007

Until the 1980s, superannuation funds generally paid no tax on contributions, and contributions made by both employers and employees were tax deductible (or, in the case of employees, granted a tax offset/rebate from the mid-1970s until the early 1980s). Neither were taxes paid on accumulation, with earnings of superannuation funds being exempt, other than in exceptional circumstances. Taxes on exit were only imposed on 5% of any lump sum up until 1983 and, if pensions or annuities were taken, tax was paid on those income streams at each recipient's marginal rate (although a portion of the annuity referable to an employee's own contributions were effectively exempt).

From 1 July 1983, new taxation arrangements for eligible termination payments were introduced. Instead of including only 5% as assessable income, the full amount was included, subject to a maximum marginal rate of 30%. To avoid retrospectivity, the new rules only applied to lump sums attributed to post-30 June 1983 service and the old rate continued to apply to sums attributed to pre-1 July 1983 service.

To further encourage the preservation of benefits for genuine retirement, the 30% on the first $55,000 of the post-30 June 1983 component was reduced to 15% where the recipient had attained the age of 55. No substantive changes were made to the treatment of pensions and annuities.

The 1983 changes substantially increased the assessable amount of lump sum benefits and therefore had the effect of increasing Commonwealth revenues. However, these revenues were not available to the then government, but to future governments when the accumulated benefits were received by retirees.

Effective from 1 July 1988, the taxation of superannuation was fundamentally altered. Until that time, it was reasonable to say that Australia followed many other countries, with an exempt-[2] exempt-taxed model for the taxation of superannuation and pensions. That is, the contributions to the fund were exempt, the earnings in the fund were exempt and the benefits were taxed. The change from 1 July 1988 resulted in what could be best described as a taxed-taxed-taxed model, although the taxation was at reduced rates.

The then government reduced the tax on the post-1983 component of benefits from 30% to 15%, at the same time imposing a 15% tax on all contributions (other than undeducted contributions) and earnings of superannuation funds. This changed the government's collection from a 30% tax rate on benefits payments from the fund to a 15% tax rate on contributions to the fund and a 15% tax rate on benefit payments. Accordingly, the total tax on deductible contributions was reduced to 27.75%. In addition, the bring forward of tax on both contributions and earnings would have an impact on future member benefits and on future government revenue. However, 15% became available to the current government.

The changes on 1 July 1988 provided for the continued exemption of income earned on assets set aside to provide pensions and annuities from tax, despite the new fund earnings tax. Annuities and pensions to members were concessionally taxed via a 15% tax offset (other than unfunded benefits which remained taxed under the 1983 rules).

The 15% superannuation contributions surcharge tax was introduced from 20 August 1996 and applied to certain employer contributions and deductible personal contributions.

Benefits paid as lump sums were taxed at varying rates, depending on whether the amount of the benefit exceeded the reasonable benefit limits (RBLs). The use of RBLs was a significant limitation on the tax concessions afforded to superannuation. Amounts in excess of the RBL were taxed at the member's marginal rate plus the Medicare levy, while pensions were included in the recipient's income and taxed at marginal rates.

1 July 2007 changes

In 2007, the Howard Government made substantial changes of far-reaching impact to the taxation of superannuation, namely that:

- RBLs were abolished;
- Australians over the age of 60 could withdraw benefits from their superannuation fund tax-free if from a taxed source; and
- the age-based limits were replaced with concessional and non-concessional contribution caps.

These changes entrenched a permanent and greater concession for superannuation than had previously existed. There was a transitional period during which large amounts could be contributed to superannuation (in theory designed for those who had failed to make adequate provision to make 'catch up' undeducted contributions before the new limits were imposed). Nonetheless, the exemption for drawdowns from superannuation after age 60 meant a fundamental reduction in overall taxation of superannuation as the superannuation contribution and accumulation tax levels remained unchanged at their concessional levels.

1 July 2017 changes

A raft of measures designed to better target the superannuation concessions were introduced by the Turnbull Government, most of which came into effect on 1 July 2017. Among these measures were the total superannuation balance (TSB) and the transfer balance cap (TBC). The various caps that were introduced determine eligibility to various superannuation concessions, such as bring-forward non-concessional contributions and catch-up concessional contributions, spouse offsets and government co-contributions. However, the dollar thresholds for these caps are also set at different values for each of these concessions.

The TBC limits the amount of capital that an individual can set aside to pay a superannuation income stream. The TBC was established at $1.6m (general cap), with the potential for increase via indexation in accordance with movements in CPI. Indexation of $100,000 is applied.[3]

Other changes (with varying effective dates) included:

- a reduction of the cap on concessional contributions to $25,000[4] per annum (formerly $30,000 for persons aged 50 years or older);
- a reduction of the Div 293 threshold from $300,000 to $250,000. Individuals with income and concessional contributions above this threshold became liable to an additional 15% tax on their concessional contributions;
- a reduction of the non-concessional contribution cap from $180,000 per annum to $100,000 per annum (limited to a threshold equivalent of the TBC);
- a replacement of the low-income superannuation contribution with a 15% low-income superannuation tax offset;
- an increase in the spouse tax offset; and
- the removal of the tax-exempt status of earnings from assets supporting transition to retirement income streams.

The overall effect of these measures was to limit the benefits arising from the 2007 changes, increasing complexity in an already complicated system. Some of these limits have been indexed from 1 July 2021.

Significant restructuring and planning for funds occurred in the lead up to these changes. Of note, some SMSFs are carrying large 'deferred capital gains' that suddenly arose by virtue of the taxation of amounts in excess of TBCs. While many were able to undertake planning to minimise the impact of the changes, the design of both the new rules and the transition was considerably over-engineered and remains an ongoing issue for practitioners and funds.

The upheaval to practitioners and their clients that 'significant' rewrites have cannot be understated. Both the 2007 and 2017 superannuation reforms placed incredible pressure on the system; practitioners have described the period as 'crushing'. Lead times were too short and the complexity was unnecessary.

Superannuation caps and thresholds

The current superannuation system is overly complex, given it not only limits the amount that can remain within both accumulation and retirement phase,[5] but also restricts how much a member can contribute in any given income year. It contains a plethora of caps and thresholds, most of which are indexed annually,[6] that require a major overhaul in order to make the system simpler to both understand and administer.

Table 1 summarises the current caps and thresholds in the superannuation system.

Superannuation concessionary measures

The superannuation system includes a range of targeted concessions that have been designed to provide relief, or assistance, to specific classes of individuals. However, the piecemeal manner in which each measure was designed and added to the existing superannuation rules has resulted in a cluttered, inefficient superannuation regime that most taxpayers and practitioners find difficult to navigate.

Table 2 summarises the current concessionary measures in the superannuation system.

Superannuation guarantee regime

The key governing legislation for the SG regime is the *Superannuation Guarantee (Administration) Act 1992* (Cth) (SGAA) which requires all employers to provide a minimum level of superannuation support.

Taxation and the superannuation life cycle

Unquestionably, the shift in policy from taxing on exit to taxing on entry has brought forward government tax receipts, but is this an appropriate setting for the long-term sustainability of the superannuation system? At which stage in the superannuation life cycle is it most appropriate to impose tax? On the contributions, on the earnings during

Table 1. Current caps and thresholds in the superannuation system (for 2021–22)

Cap/threshold	Description	Legislative reference
$27,500	Concessional contributions cap	s 291-20(2) ITAA97
$110,000	Non-concessional contributions cap[7]	s 292-85(2) ITAA97
$330,000	Non-concessional contributions cap under three year bring-forward rule	s 292-85(5)–(7) ITAA97
$1,615,000	CGT cap amount	s 292-105 ITAA97
$250,000	Division 293 threshold	s 293-20 ITAA97
$225,000	Low rate cap amount	s 307-345 ITAA97
$1,615,000	Untaxed plan cap amount	s 307-550 ITAA97
See ATO table	Minimum annual payments for superannuation income streams[8]	Sch 7 SISR
$225,000	ETP cap for life benefit termination payments	s 82-160 ITAA97
$225,000	ETP cap for death benefit termination payments	s 82-160 ITAA97
$58,920[9]	Maximum contribution base for SG purposes	s 15 SGAA
 $500 $41,112 $56,112	Co-contribution thresholds: • maximum entitlement • lower-income threshold • higher-income threshold	s 9 and s 10A of the *Superannuation (Government Co-contribution for Low Income Earners) Act 2003*
$500	Low income super tax offset (up to adjusted taxable income of $37,000)	s 12E of the *Superannuation (Government Co-contribution for Low Income Earners) Act 2003*
$1,700,000	General TBC	s 294-35 ITAA97
$106,250	Defined benefit income cap	s 294-135 ITAA97
$450	No SG obligation where employee earns less than $450 in a month[10]	s 27(2) SGAA

Table 2. Current concessionary measures in the superannuation system

Measure	Legislative reference
Government co-contributions	*Superannuation (Government Co-contribution for Low Income Earners) Act 2003*
Low income superannuation tax offset	*Superannuation (Government Co-contribution for Low Income Earners) Act 2003*
Spouse contributions tax offset	s 290-230 ITAA97
Carry-forward concessional contributions	s 291-20(3) ITAA97
Bring-forward rule for non-concessional contributions	s 292-85(3)–(4) ITAA97
Employees with multiple employers (SG employer shortfall exemption certificate)	s 19AA, s 19AB and s 19AC SGAA
Downsizer contributions	s 292-102 ITAA97
First home super saver scheme	Div 313 ITAA97 and Div 138 TAA53

accumulation phase or on benefit payments (lump sums and income streams) to members, or a combination of two or more of these stages?

Many agree that the current settings on withdrawal are too generous, even those who gladly benefit from the rules introduced with effect from 1 July 2007. Taxing contributions on entry to superannuation is accompanied by a plethora of complex rules governing how and when contributions can be made. These rules are discussed in more detail under 'Superannuation caps and thresholds' below, but they illustrate that the system imposes complex rules to restrict how much is contributed to superannuation rather than imposing a higher rate of tax on excessive benefits withdrawn from superannuation.

The former RBLs rules were repealed from 1 July 2007 to give way to the generous 'tax-free after age 60' regime. However, there was merit in taxing excessive benefits that had accumulated while in a concessionally taxed superannuation environment.

The death benefit system is also in need of a review, including who should receive death benefits and how they should be taxed. The binding death benefit nomination provisions could similarly do with an overhaul. It should be considered how readily death benefits can be, and are, challenged and whether death benefits should be tied to a deceased's estate.

Other jurisdictions have only one taxing point. Is Australia's approach to impose tax across the life cycle more equitable or does it just make the system more complicated?

The only thing that is constant in superannuation is change

Superannuation has been viewed as a pliable policy instrument by all governments for the last 50 years. The rules have been altered seemingly every year to achieve the policy objective of the moment, but this approach provides no long-term certainty and it discourages faith in the system that the rules will not change again to meet the short-term policy and fiscal objectives of the day.

One of the reasons for the 'constant tinkering' is because the tax settings of the superannuation system are inequitable and inefficient, and this will therefore always leave it open to future revisions. Compounding this issue is the fact that the superannuation system is such a large 'money pot'.

That said, reform of the superannuation system is needed to simplify the rules, remove barriers to entry, encourage retirement savings, and provide long-term certainty.

The superannuation system is currently riddled with legacy products and procedures. The removal of these relics could help simplify and streamline the system. One example that proponents have long advocated for is the ability to convert defined benefit pensions and market-linked pensions into account-based pensions.

Superannuation caps and thresholds

As mentioned above, the rules governing how and when contributions can be made are designed to restrict the amount of contributions that are made to a concessionally taxed environment. However, their operation has become unwieldy and inefficient.

The current superannuation system is overly complex, given it not only limits the amount that can remain within both accumulation and retirement phase (i.e. currently $1.7m), but also restricts how much a member can contribute in any given income year. It contains a plethora of caps and thresholds, most of which are indexed annually,[11] that require a major overhaul in order to make the system simpler to both understand and administer.

A key contributor to the complexity of the system is the inconsistency in reference points for the indexation of such caps and thresholds, and in the methodology used (with some based on movements in the CPI and others based on average weekly ordinary time earnings (AWOTE) changes).

Some of the caps are lifetime caps,[12] which are difficult to administer and rely heavily on maintaining accurate records so as not to exceed the particular cap.

While the concessional contributions cap is theoretically subject to annual indexation, actual increases in the cap rarely eventuate in practice because inflation levels are currently very low and any increases must be in minimum increments of $2,500.[13] In contrast, the annual indexation of the SG maximum contribution base does produce annual increases.

This lack of consistency in indexation will, at some point in the foreseeable future, cause individuals whose employers pay SG according to the maximum contribution base to exceed their concessional contributions cap in the absence of an increase in the cap or broader reform of the rules. It is acknowledged that this would not affect a large proportion of the working population.

Designing a system to support vulnerable workers

Once a lifetime cap is set which limits how much a person may have in either accumulation or pension phase, there should be no further restrictions placed on the person in trying to accumulate that amount of money during the accumulation phase by way of contributions (whether concessional or non-concessional).

This is considered to be a timely and sensible policy given the current situation with the COVID-19 pandemic, with superannuation balances being eroded by the severe economic downturn. Individuals should be allowed to rebuild their superannuation balances (without any limits up to a lifetime cap), in order to safeguard and not place an unnecessary burden on the government pension in the future.

This is particularly the case for those who have accessed their superannuation early[14] under the government's COVID-19 economic response package, which has left more than half a million Australians with a nil superannuation balance.[15] The $25,000 cap places an unnecessary limitation on these individuals who now face challenges to rebuild their superannuation balances.

The proliferation of the gig economy in recent years – which may prove even more popular post-COVID-19 as workers are forced to seek alternative income sources – has left many people without regular superannuation support. Most of these workers are genuine contractors who fall outside the meaning of 'employee' for SG purposes, and are left to fund their own retirement through personal contributions. They are typically low-income earners who may not consider contributing to superannuation a high priority, or do not have regular work, particularly throughout the COVID-19 pandemic, and are therefore not in a position to make a $25,000 contribution to superannuation. While their financial circumstances may improve later in their working life, at that time, the $25,000 concessional cap places an unnecessary impediment to building an appropriate level of superannuation savings.

It is important to recognise that the reach of the SG regime extends only so far and, increasingly, overlooks those working outside the conventional employee or contractor relationships. Those operating genuinely independent businesses and not paying themselves a salary or wage are effectively outside the compulsory SG regime and may require further education or encouragement to provide for their own superannuation.

There also remains a gender inequality between the average superannuation balance of men versus women. A report commissioned by AustralianSuper, titled *The future face of poverty is female*, found that:[16]

> "… women retire with 42% less super than men. In real terms, if a man retires with $270,710, a woman gets just $157,050."

The report provided some explanations for the gap:

- the gender pay gap – on average, women earn $241.50 a week less than men;
- research shows that women are more likely to take time off to care for children, elderly parents or family members with special needs. Superannuation isn't a mandatory part of paid parental leave or carers payments;
- almost half of women work part-time and many chose lower-paid work to prioritise their caring responsibilities;
- part-time workers who earn less than $450 a month don't get paid superannuation. This is a particular disadvantage to women who may work multiple jobs. We acknowledge that this is proposed to change as a consequence of the Federal Budget announcement;[17]
- unpaid caring makes women particularly vulnerable if there is an unexpected life event like divorce or the death of a partner; and
- women live four to five years longer than men, with less retirement savings.

How can the superannuation system help to restore superannuation for those who needed to access their superannuation during the pandemic, encourage those without superannuation to support to fund their own retirement, and rebalance the gender inequality?

Inadequacy of current concessional contributions cap

The current concessional contributions cap is in stark contrast to the age-based limits which were abolished by the Howard Government in 2007. At their peak, an individual aged 50 years or over could claim a deduction for up to $105,113 (indexed every year). All individuals are now subject to a $25,000 concessional contributions cap.

The current cap is inflexible and fails to acknowledge when individuals are best placed to contribute to superannuation.

To achieve a superannuation balance of $1m, without taking into account capital growth or earnings, an individual would need to contribute $25,000 each year (including SG contributions) for 40 years. It is not realistic to expect a 22-year-old worker to contribute $25,000 a year to their superannuation fund.

Individuals are best placed to contribute to superannuation when they are older, their mortgages are paid off, their children have left home, they have moved into higher-paid roles at work and have, generally, a higher disposable income than younger workers.

Overly complex contributions rules

The plethora of complex rules relating to contributions include the following:

- concessional and non-concessional contributions caps;
- TSB – individuals who have a TSB of $1.7m or more as at 30 June of the previous income year have a non-concessional contributions cap of 'nil';[18]
- excess concessional contributions tax[19] and excess non-concessional contributions tax;[20]
- election to release excess concessional contributions[21] and option to withdraw excess non-concessional contributions;[22]
- application to disregard excess concessional contributions[23] and excess non-concessional contributions[24] – since 2007, dozens of cases have appeared before the AAT and the Federal Court involving taxpayers seeking the Commissioner's discretion to disregard an excess contribution. Many of these taxpayers cited genuine intent, confusion or a lack of understanding as to how the law operates to explain how the breach of the cap has arisen and why that justified discretion being exercised in their favour. While their circumstances were such that they commonly did not qualify for discretion under the law, they are useful examples of how many taxpayers find the law difficult to navigate;
- carry-forward concessional contributions;[25]
- bring-forward non-concessional contributions;[26]
- contributions arising from structured settlements or orders for personal injuries;[27]
- contributions relating to some small business CGT concessions (the 15-year exemption and the retirement exemption) – the retirement exemption has an unindexed limit of $500,000 per stakeholder yet it counts as part of the annually indexed CGT cap of $1,565,000 (for 2020–21);[28]
- downsizer contributions;[29]
- the first home super saver scheme;[30]
- deductions for employer contributions;[31]
- reportable employer superannuation contributions;[32]
- notice of intent to deduct personal contributions;[33]
- government co-contributions;[34]
- low-income superannuation tax offset;[35]
- the spouse contributions tax offset;[36]
- spouse splitting superannuation contributions;[37]
- Division 293 tax;[38]
- no-TFN contributions tax;[39]
- choice of fund rules;[40]
- in specie contributions;[41]
- the ATO's Small Business Superannuation Clearing House (SBSCH) and commercial clearing houses;
- the SG regime, including the SC charge (discussed further below);[42]
- the maximum contributions base;[43] and
- salary sacrifice arrangements and SG contributions.[44]

This extensive list is daunting to most taxpayers who find the superannuation rules incredibly difficult to navigate. Many general accounting practitioners and financial advisers similarly find the system challenging to work with.

Many of the caps are indexed inconsistently,[45] some not at all. The various concessionary measures have attempted to cater to a range of personal and familial circumstances and have invariably been designed to target a particular demographic or achieve a policy objective. However, their introduction into the law in a piecemeal fashion has made the system inherently more complex and often without consideration of how the new measure operates in the context of the broader system.

Transfer balance cap

As outlined above, the TBC limits the amount of capital that an individual can set aside to pay a superannuation income stream. Earnings on such capital are not subject to tax.

Once an individual commences a retirement phase income stream, they obtain a personal TBC which is equal to the general TBC ($1.7m). However, if they do not utilise the full general TBC, they can apply a proportional indexation of their TBC.

Feedback from practitioners on the operation of the TBC rules include that it is inefficient and complex and has the potential to result in unfair outcomes, that the reporting and administration of the transfer balance account (TBA) is cumbersome, and that taxpayers are subject to a harsh, inflexible penalty framework.

Transfer balance account

The TBA involves a system of debits and credits, unrelated to general ledger movements, that includes reporting protocols and a penalty system (the excess transfer balance tax where the individual exceeds their TBC).

The one-off nature of the TBA debits and credit system can produce unfair results. A member whose pension balance is reduced because of market forces (e.g. COVID-19 pandemic-related) will not be able to top up their pension if they have fully utilised their TBA, whereas a member whose pension balance has performed well can end up with a pension account balance that exceeds their TBC.

The reporting mechanism of the TBA is cumbersome and administratively inefficient. The arrangements appear to have been developed assuming a high level of data management was a feature of the superannuation system. This is neither the case for superannuation providers nor the

ATO. The current system will not operate as intended until information management systems of both superannuation funds and the ATO significantly improve.

The consequences where a breach has occurred are inflexible and the Commissioner has limited discretion to apply the law more leniently when appropriate. Individuals who inadvertently breach their TBC, including where there is a reporting mismatch between the superannuation fund and the ATO, are subject to the same penalties that are designed to discourage deliberate non-compliance. This results in a lack of fairness and unnecessary penalties being applied.

Proportional indexation of TBC

The TBC is an inefficient manner in which to limit the amount of tax-free earnings due to the inherent complexity in managing an individual's cap where proportional indexation is used.

The recent indexation of the general TBC from $1.6m to $1.7m from 1 July 2021 has been met with a predictable chorus of criticisms that the proportionate indexation for those who had already commenced an income stream will make the system overly complex. Many of the concerns were first expressed when the TBC rules were introduced in 2017, foreseeing the difficulties that proportionate indexation would bring.

Proportionate indexation of the TBC for certain individuals means that thousands of superannuation fund members will have a different TBC. This complication, together with the inability to access timely TBC data from the ATO, will make it very difficult for advisers to provide accurate advice.

Age limits and $450/month limit

In the 2021–22 Federal Budget, the government announced that the restriction on an individual being unable to contribute to superannuation if they are aged 67–74 unless they satisfy the work test would be relaxed. While employer concessional contributions and non-concessional contributions are to be allowed under this measure without the requirement to satisfy the work test, personal deductible contributions will still require the test to be satisfied.[46] Individuals cannot contribute to superannuation at all if they are 75 years or older, with the exception of downsizer contributions.[47]

It is difficult to understand, with the pressure on Australians to save for their retirement, why the law prevents individuals from being able to contribute to superannuation beyond age 74. Australians should be encouraged to provide for their retirement, and with more people living and working longer, the basis for restricting the age beyond which personal contributions are allowed to be made is currently blunt and could be more targeted having regard to personal superannuation balances, for example.

Further, the SGAA does not include salaries or wages paid to part-time employees (less than 30 hours per week) who are aged under 18 for the purpose of determining an employer's SG obligation. This means that part-time and casual workers aged under 18 often do not receive superannuation support from their employers.

Superannuation guarantee regime

Introduced with effect from 1 July 1992, despite dozens of amendments, the SG law has not been substantially reviewed or overhauled in its 29-year history. A lot has changed since then so now is a good time to review the system to determine whether it is appropriately designed and meeting its objectives.

The following considerations support long-overdue reform of the SG regime:

- the ATO estimates[48] that the SG gap for 2017–18 is 4% or $2.4b;
- an Industry Super report[49] from May 2017 suggests that 2.85 million Australians did not receive their full SG entitlements in 2016–17, missing out on $5.94b. The number of workers who were affected increased by 90,000 in three years (up from 2.76 million) and now affects 31.3% of workers;
- the design of the SG charge dissuades employers who want to avoid penalties or losing deductions for late or unpaid superannuation from coming forward or owning up to shortfalls;
- the notional interest component ends on lodgment of the SG statement with the ATO, not the payment of the late contribution;
- company directors can be personally liable for unpaid SG charge liabilities;
- STP reporting provides greater transparency over non-compliant employers;
- some employers wrongly treat late contributions as simply being non-deductible (without also paying the SG charge and lodging SG statements);
- the rate of SG is legislated to increase to 12% by 1 July 2025;
- employers are often confused as to the meaning of 'ordinary time earnings' (OTE);
- there are perennial issues with correctly classifying workers as contractors versus employees;
- due to annual indexation, the maximum contributions base is within uncomfortable reach of the $25,000 concessional contributions cap; and
- due to the COVID-19 pandemic, many employers in lockdown or with greatly diminished cash flow were not in a position to avail themselves of the SG amnesty which ended on 7 September 2020.

A number of these issues are discussed below.

Harmonisation of superannuation guarantee contribution and charge base to ordinary time earnings

Under the current law, SG contributions are calculated as 10% (from 1 July 2021[50]) of OTE for the quarter. However, the SG charge is calculated by reference to the broader base of an employee's total salary or wages for the quarter. If an employer does not correctly calculate the amount of SG contributions required or fails to pay those contributions on time, they will have an SG shortfall on which the SG charge is imposed.

The SG shortfall consists of the total of the employer's individual SG shortfalls for each employee for the quarter, a nominal interest component and an administration component for the quarter.

The requirement for employers to calculate SG contributions and the SG charge on different bases increases compliance costs and complexity for employers. In addition, if an employer miscalculates its SG contributions or pays them late, the requirement to calculate the SG charge based on total salary or wages can result in an SG shortfall.

In some cases, this can be significantly higher than the minimum required SG contribution amount. The SG regime therefore has the potential to impose punitive costs on employers who miscalculate their required contributions or pay their SG contributions late. This makes the SG charge and penalty disproportionate to their level of non-compliance. This can have a significant cost impact on employers. It can particularly impact employers who pay significant amounts of overtime or have other wage components that are not part of OTE. This can result in employees receiving significantly higher contributions than intended by the legislation.

The divergence of the contribution and charge bases also creates significant administrative difficulties for employers in relation to payroll system implementation and configuration. Payroll and payment systems require additional set up and monitoring to facilitate the definitional differences arising from the divergence of the bases.

Superannuation guarantee regime design failure issues

The purpose of the SG regime is to require employers to make SG contributions (originally as part of a wage/superannuation trade off). The purpose of the Part 7 penalty is to discourage non-compliance by employers. The purpose of the nominal interest component is to recompense the employee's superannuation account for the lost earnings arising from the failure of the employer to make the contribution. However, the design of the regime has the opposite effect.

Currently, the nominal interest calculation continues until the SG charge is payable, which is, practically, when the SG statement is lodged. This can be many years after the contribution was paid, irrespective of whether the contribution was made a few months, weeks or even days late. In addition, Pt 7 of the SGAA makes an employer liable to a penalty equal to double the amount of SG charge payable (i.e. 200% of the SG charge) where they fail to notify the Commissioner of the shortfall. This is highly inconsistent with penalties imposed by the *Fair Work Act 2009* (Cth) – failure to pay salaries and wages does not attract a 200% penalty.

Given the interaction between the nominal interest component and the Part 7 penalty, the imposition of nominal interest until the date the SG statement is lodged operates as a double penalty. The nominal interest should apply only for the period that the contribution was outstanding (the start of the period for which the nominal interest is charged should continue to be the first day of the quarter). Many employers do not understand the operation of the nominal interest component and fail to realise that paying just one day late but never disclosing this to the ATO can have enormous ramifications. This issue has been raised repeatedly in AAT hearings, but neither the AAT nor the ATO have the jurisdiction to waive, remit or adjust the amount of nominal interest as it is prescribed by the SGAA.[51]

The regime does not encourage employers to disclose historical shortfalls (including those arising in relation to quarters starting on or after 1 April 2018 which fall outside the SG amnesty) or to confirm that shortfalls are ultimately repaid to ensure that their employees received all of their entitlements. In fact, the regime acts as a disincentive given the array of penalties that can be imposed, including:

- the three components of the SG charge, which, as already identified, require the employer to pay the SG charge on a higher base than OTE and pay nominal interest for a period that can extend well beyond when a late payment is made;
- non-deductibility of the SG charge;[52]
- the general interest charge for paying the SG charge late;[53]
- the 200% Part 7 penalty;[54]
- the Commissioner's inability to remit no more than half of the Part 7 penalty (i.e. no more than 100%, leaving a minimum penalty equal to no less than 100% of the SG charge) in relation to shortfalls from quarters covered by the amnesty;[55]
- an estimate of a company's SG charge liability and recovery of the estimated amount with a director penalty notice;[56]
- a direction to pay the SG charge, in relation to which non-compliance is a criminal offence;[57]
- a direction to undertake an SG employer obligations course;[58] and
- the issue of garnishee notices.[59]

An employer who pays the SG contribution just one day late but never discloses the SG shortfall to the ATO is treated the same as an employer who never pays the SG contribution. This is inherently unfair and results in a disproportionate outcome for the employer who makes the SG contribution just one day late.

Timing of contributions

The rules relating to the timing of contributions are confusing and result in unnecessary SG shortfalls.

The Commissioner's views on the timing of making of superannuation contributions are set out in TR 2010/1, which explains that a contribution is not taken to be 'made' until it is received by the fund.

This position has resulted in much confusion over the years, given:

- the interaction of payroll cycles;
- STP reporting;
- the deadline to meet SG obligations by the 28th day following the end of the quarter;
- the year-end deadline to ensure that a payment of a contribution is deductible to the employer in a particular income year; and
- the differing treatment of contributions made through the ATO's SBSCH versus commercial clearing houses.[60]

There is a general lack of understanding that contributions are not made until they are received by the fund, causing many employers who base their calculations on the date the payment is made to miscalculate the timing of contributions. Employees can end up with excess concessional contributions as a result where their cap is exceeded due to mistimed employer contributions.[61]

> "The superannuation rules have been tinkered with in virtually every parliamentary term since the 1980s."

The above issue is compounded by the ATO recently changing the Super Fund Lookup status of an SMSF to 'Regulation details withheld' where the SMSF has failed to lodge its annual return. While primarily an issue between the ATO and the trustee of the SMSF, it has flow-on effects which can result in SG charge liabilities for employers who attempt to make a contribution to the SMSF whose status has been changed to 'Regulation details withheld'. There may be insufficient time before the 28th day following the end of the quarter to redirect the payment to another complying or default fund in order to avoid an SG charge liability arising.

Superannuation guarantee amnesty

The SG amnesty announced on 24 May 2018 became law on 6 March 2020 following the lapsing of the original Bill[62] due to the 2019 federal election and the reintroduction of a second Bill.[63] The SG amnesty provided a one-off opportunity between 24 May 2018 and 7 September 2020 for employers to self-correct historical non-compliance for quarters starting on or after 1 July 1992 and ending on or before 31 March 2018.

The six-month period of certainty starting when the law was enacted and ending on 7 September 2020 unfortunately coincided with the impact of the COVID-19 pandemic. Many businesses were under significant pressure due to managing JobKeeper payments, adapting to working from home arrangements, dealing with staff downsizing and other challenging issues arising as a result of COVID-19. Accountants and advisers were under enormous pressure to help deliver the government's JobKeeper and cash flow boost assistance to their clients which pushed work on the SG amnesty to one side.

The stage 4 restrictions in Victoria highlight further issues with the deadline. The restrictions prevented the collection and sharing of physical payroll records typically archived at then inaccessible offices or off-site third-party storage areas. Without such records, it was very difficult for some employers to determine whether there are any shortfalls as far back as 1992 and therefore a need to claim the amnesty.

Determining SG shortfalls is a complex and time-consuming task. Qualified personnel are needed to identify and calculate historical superannuation shortfalls. Determining when an employer has an obligation to pay superannuation often requires professional expertise as the SG charge extends beyond the usual employment arrangements to include certain contractors and other workers.

Options

Taxation and the superannuation life cycle

A significant re-examination of the merit of taxing contributions on entry versus taxing withdrawals from superannuation should be undertaken, and whether the tax on superannuation contributions (including Division 293 tax) should be completely eliminated to encourage an increase in superannuation savings.

Consider the merit in taxing excessive benefits on withdrawal by reintroducing a form of RBL. Transitional or grandfathering rules would need to accompany any such change so that any shift back to taxing benefits accounts for taxes previously paid on contributions or earnings under the current regime.

This is often referred to an exempt-exempt-taxable model, as the taxation falls on the third (i.e. exit) stage of superannuation. This would represent a return to the pre-1987 era, and a departure from the, broadly, taxable-taxable-exempt model that applies today for those in accumulation phase and the taxable-exempt-exempt model that applies for those in pension phase. An alternative option is to impose tax more equitably across the entire life cycle, rather than weighting the tax burden more predominantly on the contributions phase and, to some extent, on the earnings phase. A combination of taxation models could be considered to ensure the optimal operation of the system.

Superannuation caps and thresholds

The complex array of caps, thresholds and concessionary measures needs a rethink. The inefficiency and complexity is not sustainable in the long term and is the cause of many taxpayers inadvertently breaching the caps or the rules, with severe consequences in terms of their retirement savings or penalties.

It is acknowledged that there is a trade-off between simplifying the complexity of the law which has evolved through piecemeal changes over many decades and ensuring that benefits provided to taxpayers in the form of concessionary measures are appropriately targeted.

Reforming the superannuation caps, thresholds and concessionary measures could involve a consideration of the merits of the following:

- adopting a consistent reference point for indexation, such as using AWOTE over CPI;
- adopting a single and consistent methodology for all caps and thresholds;
- consolidating the TSB and TBC into a single lifetime cap which would limit the amount that can remain in the superannuation system and be concessionally taxed;
- a single dollar threshold for other superannuation concessions (currently based on the TSB);
- replacing the contribution limits with a return to a mechanism based on excessive benefits (akin to the former RBL rules); and
- increasing the concessional contributions cap or reintroducing a higher cap for those who are more likely to be able to contribute towards the end of their working lives.

Age limits and $450/month limit

It is questionable whether the work test should prevent those aged 75 and over from contributing to superannuation. The restriction that prevents individuals contributing to superannuation if they are 75 years or older should be removed if they continue to work, perhaps subject to a superannuation balance limitation. The current limitation otherwise sits at odds with other government policy that is designed to prevent age discrimination.

The repeal of the rule in s 28, and the $450 limit imposed by s 27(2), of the SGAA is welcome and will ensure that most employees receive employer superannuation support.

Reform of the transfer balance cap

The provision of tax-free benefit payments to individuals in conjunction with tax-free earnings in the superannuation fund while in pension phase led to the introduction of the TBC. This suggests that there may be a case to remove one of these concessions in favour of simplicity and equity.

Reform of the TBC could involve a consideration of the merits of the following:

- modifying the TSB to limit the total amount held in superannuation (including in accumulation) and mandating the excess be withdrawn from superannuation (i.e. any excess over the threshold must be cashed out on retirement);
- possible alternative tax treatment of amounts in excess of a single lifetime cap, such as:
  - subjecting excessive amounts to personal income tax;
  - greater flexibility for the minimum annual payments for superannuation income streams;[64] and
  - potential for penalties for delaying making payments from superannuation;
- a review to determine whether the TBC threshold is set at the appropriate level – should it be lowered or raised?
- whether the current level of the TBC interacts appropriately with the operation of refundable excess franking credits under the imputation system, particularly for SMSFs;
- whether proportional indexation of the personal TBC should be removed to reduce complexity;
- whether access to the general TBC should be available regardless of the commencement date of the income stream;
- a review of the administration of the TBA;
- allowing the Commissioner discretion to amend a penalty for breaches of the TBC in appropriate circumstances; and
- more appropriate, alternative approaches to capping the amount of tax-free earnings within a superannuation fund, such as abolishing the TBC system and transferring the tax management aspect to the taxation of benefit payments. Individuals could then control the level of retirement phase benefits they commence.

Superannuation guarantee regime

A review and rethink of the SG regime is needed to consider how the SG regime could and should be overhauled or replaced with a new set of rules to encourage greater compliance, reduce inefficiencies and ensure that the system is redesigned so that penalties imposed for non-compliance are proportionate to the severity or level of culpability associated with the breach.

Redesigned rules could:

- make it easier for employers to comply;
- be less draconian for employers who pay the SG contribution one day late; and
- more adequately and effectively support a modern, sustainable retirement system.

Options to harmonise the superannuation guarantee contribution and the superannuation guarantee charge bases

Harmonising the SG contribution and the SG charge bases would make it easier for employers to comply and remove unnecessary differences in the bases. The bases could be completely revised by departing from the OTE concept and simply basing the SG obligation on actual remuneration rather than OTE (i.e. what an employee is actually paid).

Alternatively, the SG charge could be simplified by aligning the earnings base for calculating the SG charge (currently total salary or wages) with the earnings base for calculating SG contributions (OTE). This would simplify the superannuation system and make the calculation of the SG charge and penalty more proportionate to the non-compliance.

Harmonisation of the SG contribution and charge base to OTE might be a good place to start. This would reduce compliance costs and complexity for employers and would be easier to administer.

Meaning of 'SG employee'

There are gaps in the current definition of 'SG employee' in s 12 of the SGAA which result in certain workers receiving no superannuation support.

Reform of the meaning of 'employee' for SG purposes could involve a consideration of the merits of the following:

- harmonising the meaning of 'employee' across PAYG withholding, STP reporting, FBT, and payroll tax and WorkCover from a state/territory tax perspective; and
- looking at ways that the rules could be redesigned to provide incentives for employers to provide superannuation support for all workers rather than limiting it to 'SG employees' — this would ensure that those working in the gig economy would receive superannuation support.

Reforming the calculation of superannuation guarantee charge

The consequences under the SG regime should be redesigned so that the penalty on employers for paying one day late versus abscondment or complete non-payment is proportionate.

Reform of the SG charge could involve a consideration of the merits of the following:

- reforming the calculation of the nominal interest component so that it does not continue to apply to any period following the day on which the SG contribution was actually made (regardless of when the employer lodges an SG statement and notifies the Commissioner) — the nominal interest component should apply from the beginning of the quarter in question until the date on which the late SG contribution is received by the fund;
- provide better incentives for employers to make voluntary disclosures and receive reduced penalties;
- allow the Commissioner similar discretion to remit components of the SG charge as he does for other taxes that the ATO administers, including the ability to grant employers more time to make contributions;
- amend the law so that an employer's SG obligations can be considered satisfied once the employer has made, and can evidence, payment, irrespective of whether the amount is paid directly to the fund or via the SBSCH or a commercial clearing house, thereby removing the inconsistency in treatment of contributions received by the SBSCH and commercial clearing houses;
- in relation to the ATO practice of changing the Super Fund Lookup status of SMSFs, it is clear that the ATO is seeking to manage the risks associated with employers making contributions to non-complying superannuation funds, but perhaps the implications could be mitigated by requiring the ATO to notify employers who contribute to such a fund ahead of the change in fund status and to allow them the opportunity to redirect the contributions. Additionally, given that the information is available to the ATO through STP reporting, this issue may be managed by requiring the ATO to notify the trustee that such a notice will be provided to employers within, say, 14 days unless the non-lodgment is rectified; and
- offer another SG amnesty, in light of the unfortunate timing of the previous amnesty coinciding with the impact of the COVID-19 pandemic.

Improve equality in retirement

To address the issues of inequality for women relating to retirement incomes, there are a possible suite of measures that could be adopted, including:

- co-contribution by the government of $1,000 provided for all single women on a matched 2:1 basis, where total assets held in superannuation in the name of the woman is less than $100,000;
- allowing the age pension to be made available to single women who have total superannuation of less than $100,000 from the age of 60;
- providing a $1,000 per year contribution to be made to superannuation for an unpaid voluntary carer;
- modest amendments to the anti-discrimination laws to give a clear legal basis to schemes introduced by companies to provide higher superannuation payments in respect of female employees;
- the opportunity to make catch-up concessional contributions for single women who have had interrupted working arrangements; and
- the opportunity to recognise the family unit for superannuation contribution purposes (i.e. utilising dual thresholds) where one spouse is unpaid or partly paid as a consequence of providing primary care to a dependant.

In relation to the age pension, it would also be worth making the means test for age pension qualification more generous for single women who will invariably have a broader and perhaps longer reliance on the pension.

The Tax Institute acknowledges that the availability of carry-forward superannuation contributions is one opportunity for women to make catch-up concessional contributions where they have experienced interruptions to their work practices. This measure is a step in the right direction but should be supplemented by further targeted measures, such as those outlined above.

Options for reform

- Impose tax using an exempt-exempt-taxable model.
- Improve the operation of the death benefit system and the binding death benefit nomination provision.
- Adopt consistent indexation of all superannuation caps and thresholds.
- Adopt a single and consistent methodology for all caps and thresholds.
- Consolidate the TSB and TBC into a single lifetime cap.
- Tax excessive benefits on withdrawal by reintroducing a form of RBL.
- Increase the concessional contributions cap or reintroduce a higher cap for those who are more likely to be able to contribute towards the end of their working lives.
- Repeal the work test and allow all individuals, regardless of age, to make personal contributions subject to some controls, e.g. by reference to superannuation balances.
- Repeal the age limit that prevents part-time and casual employees aged under 18 years from receiving employer superannuation support.
- Mandate that excess benefits be withdrawn from superannuation on retirement.
- Review the TBC threshold to determine whether it is set at the appropriate level.
- Determine whether the current level of the TBC interacts appropriately with the operation of refundable excess franking credits under the imputation system, particularly for SMSFs.
- Remove proportional indexation of the personal TBC to reduce complexity.
- Provide access to the general TBC regardless of the commencement date of the income stream.
- Review of the administration of the TBA.
- Allow the Commissioner discretion to amend a penalty for breaches of the TBC in appropriate circumstances.
- Harmonise the SG contribution and the SG charge bases.
- Harmonise the meaning of 'employee' across employer obligation regimes.
- Provide incentives for employers to provide superannuation support for all workers rather than limiting it to 'SG employees'.
- Reform the nominal interest calculation so that it applies from the beginning of the quarter in question until the date on which the late SG contribution is received by the fund.
- Allow the Commissioner discretion to remit components of the SG charge.
- Allow the Commissioner to grant employers more time to make contributions.
- Amend the law so that an employer's SG obligations can be considered satisfied once the employer has made, and can evidence, payment, irrespective of whether the amount is paid directly to the fund or via the SBSCH or a commercial clearing house.
- Cease using an SMSF's Super Fund Lookup status and use alternative methods to improve late lodgment behaviour.
- Make a further SG amnesty available.

Conclusion

The superannuation system has become so complex that it is almost impossible to comply with appropriately and to administer. That complexity is unnecessary and stems from continuous tinkering rather than properly structured and coherent change. The system needs to be stripped back to re-examine its foundations and rebuilt in order to meet the key policy objective of providing for retirement. The level of concessions provided by the current system to the wealthiest must be addressed if the system is to maintain the confidence of citizens and members.

The Tax Institute

References

1 Australian Government, *Retirement income review – final report, July 2020. Available at https://treasury.gov.au/sites/default/files/2021-02/p2020-100554-udcomplete-report.pdf.*

2 Because contributions are often deductible to the contributor (whether employee or employer), the description of the contributions as being taxed is sometimes considered inaccurate. However, the deductibility is offset by the taxation in the hands of the fund from 1 July 1988 such that the effect is partial taxation.

3 The TBC has been indexed from $1.6m to $1.7m from 1 July 2021.

4 Increased to $27,500 from 1 July 2021.

5 Currently $1.6m, but increasing to $1.7m from 1 July 2021.

6 Indexation does not necessarily result in an increase in the particular cap or the threshold.

7 The non-concessional contributions cap for a financial year is nil if, immediately before the start of the year, an individual's TSB equals or exceeds the general TBC for the year: s 292-85(2)(b) of the *Income Tax Assessment Act 1997* (Cth) (ITAA97).

8 These have been temporarily halved due to COVID-19 for the 2019–20 and the 2020–21 financial years.

9 Income per quarter.

10 Subject to abolition as a 2021–22 Federal Budget proposal.

11 Indexation does not necessarily result in an increase in the particular cap or the threshold.

12 Such as the CGT cap amount, which also includes the $500,000 retirement exemption limit.

13 From 1 July 2021, the concessional contributions cap increased due to indexation for the first time since July 2017 to $27,500. The non-concessional contributions cap also increased from 1 July 2021 as a result of indexation to $110,000.

14 There are a range of proposals to allow the early release of superannuation in a wider range of circumstances. These include: (a) a review of the current rules governing early release of superannuation on compassionate grounds and in cases of severe financial hardship –

consultation papers were released in December 2017 (see https://treasury.gov.au/consultation/c2017-t246586) and November 2018 (see https://treasury.gov.au/consultation/c2018-t341625); (b) early access for crime victims – a consultation paper was released in May 2018 (see https://treasury.gov.au/consultation/c2018-t293803); and (c) early release for domestic violence victims – an announcement was made on 21 November 2018 (see https://ministers.treasury.gov.au/ministers/stuart-robert-2018/media-releases/improving-visibility-superannuation-assets-family-law).

15 See J Norman, "Early access superannuation scheme estimated to hit $42 billion in coronavirus support", *ABC News*, 30 July 2020. Available at www.abc.net.au/news/2020-07-30/early-access-superannuation-estimate-double-coronaviruspayment/12505984.

16 Available at www.australiansuper.com/campaigns/future-face-of-poverty.

17 This minimum earnings amount will be abolished from 1 July 2022 in respect of all employees over 18 years of age (who must work a minimum of 30 hours per week to be eligible for SG contributions).

18 S 292-85(2)(b) ITAA97.

19 Div 95 of Sch 1 to the *Taxation Administration Act 1953* (Cth) (TAA53).

20 *Superannuation (Excess Non-concessional Contributions Tax) Act 2007* (Cth).

21 Div 131 of Sch 1 TAA53.

22 Ss 97-20 and 97-25 of Sch 1 TAA53.

23 S 291-465 ITAA97.

24 S 292-465 ITAA97.

25 S 291-20(3) ITAA97.

26 S 292-85(3) to (4) ITAA97.

27 S 292-95 ITAA97.

28 S 292-100 ITAA97.

29 S 292-102 ITAA97.

30 Div 313 ITAA97 and Div 138 of Sch 1 TAA53.

31 Subdiv 290-B ITAA97.

32 S 16-182 of Sch 1 TAA53.

33 S 290-170 ITAA97.

34 *Superannuation (Government Co-contribution for Low Income Earners) Act 2003* (Cth).

35 Ibid.

36 S 290-230 ITAA97.

37 Reg 6.44 of the *Superannuation Industry (Supervision) Regulations 1994* (Cth) (SISR94).

38 Div 293 ITAA97.

39 Subdiv 295-I ITAA97.

40 Pt 3A (ss 32A to 32ZAA) of the *Superannuation Industry (Supervision) Act 1993* (Cth).

41 See TR 2010/1.

42 S 23 SGAA.

43 S 15 SGAA.

44 S 15A SGAA.

45 Some are based on CPI movements while others use AWOTE.

46 Reg 7.04 SISR94.

47 Employers are required to make SG contributions for their eligible employees regardless of their age. Individuals aged 65 or over can make downsizer contributions under s 292-102 ITAA97.

48 ATO, *Superannuation guarantee gap*, October 2021. Available at www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/Superannuation-guarantee-gap.

49 Industry Super Australia, *Super scandal: unpaid super guarantee in 2016–17*. Available at www.industrysuper.com/assets/Uploads/d62c256bec/Super-Scandal-Unpaid-super-guarantee-in-2016-17-FINAL.pdf.

50 10.5% from 1 July 2022.

51 S 31 SGAA.

52 There is a widespread misconception that an SG contribution is non-deductible solely because it is paid after the 28th day following the end of the quarter. A late contribution remains deductible under s 290-60 ITAA97 and is not non-deductible just because it is paid late. The contribution is non-deductible under s 26-95 ITAA97 when it takes the form of the SG charge (i.e. the employer lodges an SG statement and notifies the Commissioner that they are liable to pay the SG charge).

53 S 49(3) SGAA.

54 The Commissioner has discretion to remit all or part of the Part 7 penalty: see s 62(3) SGAA and PS LA 2020/4.

55 S 62(4) SGAA.

56 Divs 268 and 269 of Sch 1 TAA53.

57 Subdiv 265-C of Sch 1 TAA53. A failure to comply with the direction is a strict liability offence which is subject to a maximum penalty of 50 penalty units ($11,100), 12 months' imprisonment or both.

58 Div 384 of Sch 1 TAA53.

59 S 260-5 of Sch 1 TAA53.

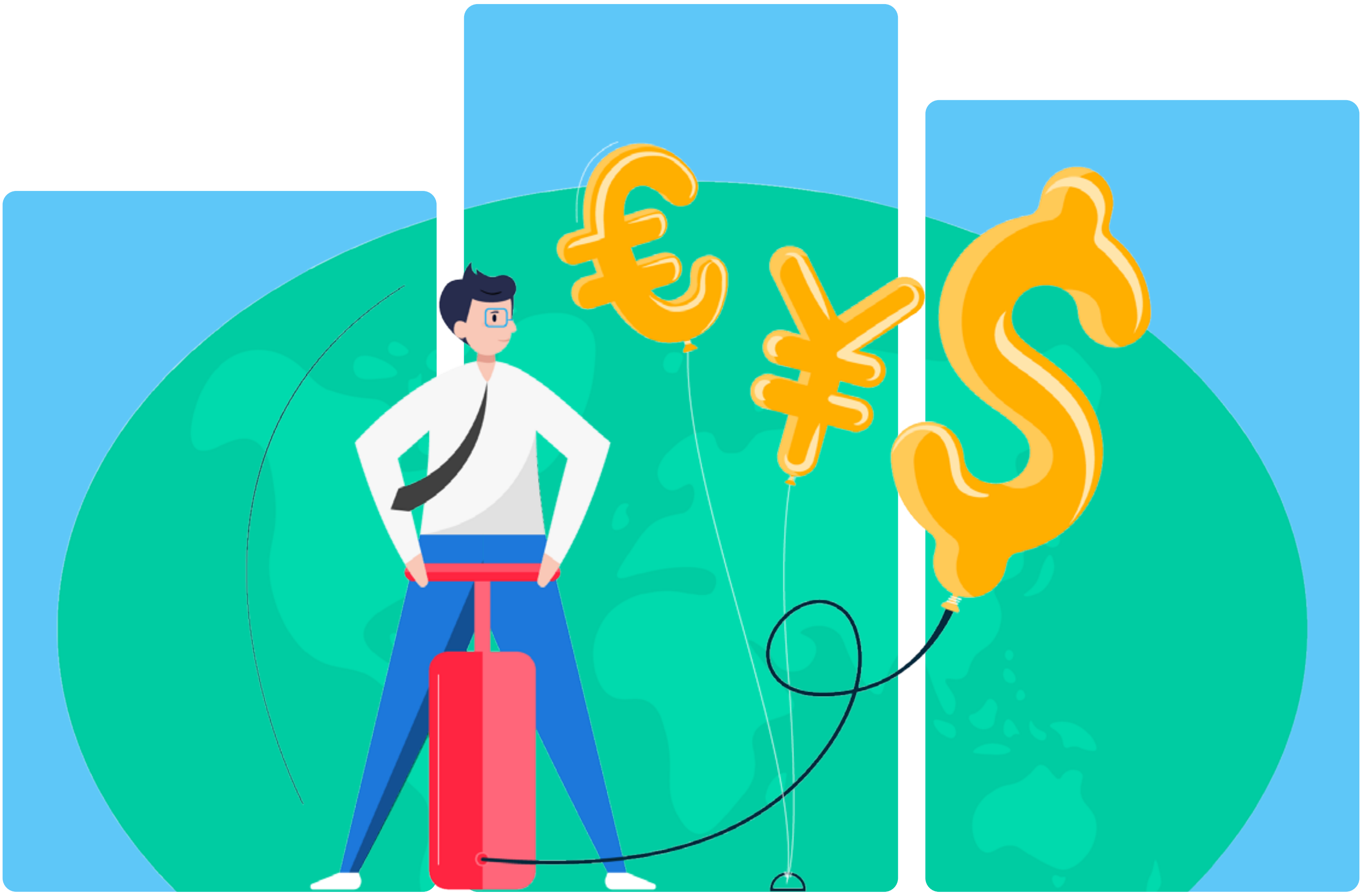
60 See PCG 2020/6.

61 This can particularly arise where the employee has also made a personal contribution or entered into a salary sacrifice arrangement.

62 Treasury Laws Amendment (2018 Superannuation Measures No. 1) Bill 2018.

63 *Treasury Laws Amendment (Recovering Unpaid Superannuation) Act 2020* (Cth).

64 The GFC in 2007 and the COVID-19 pandemic both resulted in legislative amendments to respond to the dramatic change in economic conditions.



High Court decides FCT v Carter

by Bruce Collins, CTA, Principal Solicitor, Tax Controversy Partners

The High Court decision in *Carter* disturbed a widely accepted position regarding the tax impacts of beneficiaries disclaiming their entitlement after the financial year has ended. The beneficiaries in this case made several attempts to disclaim their interests, all *after* the end of the financial year. The court considered the equitable doctrine of disclaimer by a beneficiary of their interests in a discretionary trust and analysed s 97 of the *Income Tax Assessment Act 1936* (Cth). Interpreting the wording of s 97 quite tightly in the context of Div 6, the High Court held that any disclaimer had to happen *before* the end of the relevant financial year to change the tax outcome for any disclaiming beneficiary, while recognising that this decision could have unfair results in some circumstances. Like many other practitioners, the author advocates for a retrospective legislative amendment to prevent such unfairness for past or future disclaimers.

Surprising many tax advisers and their clients involved with discretionary trusts, *FCT v Carter*[1] was decided by the High Court on 6 April 2022, holding that a potential beneficiary of such a trust is irrevocably taxable on their (then) present entitlement to a trust distribution unless they disclaim all interest in that trust *before* midnight on 30 June of the relevant income year.

As expected from the High Court, the judgment contains a fine textual analysis of the relevant statutory provision, s 97 of the *Income Tax Assessment Act 1936* (Cth) (ITAA36) – a crucial part of the machinery in Div 6 ITAA36 that deals with the taxation of trusts.

The decision also considers the case law on the equitable doctrine of disclaimer by a beneficiary of their interests in a discretionary trust, which effectively requires the relevant beneficiary to give up all of their current and future rights under that particular trust.

Unfortunately for any relevant beneficiary attempting to disclaim *after* midnight on 30 June of the relevant year, the court essentially held that any subsequent disclaimer could not retrospectively change the effect of s 97, as it is currently worded. In other words, successfully disclaiming such a present entitlement to income from a discretionary trust after 30 June will still leave the beneficiary fully taxable on that amount of income – even though they have given up all of their rights to receive that income.

The ATO running this case and the High Court making this decision unfortunately disturbs a longstanding position which was widely understood and acted on by taxpayers and their advisers permitting beneficiaries to disclaim their entitlements after the end of the relevant financial year (but before accepting the gift of funds from the actual distribution).

The issues considered in the Carter case

The joint judgment of Gageler, Gordon, Steward and Gleeson JJ sets out the statutory context for Div 6, and the questions at issue, as follows:

> "1. This appeal concerns Div 6 of Pt III of the *Income Tax Assessment Act 1936* (Cth) ('the 1936 Act'), headed 'Trust income'. The primary provision in Div 6, s 96,[2] states: 'Except as provided in this Act, a trustee shall not be liable as trustee to pay income tax upon the income of the trust estate'. Section 96 reflects that, in Div 6, the basic income tax treatment of the net income of a trust estate is to assess the beneficiaries on a share of the net income of the trust estate based on their *present entitlement* to a share of the income of the trust estate.[3] The trust is the mere conduit through which the beneficiaries under the trust receive income and are assessed.[4]
>
> 2. That basic income tax treatment, from the perspective of the beneficiary, is addressed in s 97(1), which relevantly states:
>
> 'Subject to Division 6D, *where a beneficiary* of a trust estate who is not under any legal disability *is presently entitled to a share of the income of the trust estate*:
>
> (a) the assessable income of the beneficiary shall include:
>
> (i) so much of that share of the net income of the trust estate as is attributable to a period when the beneficiary was a resident; and
>
> (ii) so much of that share of the net income of the trust estate as is attributable to a period when the beneficiary was not a resident and is also attributable to sources in Australia …' (emphasis added)
>
> 3. A criterion on which s 97(1) operates is that a beneficiary '*is presently entitled* to a share of the income of the trust estate' (emphasis added). For the purposes of that sub-section, a beneficiary is presently entitled to a share of the income of a trust estate 'if, but only if: (a) the beneficiary has

an interest in the income which is both vested in interest and vested in possession; and (b) the beneficiary has a present legal right to demand and receive payment of the income, whether or not the precise entitlement can be ascertained before the end of the relevant year of income and whether or not the trustee has the funds available for immediate payment'.[5]

4. The issue in this appeal is one of timing. Specifically, is a beneficiary's present entitlement under s 97(1) – the present legal *right* to demand and receive payment of a share of the income of a trust estate – to be determined immediately prior to the end of a year of income by reference to the legal relationships then in existence, or can events after the end of the year of income, which may affect or alter those legal relationships, be considered?"

The facts of the Carter case

Illustrating the procedural difficulties with disclaiming such an interest in a discretionary trust, it appears that the relevant beneficiaries of the trust in the *Carter* case had made several attempts to actually disclaim their current and future entitlements – each attempt made *after* the end of the relevant income year.

While impossible to tell from the case decisions themselves or the parties' submissions in the High Court proceedings, it is possible that the uncertainty as to the effectiveness of the eventual outcome arising from these multiple attempts to disclaim may have contributed to the ATO choosing to run this case.

The taxpayers were specified beneficiaries of a discretionary trust, with the trust deed providing that if the trustee did not decide to distribute or accumulate any part of the trust income in an income year (defined to be the 12 months ending on 30 June), then that income would be held by the trustee equally on behalf of each of the five specified beneficiaries (including the taxpayers). This is a variation on the standard drafting formulations to avoid the trustee becoming taxable under ss 98, 99 and 99A ITAA36 as authorised by s 96 ITAA36.

For the 2014 income year, the trustee did not decide to distribute or accumulate the trust income, leading to the Commissioner on 27 October 2015 issuing assessments to each of the taxpayers for one-fifth of the "net income of the trust estate" on the basis that they were "presently entitled" to that proportion of that "net income" under s 97.

Subsequently, the taxpayers each sought to disclaim their interests in the discretionary trust, on 3 and 4 November 2015. When these two attempts were found to be ineffective, the taxpayers then sought to disclaim on 30 September 2016 – "the third disclaimer".

Chain of dispute

The taxpayers then objected to the assessments on the basis (among other grounds) that they no longer had a "present entitlement" to that share of that "net income of the trust estate", as a result of the third disclaimer.

The Commissioner disallowed those objections, resulting in an Administrative Appeals Tribunal decision that the retrospective third disclaimer was ineffective, as the taxpayers had accepted the gift and had knowledge of it.

The Full Federal Court heard an appeal on a question of law from the tribunal decision, with the taxpayers arguing against the tribunal finding that the third disclaimer was ineffective. The Full Federal Court found that the third disclaimers were effective for the application of s 97, as there was nothing in the words of s 97 that prevented consideration of changes in legal relations that occurred after the end of the income year, ie that the taxpayers were no longer "presently entitled" to that share of the "net income of the trust estate" at the end of the 2014 income year.

High Court decision

The ATO appealed this decision solely on the grounds of this interpretation of s 97, ie that the Full Federal Court had erred in finding that the third disclaimers were effective in retrospectively changing ("disapplying") the operation of s 97 at the end of the 2014 income year.

After an analysis of the case law on "present entitlement", the joint judgment then sets out the core decision on the main issue in dispute:

"21. The fact that s 97(1) is directed to identifying the legal right of the beneficiary immediately prior to the end of the year of income is important. In relation to each trust estate, once the beneficiaries with those rights are identified, it permits the balance of s 97(1) to operate and, consistently with the stated purpose of Div 6, provides for those beneficiaries to be assessed on a share of the net income of the trust estate based on their *present entitlement* to a share of the income of the trust estate. As this Court recognised in *Bamford*, the beneficiaries may be presently entitled immediately before the end of the income year 'whether or not the precise entitlement can be ascertained before the end of the relevant year of income and whether or not the trustee has the funds available for immediate payment'.[6]

22. Put in different terms, the taxation liability of the beneficiaries is determined by ascertaining the proportion of the distributable income of the trust estate to which each beneficiary is presently entitled at that point in time – just prior to midnight at the end of the year of income – and then applying that proportion to the 'net income of the trust estate'. That has practical significance. The stepped process in s 97(1) identifies the beneficiaries who are to be assessed at the end of the income year, permits the 'net income of the trust estate' to be determined for that income year in the usual way and then enables the quantum of tax payable by the beneficiary to be calculated and subsequently assessed.[7]

23. The other relevant criteria in s 97(1) – that a beneficiary is not under any legal disability and is a resident – reinforce the conclusion that a beneficiary's present entitlement is determined immediately before the end of the income year. Those criteria, ascertained during and at the end of the income year, are conditions or circumstances which cannot be altered by facts and matters subsequent to the relevant income year. Moreover, ss 98, 99 and 99A also operate by reference to facts, events and legal relationships in existence at the end of the income year,[8] which cannot be altered after the end of the income year.

24. The respondents' contention that the phrase 'is presently entitled' should be construed to mean 'really is' presently entitled (emphasis added) for that income year, such that, for 'a reasonable period' after the end of the income year, later events could subsequently disentitle a beneficiary who was presently entitled immediately before the end of the income year, is rejected. The respondents' construction is contrary to the text of s 97(1) and the object and purpose of Div 6 identified above. It would give rise to uncertainty in the identification of the beneficiaries presently entitled to a share of the income of a trust estate and the subsequent assessment of those beneficiaries. On the respondents' construction, whether a beneficiary was presently entitled to a share of the income of a trust estate may not be resolved for a substantial period of time and, in some cases, such as the present, for years.[9] The uncertainties that would arise, and which would apply with equal force to the Commissioner, trustees, beneficiaries and perhaps even settlors, would also not be fair, convenient or efficient.[10]

25. For those reasons, the question of the 'present entitlement' of a beneficiary to income of a trust must be tested and examined 'at the close of the taxation year',[11] not some reasonable period of time after the end of the taxation year."

Warning about potential unfairness

The joint judgment in the High Court also recognises the potential for unfair results, stating:

"26. This Court recognised in *Bamford*[12] that in competing constructions of Div 6 examples can readily be given of apparent unfairness in the resulting administration of the legislation. Thus, in addressing the fact that a beneficiary might ultimately not receive the trust income to which they were entitled, the Court in *Bamford*[13] recognised that any such insufficiency arises because the beneficiary's tax liability under s 97(1) is determined by reference to the 'net income' of the trust estate, not the distributable income. Similarly, here, the construction which has been adopted means that a beneficiary might be presently entitled at the end of an income year but be unaware of it. That unfairness arises because Div 6, and s 97(1) in particular, is drafted to tax a beneficiary by reference to present entitlement, not receipt.[14]"

Calculating the net income of the trust estate

One of the practical problems arising from the High Court decision is that the vast majority of beneficiaries of discretionary trusts in Australia will only become aware of having become presently entitled to receive a distribution from that trust well after midnight on 30 June of the income year.

As anyone who has actually done this from an accounting perspective, it is usually difficult to determine the actual net income of the trust estate as required by s 95 until *after* the end of the income year, as the calculation can generally only occur once the bank records are available and accounts have been prepared.

If a resolution has specified a dollar figure to be distributed (as opposed to a proportion of distributable income below 100%) and the trustee knows that the trust will have sufficiently more than that figure to meet its expenses, it might theoretically be possible to notify the beneficiary of that dollar figure *before* midnight on 30 June of that income year but that will not notify the beneficiary of the "share" or proportion of net income (taxable income) which the beneficiary will derive at 30 June in that year.

> "… almost no beneficiaries in Australia will therefore be practically able to disclaim their present entitlements …"

However, where the resolution provides the beneficiary with a proportionate share of some part or all of that income (ie distributable income) of the trust estate, the notification of the amount of that present entitlement will necessarily need to await the calculation of that net income (taxable income) – which will normally be well after midnight on 30 June of that income year and may well differ from the amount of distributable income (ie "income of the trust estate").

As a result, under the current law, almost no beneficiaries in Australia will therefore be practically able to disclaim their present entitlements to such income that the trustee resolves for them to become theoretically able to receive, as they will only become aware of that present entitlement after it is too late to do so.

Reasons for potential disclaimer

There may be many reasons why a beneficiary may choose to disclaim their present entitlement to such income and this decision creates a manifestly unfair result, including:

- a mismatch between tax and accounting concepts applying to trust income where a beneficiary could conceivably be entitled to receive $2 in cash from accounting income, while being notionally entitled to $1m in taxable income. Unfortunately, this "Bamford" mismatch remains a recurring theme in Australian taxation of trusts, as previous government failures to introduce legislative reform have left beneficiaries, trustees, advisers and the ATO struggling to deal with such issues. The decision in the *Carter* case now shows that the problems with this broken area of the tax code can't be fixed by an affected beneficiary trying to disclaim their interest in the relevant trust and thus giving up their rights to receive that "present entitlement";
- undisclosed unpaid present entitlements such as seem to arise with disappointing frequency in family law disputes, where a corporate trustee controlled by one (higher-income) spouse resolves to "distribute" substantial amounts of "income" to their (lower income) spouse, but where that "income" isn't actually distributed to the latter. In many cases, the non-controlling spouse may only discover these transactions after many years and at the time of trying to obtain a property settlement under s 79 of the *Family Law Act 1975* (Cth). While it may be possible for the affected spouse to seek to enforce their unpaid present entitlements, in many cases, this will prove impractical. The decision in the *Carter* case shows that such an affected spouse cannot seek to retrospectively disclaim their interests in the relevant unpaid present entitlements to bring home the tax mischief to the controlling spouse (often the default beneficiary) or their corporate trustee;
- other "unpaid present entitlements" are a common feature of concern for Div 7A ITAA36 purposes, as noted repeatedly by the ATO over the last couple of decades (up to the recently released TD 2022/D1). Again, an entity discovering that they had such an unnotified unpaid present entitlement *after* the end of the relevant income might want to disclaim their interest in that unpaid present entitlement to stop themselves from being taxed on it. The decision in the *Carter* case shows that such an entity with an unpaid present entitlement cannot disclaim after the end of the relevant income year and avoid being taxable on the resolved unpaid present entitlement; and
- as-yet-undiscovered s 100A ITAA36 reimbursement agreements, where the relevant beneficiary with the present entitlement would be taxable on the resolved distribution, but the economic benefit practically flows to another entity or associate (potentially including the trustee). Such an affected beneficiary might subsequently discover the particular reimbursement arrangement and (prior to the *Carter* case) seek to disclaim their interest in that resolved distribution of that present entitlement to instead visit that tax mischief on the trustee or default beneficiaries. Unusually, this could be a situation where the relevant beneficiary might seek to have the Commissioner apply s 100A, as this might be the only pathway to address this mischief.

Potential legislative reform

While the previous government had signalled an awareness of these potential areas of unfairness, there is no definite commitment to address the above problems through specific amending legislation, as may be seen from the relevant parts of a media release from the former Assistant Treasurer, the Hon. Michael Sukkar MP, issued the day after the High Court decision:[15]

> "The Government also notes the significant decision handed down yesterday by the High Court of Australia in *Commissioner of Taxation v Carter*.
>
> The decision concerned the effect, under tax law, of a beneficiary 'disclaiming' a distribution from a trust. The High Court's determination means that, in certain circumstances, beneficiaries of a trust may still be liable to pay tax on a trust distribution they never received or had disclaimed.
>
> While the decision brings some clarity to a complex area of both tax law and the law of trusts, the Court itself noted that both its interpretation, and the alternative interpretation offered by the respondent, were capable of giving rise to apparent unfairness.
>
> The Government will carefully consider the implications of the decision, particularly for hard-working small business families, whether it raises any inequitable outcomes that may not have been the intention of the tax law, and whether they can be dealt with by legislative change.
>
> A re-elected Morrison Government will not hesitate to make common-sense legislative amendments to provide certainty for family trusts and prevent unfair application of the tax law …"

However, as we have seen over the decades, legislative reform of the taxation of trusts may often be spoken about by government, but there are practical problems with implementing such changes and conflicting legislative priorities that may delay or defeat such changes.

The author has spoken with a wide range of practitioners about these issues and every one of them has agreed that this anomaly in the practical administration of the trust taxation system is in urgent need of a retrospective law fix. This law change is urgently needed to avoid the manifest injustice for beneficiaries who do not receive sufficient cash to even pay the tax from being denied their general trust law right to disclaim in the application of s 97. That law change needs to be retrospective to safeguard the many previous disclaimers that have already been made on the previous understanding about how the law operated.

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References

1 [2022] HCA 10.

2 See *FCT v Bamford* [2010] HCA 10 at [22].

3 S 95AAA ITAA36.

4 *FCT v Bamford* [2010] HCA 10 at [20], quoting HAJ Ford, "Income and estate taxation affecting trusts", (1958) 1(4) *Melbourne University Law Review* 419 at 420.

5 *Harmer v FCT* [1991] HCA 51 at [8], quoted in *FCT v Bamford* [2010] HCA 10 at [37].

6 *FCT v Bamford* [2010] HCA 10 at [37], quoting *Harmer v FCT* [1991] HCA 51 at [8].

7 Ss 5 and 7 of the *Income Tax Act 1986* (Cth). See *FCT v Bamford* [2010] HCA 10 at [45], quoting *Zeta Force Pty Ltd v FCT* [1998] FCA 728.

8 The same approach applies for the purposes of taxing the net income of a partnership under Div 5 of Pt III of the ITAA36: *FCT v Galland* (1986) 162 CLR 408 at 414–415, 418–419, 422, 424.

9 cf *Chief Commissioner of State Revenue v Smeaton Grange Holdings Pty Ltd* [2017] NSWCA 184 at [22].

10 cf A Smith, *An inquiry into the nature and causes of the wealth of nations*, 4th ed, 1850, bk v, ch ii, pp 371–372.

11 *Union-Fidelity Trustee Co of Australia Ltd v FCT* [1969] HCA 36 at [12].

12 *FCT v Bamford* [2010] HCA 10 at [17].

13 *FCT v Bamford* [2010] HCA 10 at [45], quoting *Zeta Force Pty Ltd v FCT* [1998] FCA 728.

14 *FCT v Bamford* [2010] HCA 10 at [37], quoting *Harmer v FCT* [1991] HCA 51 at [8].

15 The Hon. Michael Sukkar MP, "Certainty and stability for family trusts", media release, 7 April 2022. Available at https://ministers.treasury.gov.au/ministers/michael-sukkar-2019/media-releases/certainty-and-stability-family-trusts.

Private rulings: are they worth it?

by Paul McNab, CTA, Partner, DLA Piper

This article seeks to describe a structured approach, with reference to the law and relevant decisions, which may be used when trying to decide whether it is worthwhile to apply for a private ruling. The framework suggested is that which is generally used in choosing consumer products. The article suggests that the decision must be made by reference to the taxpayer's corporate attitude to tax risk, and the other approaches available for achieving the desired level of certainty on the tax risk associated with a particular issue. Depending on the circumstances, other approaches may be preferred. Rulings, however, offer an opportunity to understand the Commissioner's reaction to a situation and, through engagement, achieve a positive response. They require particular care in drafting, and care in the evaluation of the response.

Introduction

Two recent Federal Court decisions present a useful opportunity to think again about the role that private rulings might play in managing a taxpayer's tax risk.

In *Aurizon Holdings Ltd v FCT*,[1] the court commented on why a ruling would not have been suitable there. And in *Landcom v FCT*,[2] the court considered the role of rulings in relation to state/territory government entities paying "GST equivalents".

Aurizon, in particular, invites us to think again about how and when we use rulings. This article will try to give taxpayers the information they will need to determine the value to them of seeking a "private ruling".

The article will discuss what actually constitutes a private ruling. It will examine the attributes of such a ruling, and then compare and contrast it with other strategies which might give similar outcomes. In doing so, it will consider the relevant statutory rules and court decisions. Finally, the article will try to offer some thoughts on how to answer the question posed by the title.

In the annual report for 2020–21, the Commissioner advised that he had issued 3,977 rulings during the year (compared to 5,285 in 2019, and 4,126 in 2020). Of these, 81% were finalised within 28 calendar days of receiving all of the necessary information, and 90% of taxpayers were contacted with 14 calendar days where the matter was expected to take more than 28 days to finalise. Approximately 60% of taxpayers thought the process and outcome were fair. So there are clearly a significant number of taxpayers who choose to seek a ruling, and most seem to think it worthwhile.[3]

The author has not set out the origin or history that led to the current rules (which came into effect in 2005).

The question of whether private rulings are worth it is a subjective one for each taxpayer, and the answer will depend on the benefits that emerge from the analysis described in this article. But these must be weighed against the cost (both in preparation and risk) in asking for a ruling. Or not asking for a ruling.

While many taxpayers will hope for a simple "yes or no" answer to the question, it is only possible for this article to give some of the information which will be needed by a taxpayer as they answer the question for themselves.

The classic factors in "is it worth it?" decisions arise around consumer products and typically involve consideration of the following:

- utility (whether the outcome from the process was more useful than from competing processes);
- enjoyment (whether the experience was no more painful perhaps than other options, in the context of a tax question); and
- cost (whether the utility and enjoyment was such that you thought the cost worthwhile).

These are deeply individual and subjective factors in most cases.

The legislation and case law are primary tools in decision-making, but taxpayers should also consider the database of redacted private rulings published by the Commissioner.[4] Although not binding on the Commissioner for other taxpayers, they can often guide the approach taken.

The author's final introductory observation is that the level of certainty on a tax issue that is required is usually set by the taxpayer's "tax risk policy". This will vary depending on factors such as the amount of the tax at stake, the level of opinion given by advisers, and public statements by the ATO on the issue. It also depends on whether the taxpayer has been advised by the Commissioner that a failure to seek confirmation of positions will lead to a deterioration in the taxpayer's relationship with the Commissioner. Not all taxpayers or all issues require certainty. The topic of this article only arises when a taxpayer makes a decision that greater comfort is required on a tax risk.

The legislation

Private rulings are dealt with under Div 359 of Sch 1 to the *Taxation Administration Act 1953* (Cth) (TAA53)[5] (there are also "common rules" relating to all types of rulings found in Div 357 that must be considered).

Under s 359-5, the Commissioner may "make a written ruling" on the way the Commissioner considers "a relevant provision" "applies or would apply" to a taxpayer in relation to a "specified scheme". This is called a "private ruling".

So a private ruling is a written document from the Commissioner to a taxpayer. Section 359-15 provides that the ruling must be in writing and given to the applicant (electronic transmission is permitted). Under s 359-20, the ruling must identify the particular entity that it applies to, and specify the scheme and provisions covered. It must "state that it is a private ruling".

The ruling may state its commencement and cessation times, but if none is specified, it applies from when it is made. If no cessation time is specified, the ruling ceases to apply at the end of the income year or accounting period when it started to apply. The ruling may start or end with reference to a specified event, and it may have a commencement time in the past (s 359-25).

The key benefit of such a ruling is found in s 357-60 which states that "a ruling" "binds the Commissioner" in relation to "you". If it applies to you, and you rely on it by acting (or omitting to act) in accordance with it, the Commissioner is then unable to increase your tax liability in relation to the subject-matter of the ruling, or apply penalties and interest if there is a later disagreement. This certainty can be valuable.

Some of the key concepts are outlined in the following discussion.

What is a "relevant provision"?

One of the key concepts is that of a "relevant provision". These are the provisions of Acts and Regulations on which the Commissioner may rule, and that the Commissioner has the "general administration" of. They are set out in s 357-55:

> "… any of the following:
>
> (a) tax;
>
> (b) Medicare levy;
>
> (c) fringe benefits tax;
>
> (d) franking tax;
>
> (e) withholding tax;
>
> (f) mining withholding tax;
>
> (fa) petroleum resource rent tax;
>
> (fb) indirect tax;
>
> (fc) excise duty;
>
> (fd) levy under the *Major Bank Levy Act 2017*;
>
> (fe) Laminaria and Corallina decommissioning levy;
>
> (g) the administration or collection of those taxes, levies and duties;
>
> (h) a grant or benefit mentioned in section 8 of the *Product Grants and Benefits Administration Act 2000*, or the administration or payment of such a grant or benefit;
>
> (i) a net fuel amount, or the administration of a net fuel amount;
>
> (ia) an assessed net fuel amount, or the collection or payment of an assessed net fuel amount;
>
> (j) a net amount, or the administration of a net amount;
>
> (ja) an assessed net amount, or the collection or payment of an assessed net amount;
>
> (k) a wine tax credit, or the administration or payment of a wine tax credit."

It is an extensive list. Although private rulings can be sought about many taxes, levies and duties, this article is focused on income and withholding tax. Relevantly, the list includes "tax", "withholding tax', and the administration or collection of those taxes.

What must the taxpayer give the Commissioner?

The primary requirement that the taxpayer must give to the Commissioner is a written request (s 359-10). The request must specify that it is for a private ruling and it must be in the approved form.[6]

In addition, s 359-20 requires that the ruling request identify the entity to whom it applies, the relevant scheme, and the relevant provision of the law that it relates to. The term "scheme" has the same meaning as it does in the *Income Tax Assessment Act 1997* (Cth), where s 995-1 defines it as:

> "***'scheme'*** means:
>
> (a) any arrangement; or
>
> (b) any scheme, plan, proposal, action, course of action or course of conduct, whether unilateral or otherwise."

And "arrangement" means:

> "***'arrangement'*** means any arrangement, agreement, understanding, promise or undertaking, whether express or implied, and whether or not enforceable (or intended to be enforceable) by legal proceedings."

Clearly, these expressions permit a wide range of matters, relating to the relevant provisions, which may be put to the Commissioner.

In addition to the material that must first be given to the Commissioner, there is a variety of other information that the Commissioner may take into account.

Under s 357-105, the Commissioner "must" request further information if he considers it is required. This effectively ensures that the Commissioner cannot simply refuse to rule if he considers more information is required.

Additional information from the applicant "may" be taken into account, whether supplied in response to such a request or not. The Commissioner may also take into account any relevant information provided by an entity other than the applicant, provided he tells the applicant and gives the applicant a reasonable opportunity to respond before making the ruling (s 357-120).

If the applicant does not give any information that has been requested, the Commissioner may decline to rule (s 357-105).

It is also possible for the Commissioner to make and state assumptions if he believes that the correctness of a ruling will depend on assumptions about a future event or other matter (s 357-110). In doing so, the Commissioner must tell the applicant about the assumption and give the applicant a reasonable opportunity to respond.

A taxpayer may withdraw a request (s 359-10(3)).

What does the Commissioner have to do?

The Commissioner *may* make a ruling (s 359-5), rather than *must*, because s 359-35 states that the Commissioner "must" comply with an application and make the ruling, but that is subject to some important carve-outs. The first are:

> "(2) The Commissioner may decline to make a private ruling if:
>
> (a) the Commissioner considers that making the ruling would prejudice or unduly restrict the administration of a taxation law; or
>
> (b) the matter sought to be ruled on is already being, or has been, considered by the Commissioner for you.
>
> (3) The Commissioner may also decline to make a private ruling if the matter sought to be ruled on is how the Commissioner would exercise a power under a relevant provision and the Commissioner has decided or decides whether or not to exercise the power."

As noted above, if an applicant fails to give requested information, the Commissioner may decline to rule. And he may decline to rule if it is considered that the correctness of the ruling would "depend on which assumptions were made about a future event or other matter" (s 357-110).

There is no private ruling unless it is recorded in writing and given to the applicant (s 359-15). And, as noted above, the ruling must state that it is a private ruling, and identify the entity to whom it applies, the relevant scheme and the relevant provision to which it relates (s 359-20).

The validity of a ruling is not, however, affected merely because a provision relating to form or procedure for making it has not been complied with (s 357-90).

Consequences of a ruling issuing

Favourable ruling

If a favourable ruling issues, the taxpayer can generally rely on it. Section 357-60 is the critical provision which states:

> "(1) … a ruling binds the Commissioner in relation to you (whether or not you are aware of the ruling) if:
>
> (a) the ruling applies to you; and
>
> (b) you rely on the ruling by acting (or omitting to act) in accordance with the ruling.
>
> …
>
> (2) You may rely on the ruling at any time unless prevented from doing so by a time limited by a taxation law. It is not necessary to do so at the first opportunity."

The Commissioner may still be bound, even if the relevant legislation is re-enacted, provided the new provision still deals with the "same ideas".[7] Section 357-85 provides:

> "If:
>
> (a) the Commissioner makes a ruling about a relevant provision (the ***old provision***); and
>
> (b) that provision is re-enacted or remade (with or without modifications, and whether or not the old provision is repealed);
>
> the ruling is taken also to be a ruling about that provision as re-enacted or remade (the ***new provision***), but only so far as the new provision expresses the same ideas as the old provision."

Unfavourable ruling

Under s 359-60(1) and (2), an unfavourable ruling is a "taxation decision" within the meaning of Pt IVC, giving rise to a right to object against it. Disallowance of the objection is an "objection decision", triggering rights of appeal to the Administrative Appeals Tribunal or the Federal Court in the usual circumstances.

An applicant cannot object if there is otherwise an assessment for the income year (or other period) which the ruling relates to (s 359-60(3)). This is because it is intended that, if an assessment has been raised, the Pt IVC proceedings should be in relation to the assessment, rather than the ruling.

An applicant also cannot object to an aspect of an assessment which has been the subject of an objection to a ruling (s 14ZVA TAA53).

Ruling withdrawn or superseded

Private rulings may be altered before the scheme commences and before the period covered by the scheme. This can occur by the ruling being revised (s 359-55), or by a later inconsistent public ruling (item 3 of s 357-75(1)).

Consequences of a refusal or failure to rule

If, within 60 days, the Commissioner has not made a ruling or told the applicant that he will decline to make it, the applicant may give the Commissioner a written notice requiring the ruling to be made. The 60-day period can be extended if the Commissioner requests further information, advises assumptions that the Commissioner proposes to make, advises of third party information that the Commissioner proposes to take into account, or refers a valuation to a valuer (s 359-50).

However, if the Commissioner has not responded within 30 days of the relevant period, the applicant may object against the failure to make the ruling and lodge a draft private ruling with the objection (s 359-50(3) and (4)).

The Commissioner must make a ruling in the same terms as the draft, or make a different ruling. If this is not done within 60 days, the Commissioner is taken to have disallowed the objection (s 14ZYA TAA53).

A refusal to rule, in itself, is not a "taxation decision" which gives rights of objection, but such a decision may be reviewable under the *Administrative Decisions (Judicial Review) Act 1997* (Cth).[8]

Relevant decisions

There have been a number of court decisions that touch on issues that have particular relevance to private rulings. The decisions relate to a number of common themes, such as:

- the standing of a taxpayer to object to a ruling;
- the precise subject-matter of any appeal;
- the question of what a valid ruling is;
- the ability of the AAT or court to consider new evidence and make assumptions; and
- the role of private rulings generally.

The decision in *Landcom v FCT*[9] is interesting, but it may have limited application beyond the world of state/territory government bodies paying "GST equivalent" tax under the state/territory and federal arrangements that tax otherwise constitutionally exempt state/territory bodies. It was held by the court that these arrangements could be the subject of a valid ruling and therefore give rise to the rights of appeal that ordinarily arise under the ruling provisions discussed above. In doing so, the court suggested that the Commissioner has wide power to issue a ruling on the operation of tax law, even where the relevant provisions may only have a glancing application to a taxpayer.

Landcom is also memorable for Thawley J's suggestion that the Commissioner's arguments were "funambulistic"[10] – probably its first use in a Federal Court judgment, and a first as an epithet for the Commissioner.

In *CTC Resources NL v FCT*,[11] it was held that a taxpayer who did not implement a scheme covered by a ruling was not "dissatisfied" because the ruling could not affect the tax liability of the taxpayer. However, in *Corporate Business Centres International Pty Ltd v FCT*,[12] it was held that, in order to be "dissatisfied", the ruling must have had some effect on the tax affairs of the taxpayer. Having a commercial interest (as scheme promoter, for instance) was not enough.

Bellinz Pty Ltd v FCT,[13] in 1998, dealt with a taxpayer who sought a private ruling concerning whether a taxpayer who was a partner in a partnership was entitled to deductions for depreciation of certain plant. The Commissioner ruled against the taxpayer who appealed, eventually to the Full Federal Court.

In *Bellinz*, the events around the ruling request appear tortuous. Despite initially getting a favourable "draft" ruling, the process was seen as not going to deliver a final ruling by the date needed for commercial reasons. The taxpayer sought a writ of mandamus against the Commissioner. Those proceedings were resolved by the Commissioner agreeing to issue a ruling by a fixed date. Which was unfavourable. The taxpayer then objected.

While it was possible to state the ruling issue fairly succinctly, the taxpayer also raised administrative law issues relating to proceedings for judicial review and mandamus which the parties had agreed would be discontinued.

Although there was little dispute between the parties as to the relevant facts, the court said that, in an appeal on a ruling:[14]

> "The Court can have regard only to the arrangement as described in the ruling itself, supplemented by any documentation referred to in it."

In *National Speakers Association of Australia Inc v FCT*,[15] it was found that there was no valid "request for ruling", or "ruling", when both documents did not identify the year or the arrangement. The taxpayer sought a ruling on whether it was exempt from tax. The court implied[16] that the arrangement might have been described in terms of "its arrangements for membership and the like". So there might have been a description of the organisation and operation of the association in a particular year (or years) and a question as to whether amounts received in those years were exempt from tax under the relevant provision. It appears that the taxpayer provided much of this information, but did not actually draft a ruling request setting out the information in this manner. This is consistent with the observation by the court in *FCT v Executors of the Estate of Subrahmanyam* that:[17]

> "… the course of conduct of a taxpayer (ie what the taxpayer does) can be seen as an arrangement and in a case where that course of conduct is complete it can be said to have been carried out."

In *Subrahmanyam*, the court was faced with potentially inconsistent evidence which could only be resolved by making assumptions about the taxpayer's state of mind. The court observed that, since the taxpayer had died and further evidence could no longer be obtained, the Commissioner could either make assumptions or decline to rule.

Section 357-90 provides:

> "The validity of a ruling is not affected merely because a provision of this Part relating to the form of the ruling or the procedure for making it has not been complied with."

Despite this, in *Corporate Business Centres International*,[18] the court held that s 357-90 could not rectify defects (such as lack of identification of the scheme) which meant that a purported ruling was actually not valid.

In *FCT v McMahon*,[19] it was held that the arrangement as described in the ruling is the arrangement that will be considered by the courts on any appeal. The question will be whether the application of the law described by the Commissioner is correct – not whether he got the facts right:[20]

> "The procedure *(of applying for a ruling)*, thus, is not designed to determine disputed questions of fact or even to make any binding determination of fact at all."

Although the court in *McMahon* placed much emphasis on ensuring that the taxpayer correctly and fully described the arrangement, the decision makes clear that it is the ruling's description that is critical.

Rosgoe Pty Ltd v FCT[21] carried this point further in finding that, on appeal, the AAT was not permitted to redefine the arrangement as defined in the ruling. It could not "find" facts not stated in the ruling. In this sense, an AAT review of a ruling is not a "normal" AAT review.

Despite a clear and accurate factual description, changes in facts can cripple a ruling's usefulness. In *Mount Pritchard & District Community Club Ltd v FCT*,[22] the Commissioner asserted that a ruling was no longer binding (part way through the seven years that it had originally covered) because an "amalgamation" with another club represented a material change to the arrangement ruled on.

> "*Landcom* is also memorable for Thawley J's suggestion that the Commissioner's arguments were 'funambulistic' …"

The court held that an assessment issued in such a case was appropriately addressed on objection in the normal course under Pt IVC where the taxpayer bore the burden of adducing evidence to show that the facts in the year were not "materially different"[23] to the arrangement covered by the ruling. In *Carey v Field*,[24] the court thought a difference would be material if it would have affected the tax outcome ruled on, had it been considered by the Commissioner. That decision concerned an application for review of a decision in relation to a public product ruling, but would seem entirely relevant.

As no evidence on whether there was a material difference had been led in *Mount Pritchard* when making the application for declaratory relief, it was a clear problem for the court. Other appeal proceedings under Pt IVC had been instituted, and it is clear the court was pointing out what would need to be addressed in those proceedings for the taxpayer to be successful. This was an important limitation. The taxpayer is unable to assert that a ruling prevents the Commissioner from raising a valid assessment.

In the author's opinion, the most recent comment on the properties of rulings is to be found in the *Aurizon* decision.[25] That decision concerned the question of whether a certain amount, to the credit of a capital distribution account, was an amount of share capital. The credit arose as recognition of an asset, a receivable, transferred to the company by the state of Queensland (not in consideration for the issue of shares, but simply as a contribution to the capital of the company at the time of its listing). The court held that it was an amount of share capital.

The taxpayer had sought declaratory relief under s 39B(IA)(c) of the *Judiciary Act 1903* (Cth), and s 21 of the *Federal Court of Australia Act 1976* (Cth).

Among his other arguments, the Commissioner contended that declaratory relief, which is a discretionary remedy, was not appropriate because the private ruling process, and the rights that a taxpayer has under Pt IVC in relation to a ruling, was an alternative and more appropriate approach for the taxpayer. The Commissioner argued that the taxpayer "had not identified any reason why relief under Part IVC in relation to a private ruling was not available".[26]

While the court acknowledged that, in relation to assessment decisions, it was accepted that the Pt IVC process meant that discretionary relief "may be (and often will be) withheld",[27] it did not feel that this logic should be extended to the private ruling process.

Thawley J set out a number of reasons why this was an appropriate conclusion:[28]

> "… it would have been, to say the least, difficult to identify with any certainty the relevant facts upon which the ruling would be made. As the course of these proceedings has shown, it was only shortly before the hearing that the parties were able to agree a number of relevant facts. Certain facts were only perceived to be relevant and made the subject of evidence, during the course of the hearing. Secondly any appeal would have been confined to the facts as put in the ruling application. It there had been a Part IVC appeal from a ruling, it is likely that the facts in the private binding ruling application would have been shown to be wrong in some respect with the result that the whole process would likely miscarry and need to start again. Thirdly, third parties (Aurizon's shareholders) have an interest in the issue being resolved in a way which binds the Commissioner and this is not achieved through a private binding ruling."

Other options

Public rulings

Public rulings are defined in s 358-5(1):

> "(1) The Commissioner may make a written ruling on the way in which the Commissioner considers a relevant provision applies or would apply to:
>
> (a) entities generally or a class of entities; or
>
> (b) entities generally, or a class of entities, in relation to a class of schemes; or
>
> (c) entities generally, or a class of entities, in relation to a particular scheme."

The basic requirements for a valid public ruling are similar to a private ruling, except that there is no right of objection against a public ruling.

Public rulings are intended to deal with the situation of a larger number of affected taxpayers. The public ruling process does not have the same application process that may be reviewed by the courts, but they are binding on the Commissioner.

Oral rulings

Individual taxpayers may apply to the Commissioner for advice in relation to the application of a "relevant provision" to a "scheme" under s 360, and receive oral advice.

The Commissioner is not obliged to give an oral ruling if it relates to a business or complex matter or has previously been considered for the individual (s 360-5(2A)).

The limitation to individual taxpayers severely limits their usefulness.

Settlement agreements

If there has been a dispute, it may be resolved by a "settlement agreement". The Commissioner may, under the power of general administration, enter into a binding agreement with a taxpayer setting out the treatment of arrangements, both past and prospective.[29]

Such agreements, if well drafted, detail the arrangement that they cover in as much detail as a ruling. Any dispute about whether either party has breached the agreement is a matter for contract law.[30]

Settlement agreements offer certainty about treatment of future years, in a manner enforceable in a court but subject to the arrangement not being materially changed. They are, however, only available when there is an established dispute with the Commissioner that is to be compromised.

Advance pricing arrangements

An advance pricing arrangement (APA) is an arrangement between a taxpayer, the Commissioner and sometimes another foreign tax authority concerning the treatment of international transactions, agreements or arrangements between related parties or associates. The Commissioner may decide not to enter into an APA and the taxpayer has no simple statutory rights in relation to the decision.

APAs are not enforceable in an Australian court,[31] although they are generally believed to be respected by the Commissioner unless there is a material change in the facts of the taxpayer.

However, advance pricing arrangements lack some of the critical qualities of a private ruling, that is, a private ruling has an application process that may be reviewed by the courts, and a legislatively enforceable status.

Advance pricing arrangements are also limited to the future pricing of related party cross-border transactions and the profits that result from them.

Applications for declaratory relief

Declaratory relief is sometimes sought pursuant to s 39B of the *Judiciary Act 1903* and/or ss 21 and 22 of the *Federal Court of Australia Act 1976* (Cth). The remedy is discretionary and will not be given if the matter is one that would be more properly dealt with under Pt IVC (*Bellinz*). In effect, if there is an assessment in relation to the issue, Pt IVC is the appropriate mechanism.

In addition, a court will not generally engage with an issue that is "hypothetical".

Litigation under Pt IVC

A taxpayer may file a return on their preferred basis, object against any unfavourable treatment by the Commissioner, and then exercise their subsequent appeal rights under Pt IVC (or even file on the basis preferred by the Commissioner and then object against the resulting assessment). The result of an appeal, if successful, will be a legally enforceable decision.

Litigation generally requires a more detailed preparation of evidence than a ruling request, with the associated costs. The whole process may take a number of years depending on the levels of appeal but, provided the claims are properly structured and the appeal process is well run, comprehensive certainty can be the result. There are, however, still the usual risks of litigation and the greater costs.

One benefit of the litigation process is the flexibility and time for the parties to more fully explore the position and the relevant evidence, although this in turn creates some of the "litigation risk".

Conclusion

The key benefit sought in a ruling application is certainty on the application of the law to a scheme.

As discussed in the introduction to this article, a framework for considering the "worth" of something involves consideration of the following:

- utility (whether the outcome from the process was more useful than from competing processes);
- enjoyment (whether the experience was no more painful perhaps than other options, in the context of a tax question); and
- cost (whether the utility and enjoyment was such that you thought the cost worthwhile).

What does the discussion above tell us about these considerations?

Utility

Public rulings and oral rulings are not usually available for corporate taxpayers dealing with their own risk, and are not discussed further here.

The outcome of a successful private ruling binds the Commissioner in a legally enforceable way, as do the outcomes from Pt IVC litigation, declaratory relief and a settlement agreement. Declaratory relief is available in a smaller range of situations, as are settlement agreements but, if a taxpayer fits their criteria, they might be considered of equal utility to a private ruling.

These solutions are not always available as alternatives, but must always be kept in mind. For instance, in an audit, it may be difficult to obtain a ruling on an issue which is presently subject to review. But in settling an audit, it is always worth considering what the totality of issues are that a taxpayer might value certainty on, and how the settlement document can be drafted so as to give it.

As noted above, an Australian APA is not generally legally enforceable.

Enjoyment

Preparation of a private ruling request which has maximum utility is obviously not always a simple task. Good legal analysis is required to identify the legal issue on which clarity will deliver the greatest benefit, and careful consideration is then required to identify the correct applicant, the relevant time period and a description of the scheme (*National Speakers Association*).

Consideration of the time period is important not only to the question of what period of coverage should be sought in a ruling, but also to the question of the value of a ruling in circumstances where changes can be foreseen (although not in precise detail). It certainly makes it important to consider and, where possible, foreshadow known future changes in the request.

We can see that a private ruling process may be appropriate if the legal issue is succinct and/or the relevant facts are able to be clearly stated and documented. In *Bellinz*, this led the court to observe that there were significant difficulties with a ruling on Pt IVA,[32] especially since one of the matters in s 177D(b) ITAA36 is "the manner in which the scheme was entered into or carried out". But even Pt IVA rulings are possible.

It is suggested that the ruling process is, however, simpler and shorter than litigation under Pt IVC. An application for declaratory relief probably falls between the two. A ruling application is likely equivalent to the effort in a well-framed settlement agreement, although part of the effort there is properly allocated to the fact of the audit itself.

It is worth noting that Pt IVC, settlement proceedings and declaratory relief are all subject to later changes in taxpayer fact patterns and the law.

Cost

Cost is a direct product of the complexity of process or "experience", so the lowest cost options for certainty are private rulings and settlement deeds. Provided the key threshold requirements are met, they may deliver real value.

If there are risks on the threshold requirements, other more expensive options may deliver better value.

After you apply

If, after this analysis, you decide to proceed with a private ruling request, there may still be reasons to withdraw later.

If the taxpayer and Commissioner cannot agree on the description of the arrangement, the appeal rights may be valueless (*McMahon*). In any event, any ruling that is issued should be carefully considered to ensure that it satisfies the formal requirements for a ruling and specifies the correct taxpayer and scheme.

The process itself may enable the taxpayer to determine whether these factors exist, and withdraw if it becomes apparent that another process may be more appropriate

Evan after getting a private ruling, be careful. Review the ruling at the time of filing each subsequent return that it applies to.

A private ruling will lose its value if there is a material change from the arrangement ruled on (*Mount Pritchard*).

When contesting an assessment where it is alleged that the Commissioner has not followed a ruling, it will be critical to adduce evidence about the arrangement ruled on and the fact that there has been no material change in circumstances.

The ruling will also lose its value if the law changes and the new law does not reflect or express the "same ideas" as the old.

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This article is an edited and updated version of "Private rulings: are they worth it?" presented at The Tax Institute's NSW Tax Forum held in Sydney on 19 to 20 May 2022.

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13 98 ATC 4634.

14 98 ATC 4634 at 4639.

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17 [2001] FCA 1836 at [44].

18 [2004] FCA 458.

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20 97 ATC 4986 at 5003.

21 [2015] FCA 1231.

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27 [2022] FCA 368 at [105], citing *FCT v Futuris Corporation Ltd* [2008] HCA 32.

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30 *Jonshagen v FCT* [2016] FCA 1545 at [83].

31 P McNab, "Could an Australian APA be enforced in a court?", (2014) 48(9) *Taxation in Australia* 514.

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Superannuation

by Daniel Butler, CTA, and
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Employee or contractor — PAYG and SG: part 1

Getting the distinction between who is an employee versus who is a contractor wrong may result in severe penalties and reputational damage which can result in the downfall of a business.

There have been a number of important recent developments in the law relating to who is an employee compared to who is an independent contractor.

Anecdotal evidence suggests that some contractor arrangements should, if they were more closely scrutinised, be treated as employees. A careful review of contractor arrangements should therefore be undertaken to ensure compliance with applicable legislation and to minimise risk of substantial penalties.

This article gives a brief overview on the distinction between an employee and a contractor, and discusses the relevant part of the PAYG withholding and the superannuation guarantee (SG) provisions.

This article is part 1 of a series of articles on this topic. Part two will be published in next month's issue of *Taxation in Australia*.

Who is an employee?

For many years, the traditional master–servant and control test has applied when determining who is an employee. In more recent years, the courts have developed a multi-factorial approach of determining whether someone is more likely to be an employee compared to an independent contractor.[1]

However, three recent High Court decisions[2] reflect a significant shift towards placing the primary focus on the contract in question and a decreased reliance on the multi-factorial test to determine whether a person is an employee or a contractor (this is not to say that the multi-factorial test does not still have a role to play in the determination of whether someone is an employee or an independent contractor). These High Court decisions will be discussed in more detail in the second article in this series.

Who is an independent contractor?

This question is probably more easily answered from the perspective of who is not an independent contractor. An independent contractor is not someone who:

- is an employee; or
- receives payments wholly or principally for that person's labour (eg they do not have the right to substitute someone else to produce the result nor do they have significant equipment).

An independent contractor is a person who is typically running their own business and the person engaging their services has little direction or control in respect of how that service is supplied (eg a plumber who repairs a blocked drain in a rental property).

At para 17 of TR 2005/16, the ATO states:

> "The relationship between an employer and employee is a contractual one. It is often referred to as a contract of service. Such a relationship is typically contrasted with the principal/independent contractor relationship that is referred to as a contract for services. An independent contractor typically contracts to achieve a result whereas an employee contracts to provide their labour (typically to enable the employer to achieve a result)."

The ATO is reviewing TR 2005/16 in view of the recent High Court decisions and other developments.

When does an obligation arise to withhold PAYG?

Most are aware that PAYG must be withheld from salary and wages when they are paid to an employee. However, what withholding rules apply to contractors?

The PAYG withholding rules have created a critical distinction between employees and contractors. The rules exist in Pt 2-5 of Sch 1 to the *Tax Administration Act 1953* (Cth) (ss 10-1 to 20-80). Section 12-35 states:

> "An entity must withhold an amount from salary, wages, commission, bonuses or allowances it pays to an individual as an employee (whether of that or another entity)."

TR 2005/16 maintains that the term "employee" has an ordinary meaning. However, with regard to independent contractors, PAYG withholding does not apply to a payment made to a contractor. As a result, various tests have been used to determine who is an employee and who is a "true" independent contractor. Paragraph 18 of TR 2005/16 states:

> "Whatever the facts of each particular case may be, there is no single feature which is determinative of the contractual relationship; the totality of the relationship between the parties must be considered to determine whether, on balance, the worker is an employee or independent contractor."

The ATO has typically taken the view that a worker is an employee and not an independent contractor if they are remunerated for their personal labour, perform the work personally, and are paid by reference to hours worked.

Not much regard is given to the contractual terms, and the question has typically been determined having regard to the multi-factorial approach as per *Hollis v Vabu Pty Ltd* and *On Call Interpreters and Translators Agency Pty Ltd v FCT (No. 3)* (*On Call*).

As discussed above, the recent High Court decisions, namely, *Workpac Pty Ltd v Rossato, Construction, Forestry, Maritime, Mining and Energy Union v Personnel Contracting Pty Ltd* (*CFMMEU v Personnel Contracting*) and *ZG Operations v Jamsek*, reflect a primary reliance on the contract while still retaining the multi-factorial test in certain circumstances. We cover These decisions are covered in detail in the second article in this series.

Superannuation guarantee

The distinction between who is an employee, as compared to who is an independent contractor, also arises in relation to who must provide the minimum level of SG contributions to a complying superannuation fund.

Section 12 of the *Superannuation Guarantee (Administration) Act 1992* (Cth) (SGAA) provides that the terms "employee" and "employer" have their ordinary meanings, but s 12 expands those meanings. In particular, s 12(3) SGAA provides that, in addition to a common law employee:

> "If a person works under a contract that is wholly or principally for the labour of the person, the person is an employee of the other party to the contract."

The ATO's view on whether a worker is subject to SG is set out in SGR 2005/1. The ATO refers to the multi-factorial approach and a range of key factors that must be considered. Paragraph 11 of SGR 2005/1 states:

> "For the purposes of subsection 12(3), where the terms of the contract in light of the subsequent conduct of the parties indicate that:
>
> - the individual is remunerated (either wholly or principally) for their personal labour and skills;
> - the individual must perform the contractual work personally (there is no right of delegation); and
> - the individual is not paid to achieve a result,
>
> the contract is considered to be wholly or principally for the labour of the individual engaged and he or she will be an employee under that subsection."

Section 12(3) was recently considered by the Full Federal Court in *Dental Corporation Pty Ltd v Moffet*[3] in relation to a dentist who claimed SG in relation to his arrangement with Dental Corporation (Dental Corporation's application for special leave to appeal to the High Court was denied earlier this year). The Full Federal Court stated that it was unnecessary under s 12(3) to consider whether Dr Moffet's services were provided in an employment-like setting as reflected in the following extracts from this decision:

> "82. In our opinion, what s 12(3) requires is that: (a) there should be a 'contract'; (b) which is wholly or principally 'for' the labour of a person; and (c) that the person must 'work' under that contract. There is no doubt that Dr Moffet provided his work under the Services Agreement so the requirements of (a) and (c) are met.
>
> ...
>
> 104. For that reason, the question of whether the Services Agreement, from Dental Corporation's perspective, was wholly or substantially 'for' Dr Moffet's labour should be answered in the affirmative. It was substantially for that purpose.
>
> ...
>
> [108] Finally, we would have rejected Dental Corporation's submission in this Court that the employment-like setting test should be answered by reference to the same kinds of indicia, especially control, which govern the general issue of whether one person is employed by another. This would collapse s 12(3) (on the assumption that *On Call* is correct) into the ordinary test of employment. It is clear that is precisely what s 12(3) does not mean."

The focus under s 12(3) is therefore on the purpose of the contract between the principal and worker and not on the ordinary meaning of "employee" and "employer". Note that there is no equivalent statutory extension like s 12(3) for PAYG purposes.

It should also be noted that a review of the potential application of s 12(3) in the Full Federal Court decision of *Jamsek v ZG Operations Australia Pty Ltd*[4] is still being considered. This point was referred by the High Court, with the ATO joined as a stakeholder. The High Court concluded that the truck drivers were not employees but did not have to consider the SG point.

The ATO is also reviewing SGR 2005/1 in view of the recent High Court decisions and other developments.

Who is a casual employee?

The High Court in *WorkPac Pty Ltd v Rossato* gave significant weight to the terms of the employment contract between WorkPac and Mr Rossato in finding that Mr Rossato was properly characterised as a casual employee and therefore was not entitled to the usual leave entitlements that permanent employees are typically entitled to. The decision of Kiefel CJ and Keane, Gordon, Edelman, Steward and Gleeson JJ was unanimous and some key extracts are as follows:

> "57. A court can determine the character of a legal relationship between the parties only by reference to the legal rights and obligations which constitute that relationship. The search for the existence or otherwise of a 'firm advance commitment' must be for enforceable terms, and not unenforceable expectations or understandings that might be said to reflect the manner in which the parties performed their agreement. To the extent that Bromberg J expressed support for the notion that the characterisation exercise should have regard to the

entirety of the employment relationship, his Honour erred.

…

62. To insist upon binding contractual promises as reliable indicators of the true character of the employment relationship is to recognise that it is the function of the courts to enforce legal obligations, not to act as an industrial arbiter whose function is to synthesise a new concord out of industrial differences …

101. … the present case is concerned with the character of an employment relationship, a question the resolution of which has no significance for the rights of persons who are not privy to the relationship. The analysis in *Hollis v Vabu* affords no assistance, even by analogy, in the resolution of a question as to the character of an employment relationship, where there is no reason to doubt that the terms of that relationship are committed comprehensively to the written agreements by which the parties have agreed to be bound."

The decision in *WorkPac Pty Ltd v Rossato* is important as the High Court gave primacy to the contract and distinguished the multi-factorial test applied in *Hollis v Vabu Pty Ltd* as confirmed in *On Call*. Moreover, primacy to the contract has also been given by the High Court in *CFMMEU v Personnel Contracting* and *ZG Operations v Jamsek*.

Conclusion

The distinction between who is an employee and who is an independent contractor has had a number of important recent developments. There is a definite trend away from the multi-factorial test (and prior to that, away from the master–servant control test) towards focusing on the terms of the contract as reflected in the majority decisions in *WorkPac v Rossato Pty Ltd, CFMMEU v Personnel Contracting* and *ZG Operations v Jamsek*.

There are numerous tax and other factors that depend on the critical distinction of who is an employee versus who is a contractor. So much so that the severity of the penalties, human resource and reputational damage can result in the downfall of a business. Given these recent developments, it is particularly important now for all businesses and advisers to examine their situations.

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1 See *Hollis v Vabu Pty Ltd* [2001] HCA 44 (*Hollis*), and *On Call Interpreters and Translators Agency Pty Ltd v FCT (No. 3)* [2011] FCA 366.

2 See *WorkPac Pty Ltd v Rossato* [2021] HCA 23, *Construction, Forestry, Maritime, Mining and Energy Union v Personnel Contracting Pty Ltd* [2022] HCA 1, and *ZG Operations Australia Pty Ltd v Jamsek* [2022] HCA 2 (*ZG Operations v Jamsek*)

3 [2020] FCAFC 118.

4 [2020] FCAFC 119.

Alternative Assets Insights

by Matthew Sealey, FTI, PwC

NSW duties: significant law changes

New legislation has been enacted in New South Wales which makes some important amendments to the NSW duties, land tax and tax administration provisions.

Introduction

The *State Revenue and Fines Legislation Amendment (Miscellaneous) Act 2022* (the amending Act), which amends the *Duties Act 1997* (NSW), the *Land Tax Management Act 1956* (NSW) and the *Taxation Administration Act 1996* (NSW), received royal assent on 19 May 2022.

Some of the significant amendments which commenced on the date of assent include:

- imposing duty on certain transactions that result in a change of beneficial ownership of dutiable property;
- charging duty on an acknowledgment of trust;
- providing for a refund of foreign purchaser surcharge duty/surcharge land tax in relation to a transfer of land if, after the transfer, the land is used by the transferee wholly or predominantly for commercial or industrial purposes;
- introducing a new anti-avoidance regime into the *Taxation Administration Act 1996* that will cover a range of NSW taxes; and
- increasing the base rate of penalty tax for "significant global entities" from 25% to 50%.

These amendments represent some of the most important changes we have seen in NSW in relation to state taxes in recent years. The amendments will significantly broaden the types of transactions that are subject to stamp duty, and this increased breadth has the potential to create uncertainty in relation to exactly which additional transactions will now be dutiable. However, it is not all bad news for taxpayers as there is a helpful amendment that should assist foreign purchasers of residential land.

A *Legislation Amendment Act 2022 guide* has been released on the Revenue NSW website to accompany the changes (the guide).[1] This provides a useful guide to the way in which Revenue NSW will administer these new laws in practice.

Overview of the amendments

Change of beneficial ownership

A key amendment is the introduction of a broad new type of dutiable transaction which captures any other transactions "that result in a change in beneficial ownership of dutiable property". A "change in beneficial ownership" is widely drafted to include the creation or extinguishment of dutiable property, a change in equitable interests in dutiable property, and dutiable property becoming or ceasing to be the subject of a trust. Because this new dutiable transaction is so broad, there are a series of specifically identified transactions that are excluded from its ambit, including (but not limited to) certain transactions related to units in unit trust schemes (noting that these may be subject to the separate landholder duty regime) and the grant of certain interests in land for no consideration. There is also the ability for additional classes of transactions to be subsequently excluded by regulations. Surcharge purchaser duty (which applies to foreign purchasers of residential land) will not apply to transactions that are taxed as a "change in beneficial ownership".

The new provision seems largely modelled off the Victorian equivalent. However, unlike in Victoria, there is no exclusion for the grant of an option. That the grant of an option will now be dutiable in NSW has been confirmed by the guide, which states that such a transaction is required to be lodged and duty paid, calculated with reference to the option fee. Furthermore, premium transfer duty may be payable if the option relates to residential property with a value greater than the relevant premium duty threshold.

Unfortunately, there is no crediting mechanism (such as the type that exists in other states) that allows for a credit for the duty paid on the grant of an option against the transfer duty payable on the agreement formed by its exercise. This gives rise to the potential for double duty on the same economic transaction (ie the acquisition of the land).

It is also noted that the guide provides that, if the call option is not exercised, a refund of duty will not be issued for duty paid on the grant of an option. Whether or not a refund of duty would be available where an option is cancelled or rescinded before exercise remains to be seen, as the existing provisions which provide for a refund on a cancelled agreement have not been extended to options.

Taxpayers should also be aware that an alteration in the entitlements of beneficiaries of fixed non-unitised trusts that hold dutiable property may now attract duty, to the extent that such alterations effect a change in the equitable interests in the trust property. There are numerous other examples of transactions which previously may not have been thought to attract duty that may be captured by the new provisions.

Finally, for this measure, there is a transitional rule which provides that the new provisions should not apply to a transaction following commencement if it occurs in accordance with an agreement or arrangement entered into before commencement. As noted above, the date of commencement of the new provisions was the date that royal assent was received, being 19 May 2022.

Acknowledgment of trust

Another amendment is the introduction of a new type of dutiable transaction whereby "an acknowledgment of trust" in relation to dutiable property will be a dutiable transaction. An "acknowledgment of trust" broadly means a statement that purports to be a declaration of trust, but merely has the effect of acknowledging that identified property vested/to be vested is already held. This goes beyond the type of "declaration of trust" of dutiable property that is currently subject to duty and could, by virtue of its broad application, tax situations where there is no change in the rights of any party relating to the property. This amendment was made in response to the Supreme Court decision of *Chief Commissioner of State Revenue v Benidorm Pty Ltd*,[2] where it was determined that, although a declaration of trust is identified as a dutiable transaction, it will not attract duty unless it actually effects a transaction.

The guide provides that the new provision will capture the "making of a statement that has the effect of acknowledging that identified property vested, or to be vested, in the person making the statement is already held, or to be held, in trust for a person or purpose mentioned in the statement".

Surcharge purchaser duty will be payable if the trustee of the trust is a foreign person and the dutiable property is residential-related property.

The new provision means that care should now be taken when entering into "routine" documents that, for example, amend trust deeds, and in which a statement as to the trustee capacity of a contracting party is made (even where that statement has no substantive effect on the interests of anyone).

Revenue NSW has indicated that further guidance is intended to be provided regarding examples of common situations in "routine" documents that Revenue NSW will not be seeking to impose duty on. However, this has not been included in the materials published to date.

From a policy perspective, the "acknowledgment of trust" amendment is concerning as its effect seems contrary to the overall purpose of the duties legislation (as identified in recent Supreme Court decisions, including *Benidorm*) which is to tax transactions/changes in rights, rather than documents.

Foreign purchaser surcharge duty/foreign surcharge land tax

Helpfully, the amendments introduce a refund mechanism which enables surcharge duty paid in relation to a transfer of land to be refunded if, after the transfer, the land is used by the transferee wholly or predominantly for commercial or industrial purposes. Any such surcharge duty paid can be refunded if the application is made within 12 months after the "entitling event", being "the start of the use of the land wholly or predominantly for commercial or industrial purposes". A similar mechanism has been introduced into the land tax legislation so as to refund any surcharge land tax paid on land which is subsequently used for a commercial or an industrial purpose.

These are welcome amendments as they make it clear that residential land acquired for a future commercial or industrial use is not intended to be ultimately subject to surcharge taxes. The second reading speech to the amending Act recognises the competitive disadvantage that taxes of this type impose on foreign investors who want to develop land which may be better used or intended for commercial or industrial use, and the adverse impact that it can have on the development of priority precincts in NSW.

For refund mechanisms of this type, the *Duties Act 1997* also provides the Chief Commissioner a power to grant an exemption in advance (rather than requiring payment and refund) for particular transactions or classes of transactions where they are satisfied that the entitlement to the refund is likely to arise in the future (ie that the use of the land for commercial/industrial purposes will be achieved within 10 years after the transfer). Practically, the exercise of this power is likely to require the provision of sufficient evidence to satisfy the Chief Commissioner that the intended change of use will occur and an undertaking to refund the money if the intended change of use is not ultimately achieved.

Penalty tax

Amendments to the *Taxation Administration Act 1996* have doubled the base rate of penalty tax payable for a tax default by a significant global entity as defined by the *Income Tax Assessment Act 1997* (Cth) from 25% to 50%. A "significant global entity" is broadly an entity that has an annual global income of $1b or more, or is a member of a group of entities that is actually consolidated for accounting purposes or would be required to consolidate for accounting purposes as a single group if the members of the group were assumed to be a listed company and were not affected by the accounting exceptions for consolidation or materiality, whose annual global income for the period is $1b or more.

The Chief Commissioner will publish guidelines outlining circumstances in which no penalty tax is payable for a tax default.

General anti-avoidance provisions

The duty avoidance provisions in the *Duties Act 1997* which deter schemes to avoid duty have been broadened and migrated to the *Taxation Administration Act 1996* so that they now extend to schemes for the avoidance of all kinds of state tax liabilities (including payroll tax and land tax), rather than only a liability to pay duty. Notably, the definition of "avoid" in the amended provisions has been broadened to include the postponement or deferral of tax.

New provisions have also been introduced to prohibit the promotion of tax avoidance schemes, and which provide for the ordering of civil penalties and the making of injunctions in relation to proposed breaches of the prohibition. These provisions are similar to the anti-tax promoter provisions enacted by the Commonwealth.

It remains to be seen how these broadened avoidance provisions will be actively administered. It is noted however that the second reading speech to the Act stated that "it is not the intention of the Government to start chasing large numbers of taxpayers for avoidance. The chief value of such provisions lies in their deterrent effect".

The takeaway

The amending Act represents a significant broadening of the types of transactions subject to stamp duty in NSW, as well as making important changes to the anti-avoidance and penalty tax provisions that apply to all NSW state taxes.

Taxpayers and their advisers need to be aware of the effect of these changes, and to properly understand the impact that they have on transactions entered into on or after 19 May 2022.

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1 Available at www.revenue.nsw.gov.au/electronic-duties-for-professionals/professionals-resources/duties-technical-guides/legislation-amendment-act-2022-guide.

2 [2020] NSWCA 285.

Events Calendar

Upcoming months

JULY
21–22
Thu–Fri

VIC

Yarra Valley Tax Retreat

12 CPD hours

JULY
28–29
Thu–Fri

ACT

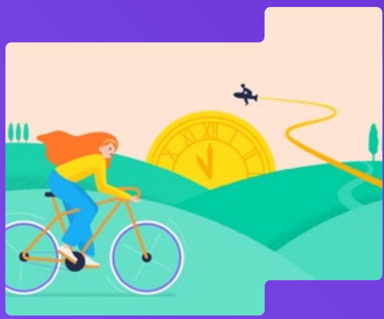
State Taxes Convention

12 CPD hours

AUGUST
10–12
Wed–Fri

SA

Barossa Convention



12 CPD hours

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Giving back to the profession

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