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The Tax Institute

Taxation in Australia

Resolving transfer pricing disputes
Tamara Phillips and Anthony Seve

UK pension transfers: part 2
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Duties: land-owning unit trusts
Craig Milner, CTA, and Tom Tian, ATI

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Invitation to write

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

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Tax News – at a glance

by TaxCounsel Pty Ltd

November – what happened in tax?

The following points highlight important federal tax developments that occurred during November 2022. A selection of the developments is considered in more detail in the "Tax News – the details" column on page 308 (at the item number indicated).

Public register of beneficial ownership

The government has released a consultation paper in relation to the first phase of its proposal to introduce a public register of beneficial ownership to record who ultimately owns, controls and receives benefits from a company or legal vehicle operating in Australia. **See item 1.**

2022–23 Budget

The Treasurer handed down the updated Federal Budget on 25 October 2022. The tax highlights are set out. **See item 2.**

ABN reforms

Exposure draft legislation and explanatory materials relating to the previous government's proposal to strengthen the Australian business number (ABN) system (to target misuse, enhance the quality of ABN data, and improve ABN holder engagement and compliance) have been released. **See item 3.**

Working from home deductions

The Commissioner has released a draft practical compliance guideline that sets out a revised fixed rate method for claiming working from home deductions (available from 1 July 2022) (PCG 2022/D4). **See item 4.**

Residency tests for individuals

The Commissioner has issued a draft ruling that outlines the residency tests for individuals for tax purposes as set out in s 6(1) of the *Income Tax Assessment Act 1936* (Cth) and his view on when a person will be a resident of Australia (TR 2022/D2). **See item 5.**

Property held in one spouse's name

The Full High Court (Keifel CJ, Gageler, Gordon, Edelman and Glesson JJ) has unanimously allowed an appeal from the Full Federal Court and held that the appellant (Ms Bosanac) did not hold half of her interest in a residential property on trust for her husband (Mr Bosanac) where the purchase money was paid jointly by Ms and Mr Bosanac (*Bosanac v FCT* [2022] HCA 34). **See item 6.**

Iceland DTA

On 12 October 2022, the government signed a tax treaty with Iceland, the first of its kind between the two nations. Once in force, the treaty will facilitate cross-border trade and investment and enhance the economic relationship between Australia and Iceland.

Value of goods taken from stock: 2022–23

The Commissioner has released a taxation determination that provides an update of amounts that he will accept as estimates of the value of goods taken from trading stock for private use in the 2022–23 income year by taxpayers in named industries (TD 2022/15).

Residence: individual

The AAT has rejected an individual taxpayer's contention that, although he was born in Australia and was a resident before the 2016 income year and was a resident after that income year, he was not a resident for the 2016 income year during which he worked under short-term contracts for a total of 279 days as a chef on a Norwegian cruise liner (*Duff and FCT* [2022] AATA 3675).

Tax Practitioners Board changes

The government has released exposure draft legislation and accompanying explanatory material on a number of recommendations of the Tax Practitioners Board (TPB) Review.

The proposed amendments that are the subject of the draft legislation relate to:

- amending the object clause of the *Tax Agent Services Act 2009* (Cth) (TASA) to make it more contemporary and better aligned with the TPB's role and responsibilities;
- enhancing the TPB's financial independence by establishing a Special Account;
- amending the TASA to strengthen the disclosure requirements to require tax practitioners to not employ or use disqualified entities in the provision of tax agent services without approval from the TPB;
- converting the three-year registration cycle to annual registration to align with the TPB's administrative annual declaration process; and
- amending the TASA to give the relevant minister the power to supplement the TASA's Code of Professional Conduct to address emerging or existing behaviours and practices.

President's Report

by Jerome Tse, CTA

This year's achievement and future opportunities

Our work throughout the year sets the Institute up for future growth, writes President Jerome Tse.

2022 has been a huge year for the Institute, bringing with it much change, development and investment for years to come.

I have been proud to represent The Tax Institute's community as President throughout 2022 and to engage with our members in this capacity. Our organisation and the tax industry continue to face unique challenges, including regulatory uncertainty, technological change and resourcing dilemmas. The Institute continues to grow, thanks in no small part to the efforts and generosity of our members and volunteers. Thank you for your support.

A big thank you also to Giles, our committee members, volunteers and staff, all of whom remained dedicated and engaged throughout a year that has continued to be challenging in many ways.

I was also pleased to announce at our AGM that Marg Marshall, CTA will be taking up the mantle of President of The Tax Institute in 2023, while Todd Want, CTA steps up as Vice President. We could not ask for two more dedicated and talented representatives to lead the Institute. I wish Marg and Todd all the best and look forward to seeing their impact in making the Institute more relevant to you and your practices.

In my role as President and working with our National Council, we have been looking ahead to tomorrow's issues and opportunities so we can invest in our organisation's future. While there has been much work in this area, three major initiatives come to mind.

Developing Tax Academy for further learning opportunities

Tax Academy, our new micro-credential education program, is an exciting new opportunity for us to bring tax knowledge to a wider audience and to meet the needs of a new generation of learners. Set to launch early next year, preparing Tax Academy has been a 2+ year journey, with significant investment by The Tax Institute, both financially and from a people perspective. It's no small feat to introduce a brand new way of learning into the mix of what we do and my congratulations go to all involved.

Tax Academy will give our members the opportunity to brush up on specialist skills or knowledge areas in a detailed and structured way, without embarking on a full education program. This kind of specialised learning opens doorways and grows careers. I'm excited that the Institute will soon be facilitating it in this new way.

Increased management of governance and risk

Governance and risk management is a key part of any organisation, especially as they become larger and more complex. Our increased focus in this area over the last year or two is a sure sign that the Institute is growing and developing in positive ways.

We finished the 2021–22 financial year by appointing the Institute's first independent chair, Clare Mazzetti. I have been able to work closely with Clare and I am confident that our members and our organisation are in safe hands with her.

Making diversity and inclusion an official part of the Institute

At the beginning of the year, I pinpointed diversity and inclusion as an area that I wanted to focus on during my presidency. This is something that is not only very close to my heart, but it also makes us better as a community and as an organisation. The Tax Institute, like the tax community, wouldn't be the same without the people involved and it's vital that we have voices from all walks of life at the table. The institute must reflect the community that it represents and serves.

I was very proud to introduce a formal diversity and inclusion policy this year. While this official policy is a great start, it is just the start. I challenge all of us to continue this journey, whether as a part of The Tax Institute, in our workplaces or at home.

The end of the year does not mean the end of our work. Other major projects and initiatives for the Institute's future are still underway. We continue to advocate for holistic tax reform and, in the meantime, good and sensible tax policy. We continue our positive engagement with government and regulators. We continue to deliver quality tax education, resources and events to our members and beyond.

As I sign off for 2022, I look forward to seeing our board continue its efforts to represent our members, shape the future of the tax profession, and continually improve the tax system for the benefit of all. We are a wonderful organisation and I am honoured to be a part of The Tax Institute team now and in the future.

CEO's Report

by Giles Hurst

A year of investment in the Institute

In 2022, we have planted the seeds of success, writes CEO Giles Hurst.

While it may not have brought with it the same level of challenges as the previous two years, 2022 has been a significant year in its own ways. Not only have we continued to navigate the world of working alongside COVID-19, but for the Institute, we have also planted the seeds of plans that will see us through sustainable growth for years to come.

As we close out the year and look forward to a new one, I'd like to thank everyone who supported and came along on the journey with us, including our wonderful members, volunteers and staff. Special thanks go to our outgoing President, Jerome Tse, who will wrap up his tenure at the end of this year.

Jerome has led the Institute through a year that saw us invest heavily in ourselves – our organisation and our people. He has approached the role with a clear vision and a genuine enthusiasm for the tax community, the Institute and everyone it touches. For many years, Jerome has been an advocate for the Institute and everything we stand for. His presidency allowed him to take that advocacy to a new level and he has had a significant impact on our work. Thank you, Jerome.

To Marg Marshall, CTA and Todd Want, CTA, who have been elected President and Vice President, respectively, for 2023, my heartfelt congratulations. Marg and Todd have been active members of the Institute for many years and instrumental in many of our successes. I trust that they will continue along the path of growth and development that we have embarked on.

As Jerome has said in his report, we have spent this last year focusing on some key milestones in our development and laying the groundwork for further success in the future. In 2023 and the years that follow, we will have the exciting opportunity to see these investments bear fruit.

Jerome has mentioned three of the key projects we undertook this year. There are many more, some big and some small, but all with value to our continued operation.

Of particular note for me, this financial year has seen our new website and new branding launch publicly. In an increasingly digital world, this was a crucial update that allows our organisation to move confidently forward. It also makes a huge impact on our members, allowing them to access their benefits, tools and resources through a digital platform that is capable of growing and improving over the years.

In the events space, we successfully delivered over 100 events throughout the year, despite ongoing challenges in regard to travel and face-to-face gatherings. We know these events are important to our members not only for their professional development value, but also for the chance to connect with the tax community on common ground. From the major undertaking of The Tax Summit to the familiarity of the Local Tax Clubs, our event calendar is an incredible feat of organisation, enthusiasm and expertise. I'm very proud we were able to continue offering these opportunities for members this year.

Another very important investment that you may not be aware of as a member is our investment into the wellbeing of our people. When I talk about "our people", I mean our extensive network of volunteer committee and council members, speakers, contributors and, of course, our staff who make the Institute run on a daily basis.

We have invested in training to further enhance the skills and abilities of our staff and are committed to creating a workplace where our people feel valued, respected and safe, and one that is inclusive and values and embraces diversity. This is a point of pride for me, as I know it is for many in leadership positions at the Institute.

There are many more projects from this year that will continue on into the new year. It is an exciting time at the Institute because, with some important work now behind us, we are in a position to continue long-term, ongoing work and embark on new projects to continue the evolution of the Institute. Our investment in major projects over the financial year is a sign that, despite a challenging operating environment, we are continuing to change and ready the Institute for future stability. The benefit of these investments will certainly be seen in future years.

I hope you have time off scheduled over the holiday season and that you are able to rest, recharge and join us again in 2023 feeling energised. The seeds of success have been planted at the Institute and we are all eagerly looking forward to what grows from them.

Tax Counsel's Report

by Julie Abdalla, FTI

Looking back on 2022

We take stock of the key events of 2022 to better understand the upcoming challenges Australia faces and how we can best prepare for them.

2022 has been a year of changes and challenges. Australians tried to settle into the "new normal" after more than two years of back-to-back disasters and a global pandemic. Individuals and businesses were also pressured by a number of factors, such as increasing costs of living, economic uncertainty, global geopolitical instability, and skilled labour shortages. In this context, we saw notable changes and challenges to our taxation and superannuation systems.

Election and two Budgets

In May, Australia went to the polls where the Labor Party formed a majority government for the first time since 2007. The new government has since taken steps to give effect to their election priorities, as seen in the Updated Federal Budget 2022–23 (updated Budget).

The updated Budget saw an emphasis placed on addressing the costs of living, tax integrity measures impacting multinationals, and an extension of the ATO's compliance-based funding model. The approach had some similarities with the Federal Budget 2022–23, which introduced measures to assist Australians with the cost of living and to encourage business investment through measures such as the small business "boosts". Unfortunately, no attempts were made to undertake comprehensive taxation and superannuation reform.

The new government was tasked with managing the extensive backlog of announced but unenacted measures (ABUMs). The Tax Institute's Incoming Government Brief prioritises the ABUMs to assist government in determining the most appropriate pathway to benefit the system overall.

Non-arm's length income

A key ABUM is the former government's announcement to address the significant and disproportionate outcomes that are inherent in the current legislation for non-arm's length income (NALI). The NALI rules were introduced to deter superannuation funds from entering into schemes to increase member balances through non-arm's length arrangements that resulted in excessive income or not charging expenses. As highlighted in submissions to government in September 2021 and December 2021, the current regime will likely result in penalty rates being applied to fund members for minor or inconsequential breaches.

Taxation of digital assets

There were some positive steps taken towards improving the operation of our taxation system. The Board of Taxation's (Board's) review of the tax treatment of digital assets and transactions in Australia will hopefully mark the beginning of much-needed changes to clarify tax outcomes for a class of assets that our legislative regime likely did not envisage. As highlighted in the submission by The Tax Institute and other professional bodies, there are numerous issues in this field which will likely need to be resolved through a combination of legislative amendments, changes to the ATO's administration, and further collaboration on an ideal future framework.

Section 100A

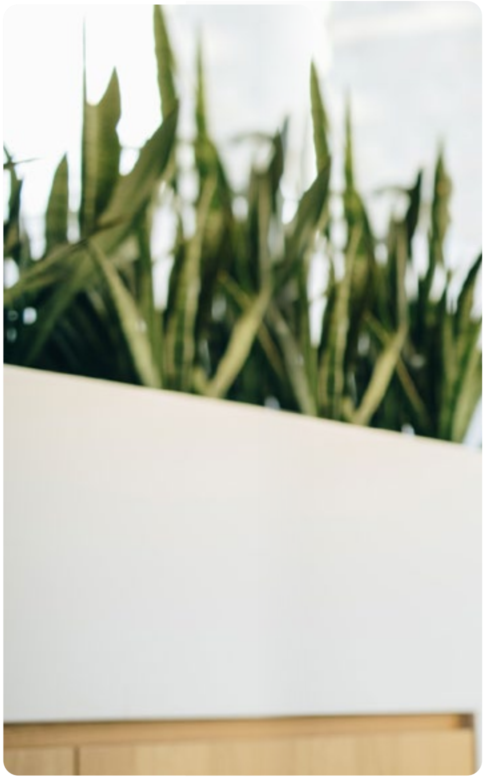
The ATO also released an array of draft guidance on s 100A, including a draft ruling and a draft practical compliance guideline (PCG). The draft ATO guidance marked a significant shift for many tax practitioners in the ATO's compliance approach to reimbursement agreements and provided examples of the ATO's views in relation to key concepts, such as "ordinary family and commercial dealings". The concerns around the draft guidance were relayed to the ATO in our submissions regarding the draft ruling, draft PCG, and subsequent conversations. These have resulted in proposed changes to the some of the risk zones in the draft guideline and the inclusion of further guidance and examples.

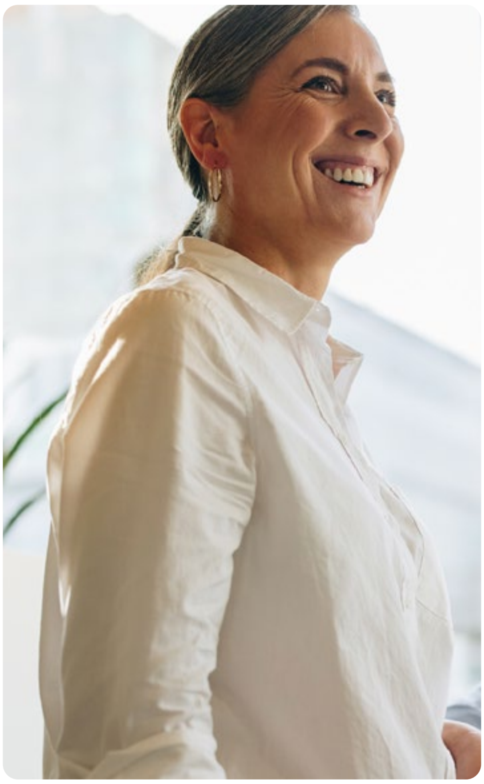
Importance of consultation

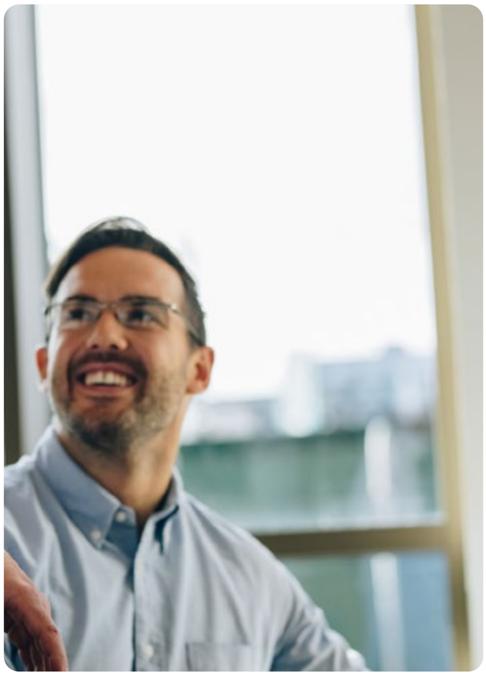
A key theme throughout the year has been the importance of consultation with government bodies. There have been numerous concerns identified with other government proposals this year, including the exposure draft legislation concerning franked distributions, and the consultation concerning the government's multinational election priorities. Consultation has also occurred on key aspects in the way taxpayers and tax practitioners interact with the ATO, such as the review into the Taxpayer's Charter, the ATO's management of objections and their exercise of the general powers of administration. Consultations are needed to ensure that legislation and administration is equitable and efficient.

Moving into 2023

Although 2023 is likely to continue to provide many economic challenges, we look forward to resolving outstanding issues and ensuring that new proposals are appropriate in scope and operation. 2023 will also provide us with the opportunity to push for comprehensive taxation and superannuation reform.







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The Tax Institute

22-027EDU_11/22

Tax News – the details

by TaxCounsel Pty Ltd

November – what happened in tax?

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

Government initiatives

1. Public register of beneficial ownership

The government has released a consultation paper in relation to the first phase of its proposal to introduce a public register of beneficial ownership to record who ultimately owns, controls and receives benefits from a company or legal vehicle operating in Australia.

Making the beneficial ownership information available on a public register is intended to increase transparency and discourage the use of complex structures that avoid legal requirements and obscure tax liabilities. The consultation paper states that, currently, Australia is not ranked highly against international benchmarks for the collection and disclosure of beneficial ownership information.

Ultimately, the register is intended to support stronger regulatory and law enforcement responses to tax and financial crime, assist foreign investment applications, and facilitate the enforcement of sanctions. Implementation of a beneficial ownership register would broadly align Australia with international approaches to transparency of beneficial ownership information.

The government's beneficial ownership commitment and the proposals in the consultation paper are intended to complement other initiatives in the government's multinational tax integrity package to address the tax avoidance practices of multinational enterprises, including its recent consultation on multinational tax integrity and tax transparency.

As indicated, the government proposes to adopt a phased approach to implementing beneficial ownership disclosure requirements. Under the first phase, specified unlisted entities regulated under the *Corporations Act 2001* (Cth) would be required to maintain accurate, up-to-date and publicly accessible beneficial ownership registers. The relevant entities would include proprietary companies, unlisted public companies, unlisted registered managed investment schemes, and unlisted corporate collective investment vehicles.

2. 2022–23 Budget

The Treasurer handed down the updated Federal Budget on 25 October 2022. The following are the tax highlights.

Depreciation: intangible assets

The government will not proceed with the measure (announced in the 2021–22 Budget) to allow taxpayers to self-assess the effective life of intangible depreciating assets.

Digital currency

Legislation is to be introduced to clarify that digital currencies (such as Bitcoin) continue to be excluded from the Australian income tax treatment of foreign currency. The exclusion does not apply to digital currencies issued by, or under the authority of, a government agency, which continue to be taxed as foreign currency.

ATO compliance programs

Funding is to be provided to enable the following ATO compliance programs to be extended:

- personal income tax (by two years);
- the shadow economy (by three years); and
- the tax avoidance taskforce (by four years).

Off-market share buy-backs

The tax treatment of off-market share buy-backs undertaken by listed public companies is to be aligned with the treatment of on-market share buy-backs, with effect from 7:30 pm AEDT 25 October 2022.

COVID-19 business grants

In response to the COVID-19 pandemic, payments from certain state and territory business grants, made prior to 30 June 2022, can be made non-assessable non-exempt (NANE) for income tax purposes, subject to eligibility. This tax treatment is only provided in exceptional circumstances, such as the severe economic consequences facing businesses during the pandemic. The government has made a number of state and territory COVID-19 grant programs eligible for NANE treatment, which will exempt eligible businesses from paying tax on these grants.

Thin capitalisation rules

For income years commencing on or after 1 July 2023, the thin capitalisation rules are to be strengthened.

The current thin capitalisation regime limits debt deductions to the maximum of three different tests: a safe harbour (debt to asset ratio) test; an arm's length debt test; and a worldwide gearing (debt to equity ratio) test. The government will replace the safe harbour and worldwide gearing tests with earnings-based tests to limit debt deductions in line with an entity's activities (profits).

The proposed changes include the following:

- limiting an entity's debt-related deductions to 30% of profits (using EBITDA (earnings before interest, taxes, depreciation and amortisation) as the measure of profit). This new test will replace the safe harbour test;

- allowing deductions denied under the entity level EBITDA test (interest expense amounts exceeding the 30% EBITDA ratio) to be carried forward and claimed in a subsequent income year (up to 15 years);
- allowing an entity in a group to claim debt-related deductions up to the level of the worldwide group's net interest expense as a share of earnings (which may exceed the 30% EBITDA ratio). This new earnings-based group ratio will replace the worldwide gearing ratio; and
- retaining an arm's length debt test as a substitute test which will apply only to an entity's external (third-party) debt, disallowing deductions for related-party debt under this test.

The changes are to apply to multinational entities operating in Australia and any inward or outward investor, in line with the existing thin capitalisation regime. Financial entities will continue to be subject to the existing thin capitalisation rules.

Intangibles held in low- or no-tax jurisdictions

An anti-avoidance rule (to apply to payments made on or after 1 July 2023) is to be introduced to prevent significant global entities (with a global revenue of at least $1b) from claiming tax deductions for payments made directly or indirectly to related parties in relation to intangibles held in low- or no-tax jurisdictions. For the purposes of this measure, a low- or no-tax jurisdiction is a jurisdiction with a tax rate of less than 15% or a tax preferential patent box regime without sufficient economic substance.

Electric car discount

From 1 July 2022, battery, hydrogen fuel cell and plug-in hybrid electric cars will be exempt from FBT and import tariffs if they have a first retail price below the luxury car tax threshold for fuel-efficient cars. The car must not have been held or used before 1 July 2022.

Improved tax transparency

Reporting requirements will be introduced for relevant companies to enhance the tax information that they disclose to the public, for income years commencing from 1 July 2023. Under the new reporting rules:

- large multinationals (significant global entities) will be required to prepare for public release certain tax information on a country-by-country basis and a statement on their approach to taxation, for disclosure by the ATO;
- Australian public companies (listed and unlisted) will be required to disclose information on the number of subsidiaries and their country of tax domicile; and
- tenderers for Australian Government contracts worth more than $200,000 will be required to disclose their country of tax domicile (by supplying their ultimate head entity's country of tax residence).

Announced changes not proceeding

A number of legacy tax and superannuation measures that were previously announced but not legislated for by the previous government will not be proceeding. These include:

- the proposal to amend the debt/equity tax rules (*2013–14 Mid-year economic and fiscal outlook* (MYEFO));
- the proposed changes to the taxation of financial arrangements (TOFA) rules (2016–17 Budget);
- the proposed changes to the taxation of asset-backed financing arrangements (2016–17 Budget);
- the proposed introduction of a new tax and regulatory framework for limited partnership collective investment vehicles (2016–17 Budget);
- the proposed changes to the annual audit requirement for certain self-managed superannuation funds (SMSFs) (2018–19 Budget); and
- the proposed introduction of a limit of $10,000 for cash payments made to businesses for goods and services (2018–19 Budget).

Announced changes being deferred

The following legacy tax and superannuation measures that were announced but not legislated by the previous government are to be deferred:

- the proposed introduction of a sharing economy reporting regime (2019–20 MYEFO);
- the proposed relaxation of the residency requirements for SMSFs (2021–22 Budget); and
- the making of technical amendments to the TOFA rules (2021–22 Budget).

Penalty unit

The amount of a penalty unit for the purposes of Commonwealth laws is to increase from $222 to $275 from 1 January 2023.

Foreign investment: residential land penalties

The government has increased foreign investment fees and will increase financial penalties for breaches that relate to residential land. Fees doubled on 29 July 2022 for all applications made under the foreign investment framework. The maximum financial penalties that can be applied for breaches in relation to residential land will also double on 1 January 2023.

3. ABN reforms

Exposure draft legislation and explanatory materials relating to the previous government's proposal to strengthen the Australian business number (ABN) system (to target misuse, enhance the quality of ABN data, and improve ABN holder engagement and compliance) have been released.

Under the proposed changes, the ABN Registrar (the Commissioner of Taxation) will be able to cancel a person's ABN in either of the following circumstances:

- where the person is required to lodge income tax returns but has failed to lodge returns for two or more income years and those returns remain outstanding; or
- where the person fails to confirm the accuracy of their details held by the Registrar in a 12-month period, together with confirmation that their ABN is still required.

These changes are being made in response to the *Black Economy Taskforce Final Report*.

The Commissioner's perspective

4. Working from home deductions

The Commissioner has released a draft practical compliance guideline that sets out a revised fixed rate method for claiming working from home deductions (available from 1 July 2022) (PCG 2022/D4).

Prior to 1 July 2022, to calculate a deduction for expenses incurred as a result of working from home, taxpayers have had the choice of using one of the following methods:

- the shortcut method;
- the fixed-rate method; or
- actual expenses, that is, calculating the actual expenses incurred as a result of working from home.

From 1 July 2022, taxpayers can continue to claim their actual expenses or, alternatively, they can use the revised fixed rate method outlined in PCG 2022/D4. The draft guideline should be read in conjunction with TR 93/30 which explains when working from home expenses are deductible.

PCG 2022/D4 does not cover occupancy expenses such as rent, mortgage interest, property insurance and land tax.

Revised fixed-rate method

The revised fixed-rate method apportions the following additional running expenses that a taxpayer incurs on a fair and reasonable basis by using a fixed rate of 67c per hour for each hour that the taxpayer worked from home during the income year:

- energy expenses (electricity and/or gas) for lighting, heating/cooling and electronic items used while working from home;
- internet expenses;
- mobile and/or home telephone expenses; and
- stationery and computer consumables.

This means that a taxpayer cannot claim an additional separate deduction for any of these expenses. For example, if the taxpayer uses their mobile phone when working from home and when working from somewhere other than their home, the taxpayer's total deduction for mobile phone expenses for the income year will be covered by the hourly rate of 67c per hour.

Adequate records of hours worked from home would need to be kept.

Additionally, a deduction would be allowable for the work-related decline in value of any depreciating assets that the taxpayer used to work from home during the income year and any other running expenses that the taxpayer incurred.

The draft guideline provides a number of illustrative examples.

5. Residency tests for individuals

The Commissioner has issued a draft ruling that outlines the residency tests for individuals for tax purposes as set out in s 6(1) of the *Income Tax Assessment Act 1936* (Cth) and his view on when a person will be a resident of Australia (TR 2022/D2).

TR 2022/D2 explains that the definition of "resident of Australia" has four alternative tests. An individual is a resident if they meet any one (or more) of the tests but a non-resident if they do not meet any of the tests.

TR 2022/D2 further explains that residency under the first three tests is determined by considering all of the individual's relevant facts and circumstances. No single fact determines the outcome and the significance of facts varies from case to case. Because of this, there are no "bright-line rules" or any single factor that can be said to be paramount.

TR 2022/D2 also explains that:

- residency is about an individual's connection to Australia; and
- for tax purposes, an individual can be a resident of more than one country at the same time.

Each residency decision turns on its facts. While court and tribunal decisions provide illustrations of how the court or tribunal has considered and weighed facts, an outcome in one case does not govern the outcome in a different case, even where the facts are similar.

Similarly, the examples in TR 2022/D2 are provided to illustrate a point. Having similar facts to those in an example will not always result in the same outcome. Differences in intention, motivations and life circumstances may produce different outcomes.

Recent case decision

6. Property held in one spouse's name

The Full High Court (Keifel CJ, Gageler, Gordon, Edelman and Glesson JJ) has unanimously allowed an appeal from the Full Federal Court and held that the appellant (Ms Bosanac) did not hold half of her interest in a residential property on trust for her husband (Mr Bosanac) where the purchase money was paid jointly by Ms and Mr Bosanac (*Bosanac v FCT*[1]).

The relevant facts arose out of the purchase by Ms Bosanac of a residential property in Perth (the Dalkeith property) in 2006. She and Mr Bosanac had married in 1998. They separated in 2012 or 2013 but continued to reside together at the Dalkeith property until September 2015, when Mr Bosanac moved to a new residential address.

It appeared that Ms Bosanac instigated the purchase of the Dalkeith property. In April 2006, she offered to purchase it for $4,500,000, subject to her obtaining approval for a loan of $3,000,000 from a bank. The offer was accepted in May 2006. The contract for sale required Ms Bosanac to pay a deposit of $250,000 within 30 days. The deposit was provided from an existing joint loan account in the names of Ms and Mr Bosanac.

In October 2006, Ms and Mr Bosanac applied for two loans in the sums of $1,000,000 and $3,500,000. The balance of the purchase price was paid from two loan accounts in their joint names and, after settlement, the surplus funds in these accounts were paid into the joint loan account from which the deposit had been drawn. The Dalkeith property was registered in Ms Bosanac's name alone. Mr Bosanac had never claimed an interest in the Dalkeith property.

The securities required by the bank for the loans were mortgages over the Dalkeith property and three other properties – units at Mount Street and a property at Hardy Street. The unit at 10/41–43 Mount Street was owned by Mr Bosanac. Ms Bosanac owned the Hardy Street property. The Dalkeith and Hardy Street properties were used as securities again almost a year later when the loans were refinanced.

The Commissioner had obtained judgment against Mr Bosanac for a considerable amount of tax (approximately $9.3m) and, relying on the presumption of resulting trust, sought a declaration from the Federal Court that the Dalkeith property was in equity jointly owned by him.

At first instance, McKerracher J held that the evidence did not support an inference that Mr Bosanac intended to have an interest in the Dalkeith property, and the presumption of advancement stood unrebutted. In that regard, his Honour observed that, at the time of the registration of the property in Ms Bosanac's name, Mr Bosanac was a sophisticated businessman, a "self-styled venture capitalist", who must have appreciated the significance of the name in which real property was held.

The Full Federal Court unanimously allowed the Commissioner's appeal. Their Honours held that the presumption of advancement was liable to be displaced or rebutted by evidence, including evidence of the nature of the particular transaction. There were facts which the Full Federal Court said tended strongly against the presumption and in favour of a trust being intended by both Ms and Mr Bosanac: Mr Bosanac assumed a substantial liability without acquiring any beneficial interest; the Dalkeith property was intended to be the matrimonial home for the joint use and benefit of Ms and Mr Bosanac; and the funds for the purchase came from joint borrowings. The Full Federal Court declared that Ms Bosanac held 50% of her interest in the Dalkeith property on trust for Mr Bosanac.

As indicated, the High Court has now unanimously allowed Ms Bosanac's appeal from the decision of the Full Federal Court.

The High Court held that the presumption of resulting trust will not arise where there is evidence from which it may be inferred that the parties' objective intention was inconsistent with the person who provided the purchase money obtaining an interest in a property. The "presumption" of advancement allowed an inference to be drawn from the fact of certain relationships, such as husband and wife, that the presumption of resulting trust will not arise. When evidence of the way in which the spouses deal with their property is given, inferences to the contrary of the presumption may readily be drawn.

Both presumptions cease to be of practical significance other than in a rare case where the totality of the evidence is incapable of founding an inference as to what the purchaser intended. The question of intention as to whether a trust arises is entirely one of fact, and the facts of the case before the court did not give rise to such an intention. The proper inference to be drawn from the objective facts was that the parties objectively intended Ms Bosanac to be the sole beneficial owner of the Dalkeith property, and that Mr Bosanac was merely facilitating Ms Bosanac's acquisition of the Dalkeith property.

It may be noted that the Commissioner invited the High Court to abolish the presumption of advancement as it had no acceptable rationale and was anomalous, anachronistic and discriminatory. The court refused, observing that the "presumption" of advancement was an entrenched "landmark" of the law in Australia.

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Reference

1 [2022] HCA 34.

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Tax Tips

by TaxCounsel Pty Ltd

Deceased estates: present entitlement issues

A recent decision of the NSW Supreme Court highlights some issues in relation to the present entitlement concept in the context of deceased estates.

Background

In *Walker v Walker*,[1] Richmond J considered a number of issues relating to the entitlement of a residuary beneficiary under a will, including the circumstances in which an entitlement to a part of the residue may arise. The decision arose in the context of the interpretation of a deed entered into by the residuary beneficiary under a will and an individual who was asserting a claim in relation to the deceased estate.

In the context of the issues raised for decision in the case, it is to be noted that the Commissioner's views on the income tax liabilities of executors or administrators, and of beneficiaries under the estates of deceased persons during the stages of administration of deceased estates, are set out in IT 2622.

This article considers the decision in the *Walker* case and notes some aspects of the Commissioner's ruling.

The parties to the litigation

In essence, the dispute in the *Walker* case raised the issue of the proper construction of the terms of a deed dated 4 September 2020 that was entered into by an individual who was in effect making a claim against a deceased estate and the residuary beneficiary under the deceased's will.

More particularly, the first defendant (Belinda) in the litigation before the Supreme Court was the sole residuary beneficiary under the will and codicil (the will) of her late husband, John Jeffrey Walker (John), who died on 6 August 2017. The plaintiff was David Alfred Walker (David) who was a brother of John and was not a beneficiary under the will.

The second defendant (Kate) was the sister of Belinda and she acted as her financial manager by an order of the NSW Civil and Administrative Tribunal made on 11 April 2018 and was appointed as Belinda's tutor in probate proceedings.

The facts

During his lifetime, John conducted a farming enterprise on a property at Yass, New South Wales, called "Tulla Park", which was owned as tenants in common in equal shares by two companies, Fred Walker (Yass) Pty Ltd (FWY) and Esdale Pastoral Company Pty Ltd (EPC). FWY and EPC purchased Tulla Park in 1987 and operated a primary production business in partnership on the property under the name "Lena Pastoral Co".

The issued shares of FWY and EPC comprised A class shares (preference shares with limited rights) and B class shares (ordinary shares). John held the A class shares in both companies. The B class shares in FWY were held by the trustees of a discretionary trust called the FJ Walker Trust, and the B class shares in EPC were held by a discretionary trust called the JJ Walker Trust. John and David (and their respective spouses) were discretionary objects of both the FJ Walker Trust and the JJ Walker Trust (the trusts).

On 30 June 2017, Belinda and the other trustees of the FJ Walker Trust signed a resolution which had the effect of advancing the vesting date of that trust to 30 July 2017. On the same day, Belinda signed a resolution in her capacity as the sole trustee of the JJ Walker Trust which had the effect of advancing the vesting date of that trust to 30 July 2017.

The effect of the vesting of each trust was that at the time of John's death on 6 August 2017, he was beneficially entitled to both the A class and B class shares in FWY and EPC. Given the rights attaching to the B class shares, the effect of the vesting of the two trusts was to cause a significant increase in the value of John's estate (in the order of $8m).

David's claim

David brought a claim against the administrators of the will (the administrators) that John's estate was not entitled to the assets of either trust because, at the time Belinda signed each resolution on 30 July 2017, she lacked legal capacity, and in those circumstances, the resolutions were of no effect and liable to be set aside. David's contention was that, if that claim was upheld, the assets of each trust would not be part of John's estate but would rather devolve to him.

John's will

Under the will, Belinda was one of five persons named as the executors. The effect of the dispositive provisions of the will was that a property at Narooma, NSW, was given to Kathryn Jane Berrell, a legacy of $500,000 was given to Yass Aged Care Trust, and the rest and residue of the estate was given to Belinda.

Belinda suffered from both multiple sclerosis and cognitive problems which led to Kate being appointed her tutor in probate proceedings brought against her by the other four executors under John's will. Those proceedings led to two mediations. The outcome of the second mediation (in September 2020) was that, on 4 September 2020, David and Belinda entered into a deed (the deed) which provided in cl 2 as follows:

> "2.2 [Kate] as Tutor and Financial Manager of Belinda will, within fourteen (14) days after the Administrators pay to her the residue of John's estate will [sic] make a payment to David Alfred Walker in the sum of $1,000,000.00.
>
> 2.3 Belinda's payments and entitlements in the deceased's Estate are charged for the purpose of securing the payments referred to in the above paragraph."

Under cl 3 of the deed, David gave a release in the following terms:

> "3.1 David unconditionally releases John's Estate from any and all Claims which he, but for this Deed, had and/or may have had in relation to the vesting of the Trusts and an assertion that John's Estate now holds assets of those Trusts on trust for those Trusts.
>
> 3.2 For the avoidance of doubt, on the receipt of the payment in clause 2.2 above, David will release and discharge Belinda and the FJ Walker Trustees and JJ Walker Trustees from any and all claims he has or might have had concerning the vesting of the FJ Walker Trust and the JJ Walker Trust, John's estate and Belinda's estate."

While David's claim was against John's estate and the trustees of the trusts, it was Belinda who received the release given by David, as the only parties to the deed were David and Belinda. Clause 3.2 therefore served the purpose of enabling Belinda to obtain a release from David in favour of the trustees of the trusts once the payment under cl 2.2 had been made.

Other factual matters

On 28 September 2017, FWY and EPC entered into a contract for the sale of Tulla Park for a price of $7,300,000 which completed on 9 November 2017. The capital gain realised on the sale was $6,054,662.

On 17 April 2019, Nexia Australia (Nexia) provided advice as to the availability of the CGT small business 15-year exemption (provided for in Div 152 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97)) in respect of the capital gain in light of the facts as they existed at the time of the sale. Nexia advised that the requirements in s 152-125 ITAA97 (Payments to company's or trust's CGT concession stakeholders are exempt) were satisfied in relation to Belinda as the "CGT concession stakeholder" in respect of the entirety of the CGT exempt amount so that the CGT exempt amount could be distributed to Belinda tax-free in her hands, provided it was made by 28 September 2019 (this being two years after the contract for the sale of Tulla Park).

A binding private ruling was obtained from the Commissioner in which, in exercise of the discretion conferred on him in that regard, the Commissioner extended the date for making the payment to Belinda to 30 June 2021.

On 8 June 2021, Belinda's solicitors sent a letter to the administrators' solicitors which stated relevantly that the distribution could only be made by the estate from Belinda's entitlement to the residuary estate, and that a failure to meet this requirement would result in the two companies automatically having, between them, a potential tax liability of $832,502.27. Thus, the administrators were told that there would be a very significant tax liability which would, one way or another, be borne by Belinda (as residuary beneficiary) if the CGT exempt amount was not distributed to her by 30 June 2021.

On 23 June 2021, the administrators' solicitors responded by letter advising that the administrators had decided to make an interim distribution of the full CGT exempt amount (described as one "to be made on account of your client's interest in residue").

Subsequently, a dispute arose between David and Belinda as to whether the obligation under cl 2.2 of the deed had arisen. Belinda's solicitors contended that the obligation would not arise until the estate was fully administered. David's solicitors made enquiries of the administrators' solicitors as to when a final distribution to Belinda as residuary beneficiary could be expected.

On 29 June 2021, the administrators paid to Belinda the amount of $6,054,662. The issue that arose was whether this payment triggered the operation of cl 2.2 of the deed.

The issues

Richmond J said that the two issues that arose for decision were:

> "53. … (a) whether the payment to Belinda of the CGT exempt amount had the character in her hands of a distribution of residue and (b) if so, whether on that payment being made to Belinda, she became subject to an obligation to pay David an amount of $1,000,000 within 14 days pursuant to cl 2.2 of the Deed …"

Character of the interim distribution

Richmond J said[2] that, on 29 June 2021, when the interim distribution of $6,054,662 was made to Belinda, the estate was not fully administered. However, it was clear that the funeral and testamentary expenses, the debts of the deceased and the legacy under the will had all been paid. While the transfer of the property at Narooma to Ms Berrell may not have been made by that date (the evidence did not disclose this either way), it was clear that it was a straightforward conveyancing matter. The estate had also by that time paid an amount of $1,000,000 to Ms Berrell following a family provision order made in her favour under s 59 of the *Succession Act 2006* (NSW). What remained outstanding at the time of the interim distribution were the matters referred to earlier in his Honour's judgment.[3]

Basic propositions

Richmond J said that, before dealing with the character of the interim distribution in Belinda's hands, it was necessary to state some uncontroversial propositions.

First, on the grant of letters of administration with will annexed to the administrators, all of the real and personal property of John was vested in the administrators from the time of John's death (s 44 of the *Probate and Administration Act 1898* (NSW)).[4]

Second, while the administrators were not executors, they had the same rights and liabilities, and were accountable in the same way, as if they were executors (s 74A of the *Probate and Administration Act 1898* (NSW)).[5] Accordingly, when describing the nature of the respective duties of executors and administrators with will annexed, each could be referred to interchangeably as a legal personal representative.

Third, the core duty of a legal personal representative is to hold the property of the deceased for the purposes of carrying out the functions and duties of the administration.[6] This involves getting in the assets of the deceased, paying the debts of the deceased and the expenses of the administration, paying the legacies under the will, and distributing the residue of the estate in accordance with the will. The legal personal representative is in a fiduciary relationship with the beneficiaries under the will, and one of the key features of that fiduciary relationship is that the legal representative is required to act in the interests of the beneficiaries and not for the legal personal representative's own benefit. In the present case, at the time of the interim distribution to Belinda, the sole beneficiaries to whom the administrators owed this fiduciary duty were Belinda as residuary beneficiary and, in relation to the Narooma property, Ms Berrell.

Fourth, while the legal personal representative is not a trustee in the strict sense, and consequentially the residuary beneficiary does not have a beneficial interest in the property held by the legal personal representative during the course of administration, the residuary beneficiary has a right to secure the proper administration of the estate which is a chose in action held by it.[7]

Fifth, the legal personal representative will become a trustee for the residuary beneficiary of the property remaining in the estate once the administration is complete and the residue is ascertained.[8] It is at this point that the residuary beneficiary's interest is transmogrified from a chose in action against the legal personal representative to an equitable proprietary interest in the property comprising the residue of the estate.

Richmond J said[9] that one of the consequences of the limited rights of a residuary beneficiary during the course of administration of a deceased estate is that the residuary beneficiary is not presently entitled to the income of the estate during that period. This was established by *FCT v Whiting*[10] which concerned a deceased estate in the course of administration which comprised assets (including a partnership interest in a Queensland pastoral business) which were insufficient to pay the debts of the estate and the annuities and legacies provided for in the will. The High Court held that, as the administration was incomplete, the residuary beneficiaries were not "presently entitled" to income of the estate for the purposes of s 97(1) of the *Income Tax Assessment Act 1936* (Cth), and consequently the executors were subject to tax on that income under s 99 of that Act. Latham CJ and Williams J said:[11]

> "Numerous authorities, many of which are collected in the recent decision of this Court in *Robertson v. Deputy Federal Commissioner of Land Tax*,[12] have established that until an estate has been fully administered by payment or provision for the payment of funeral and testamentary expenses, death duties, debts, annuities, and legacies and the amount of the residue thereby ascertained, the income of the residuary estate is the income of the executors and not of the residuary beneficiaries … The crucial question is at what moment of time, having regard to these general principles and to the provisions of the trust instrument, can it be said that a beneficiary has become presently entitled to a share in the income of a trust estate. A beneficiary under a will may become entitled to a share of such income as an annuitant legatee or a residuary beneficiary. His right to share in such income would be determined by the trusts in the will … The only part of an estate which can be made available to satisfy the claims of the beneficiaries is that part which remains after the funeral and testamentary expenses, death duties and debts *have been paid or provided for*, if necessary out of the whole estate, including any income earned by the estate during the period of realization. Entries made in the books of the estate to adjust the rights of the beneficiaries in the income and capital of the estate can only operate subject to the satisfaction of the claims of and cannot affect the rights of the creditors. But, as has been made clear in the authorities already mentioned, the existence of mortgage debts does not prevent the administration of the estate advancing from the stage when the liabilities to creditors are in process of discharge to a stage when the beneficial trusts of the will can attach to assets which are not required to satisfy the mortgage debts …" (emphasis added)

Richmond J then said[13] that what was important about this passage in the present context was the statement that, in order for the residue to be ascertained, the funeral and testamentary expenses, debts, annuities and legacies needed to be paid or provided for. Recognition that it was sufficient that those prior claims could be "provided for" rather than paid leads to the sixth proposition.

In formulating the sixth proposition, Richmond J said that it is recognised that, in certain circumstances, a legal personal representative can come under a duty to make an interim distribution of residue to a residuary beneficiary prior to the estate being fully administered.[14] After referring to the observations of Campbell J in *Gonzales v Claridades*,[15] Richmond J said[16] that there was a clear recognition in the observations that a duty to make an interim distribution of residue can arise even if the residue has not been finally ascertained because the expenses of the administration were uncertain, provided that, on a cautious view, those expenses of administration could be adequately provided for. There were several examples in the authorities where an interim distribution of residue has been accepted as necessary and appropriate in such circumstances.

Application of the principles

Richmond J said that, as had been noted, the fiduciary obligation imposed on a legal personal representative requires it to act in the best interests of all of the beneficiaries. In the present case, it was open to the administrators to conclude that they had a duty to make an interim distribution of residue to Belinda prior to 30 June 2021 of the CGT exempt amount of $6,054,662 if proper allowance could be made for the further costs and expenses required to finalise the administration of the estate. This was for three reasons:

> "67. First, it is the duty of a legal personal representative to act with due diligence in realising the estate's assets, discharging debts and expenses of administration and then distributing the estate to the beneficiaries. The interim distribution was made nearly four years after John's death. While this delay was not due to any fault on the part of the Administrators as they were not appointed until November 2020, the elapse of time since John's death and what had occurred in relation to the estate in the interim meant that the Administrators had an onus to justify any further delay beyond 30 June 2021.
>
> 68. Second, at the time the interim distribution was made, the only person entitled to a distribution of the residue was Belinda, and all other gifts under the will had been paid or provided for. A notice had been issued under s 92 of the [*Probate and Administration Act 1898* (NSW)] giving the Administrators the protection provided by that section. The substantive matters remaining to be done were … for Belinda's benefit as the residuary beneficiary.
>
> 69. Third, the Nexia advice indicated that unless the distribution of the CGT exempt amount was made to Belinda by 30 June 2021 a distribution of that amount to her at a later time would not be tax free in her hands. It would clearly not be in the best interests of Belinda as the sole beneficiary entitled to residue to delay an interim distribution of residue beyond 30 June 2021 in those circumstances if proper allowance could be made for the further costs and expenses of administration."

Richmond J said that it was clear that the administrators, both of whom were solicitors experienced in probate matters, were alive to the potential adverse tax consequences for Belinda if no interim distribution was made by 30 June 2021. It was also clear that they considered that proper allowance could be made for the further costs and expenses of administration given the stage at which the administration had reached. In these circumstances, they could properly form the view that it was their duty to pay the CGT exempt amount to Belinda as an interim distribution of residue by 30 June 2021 and it was apparent that they did so.

It followed, in his Honour's opinion, that the interim distribution to Belinda was made in respect of her interest in residue of the estate and therefore was a distribution of residue. It followed that the submissions by Belinda and Kate to the contrary were to be rejected.

Construction of cl 2.2

Richmond J considered the proper approach to the construction of cl 2.2 of the deed in some detail and concluded that the obligation under cl 2.2 could arise in respect of each distribution of residue made to Belinda up to the total amount of $1,000,000.[17]

His Honour rejected the submissions of Belinda and Kate that this construction of cl 2.2 was inconsistent with the use of the expression "the residue" in cl 2.2. While the expression "the residue" in the context of a deceased estate is generally used to refer the property remaining after the payment (or provision for) the debts of the deceased, the expenses of administration and all other devises or legacies under the will, that did not mean that the legal personal representative could not make an interim distribution of the residue before the estate was fully administered.

In addition, Richmond J said that he accepted David's submission that this construction of cl 2.2 avoided a "commercial nonsense". This was due to cl 2.3 which created an equitable charge in favour of David over Belinda's "payments and entitlements in the deceased's estate" to secure the due payment of the amount owing under cl 2.2. Belinda's "payments and entitlements in the deceased's estate" comprised her rights as residuary beneficiary under John's will and all payments received by her in respect of those rights, which would encompass an interim distribution of residue.

His Honour said that it was the essence of an equitable charge that it confers on the chargee a proprietary interest by way of security in the property charged. Where, as here, the charge is a fixed rather than a floating charge, the charge attaches and continues to attach to the charged property until released by the chargee.

At the time the deed was executed in September 2020, Belinda was expected to receive a very large distribution of $6,054,662 by 30 June 2021 in respect of her entitlement to the residue because that was the only basis on which she could receive it. It was clear that this would not necessarily be her entire entitlement to the residue, given that probate of the will still had not been granted. It did not make commercial sense that the whole amount of $6,054,662, which she was expected to receive within the same financial year as the deed was executed, would be subject to the fixed charge under cl 2.3 for an indefinite period, ie until administration of the estate was completed, and only be available for use by Belinda in that period with David's consent (as chargee). Rather, it would make commercial sense that the charge was intended to attach to payments to Belinda of residue for the short period (of 14 days) from receipt by her and payment over to David under cl 2.2.

Conclusion and orders

The upshot was that Richmond J considered that cl 2.2 of the deed required Belinda to pay David $1,000,000 within 14 days after her receipt of the interim distribution of $6,054,662 on 29 June 2021.

The Commissioner's ruling

As noted, the Commissioner has issued a ruling (IT 2622) which considers the income tax position of legal personal representatives and beneficiaries of deceased estates. It is not possible to canvass the details of this ruling here.

However, one point that may be noted is the view taken in IT 2622 that, until the estate of a testator has been fully administered and the net residue ascertained, a residuary beneficiary has no proprietary interest in any specific investment forming part of the estate or in the income from any such investment. Both corpus and income are the property of the executors or administrators.

It is submitted that the decision of Richmond J in the *Walker* case illustrates that this proposition may be too widely expressed and that, unless that proposition is modified, the Commissioner's administration of the provisions of the tax law that may be relevant to deceased estates could create problems.

It is to be hoped that the Commissioner will revise IT 2622 in light of the *Walker* case, with a view to issuing a binding public ruling.

Comment

The affairs of a deceased estate often have the potential to create tax issues that need to be addressed. At a basic level, the deceased's will may raise issues of construction, but other issues may arise, for example, under the CGT provisions of the ITAA97, as is illustrated by the *Walker* case.

TaxCounsel Pty Ltd

References

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3 [2022] NSWSC 1104 at [43]–[45].
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Mid Market Focus

by Jordan Phung, HLB Mann Judd

Share trading versus speculating

For advisers with clients who invest in the stock market, there are a few ways to provide more certainty on eligibility for the CGT discount and CGT relief.

Introduction

When assisting your clients with acquiring any asset, there are key planning items that should be addressed before moving ahead with the transaction. As always with most tax issues, the end outcome is generally dictated by how well the arrangement is structured and documented from the beginning. Skipping these initial steps can be a costly mistake to make later down the track.

In this article, some practical considerations for advisers providing advice to clients investing in the stock market are discussed, including understanding the difference between share trading and speculating, choosing the appropriate structure, and how to properly document the activity to help your clients understand which side they are likely to fall on with regard to the capital versus revenue rules.

Share trading versus speculating

In the author's experience, the ATO's general view is that there are two possible outcomes from share trading activity for income tax purposes:

1. business income ("revenue" account): you are a share trader, the shares are trading stock, and any income/losses from your activity would be included in your assessable income; or
2. investment/speculator ("capital" account): you are a share investor/speculator, the shares are CGT assets, any income/losses from your activity would be a capital gain/loss, and dividends would be included in your assessable income.

Broadly, shares held as trading stock are more likely to be traded frequently to derive profits from short-term market fluctuations. Conversely, shares held as CGT assets would typically be held long-term to derive passive dividend income or for speculative capital growth. In practice, however, this capital versus revenue distinction is rarely "black and white" and the ATO can argue both ways.

It can be useful to apply this dichotomy if your clients are investing in digital currencies, or most other assets for that matter. Once again, how these assets will be treated for tax purposes will depend on whether you are conducting a business or are simply a speculator, and whether the assets have a capital or revenue character.

Whether a taxpayer's investment activity is carried on as a business is a question of fact and, while relevant indicators have been outlined in case law, no one indicator is determinative – it will be determined by the overall impression of the activity. Some of the relevant indicators of a business include:

- the nature of the activities and whether they have the purpose of profit-making;
- the complexity and magnitude of the undertaking;
- the intention to engage in trade regularly, routinely or systematically;
- operating in a business-like manner and the degree of sophistication involved;
- whether any profit/loss is regarded as arising from a discernible pattern of trading; and
- the volume of the taxpayer's operation and the amount of capital employed.

To distill the above indicators further, the following factors will be important to assess in respect of share traders:

- the repetition and regularity in the buying and selling of shares;
- the turnover;
- whether the taxpayer is operating to a plan, setting budgets and targets, and keeping records;
- the maintenance of an office;
- accounting for the share transactions on a gross receipts basis; and
- whether the taxpayer is engaged in another full-time occupation.

A common case referred to in many decisions on this matter is *TT88/98 and FCT*[1] involving a trainee accountant who purchased 20 parcels of shares between April 1986 and February 1987. All of the shares were sold between September 1986 and April 1987, no share having been held for more than five months. A small loss made on four parcels was claimed as a deduction. The AAT held that the shares were purchased as trading stock during the 1987 year. As the shares were bought and sold repeatedly with a view to making a profit, and all shares were sold within a year of acquisition, the taxpayer was considered to be in the business of share trading, despite only having invested $1,300.

In contrast to the above decision, *Re Taxation Appeals*[2] disallowed losses on two parcels of shares sold after the 1987 stock market crash. Instead, the losses were quarantined under the capital gains provisions. It was found that there was a lack of sophisticated share trading techniques, a business plan, market research in the shares invested, a contingency plan in the falling market or a large number of transactions, such that the applicant's activities did not exhibit a system of operation of a business in share trading. The taxpayer had only limited contact with the share market, which he then entered for the purpose of making quick profits by generally buying and selling speculative mining shares. The taxpayer was considered a speculator in the share market, although they had invested a much higher sum of $100,000.

Although the above cases are admittedly dated, they are repeatedly referred to in most private rulings on this issue. In a more recent example,[3] the taxpayer purported to be a share trader as they undertook the activity according to a business plan and with the primary focus of trading in shares with a view to profit from short-term movements. The business plan outlined that the taxpayer would spend four hours per day on the activity and included a stop-loss strategy to trigger sale requests once the price fell below a specified price. The taxpayer established several commercial trading accounts with financial institutions, engaged a professional broker for specialist advice, and used a web-trader platform trading software.

In this case, the ATO's overall impression was that the taxpayer was not a share trader because the level of activity was considered low, there were irregular trades conducted with large periods of inactivity, and there was low turnover despite substantial amounts being invested. Furthermore, the stop-loss trigger outlined in the taxpayer's business plan was not consistently followed, as evidenced by varying degrees of losses made on the sale of shares in the same company.

What can be gleaned from these cases and rulings is that there can be uncertainty at both ends of the spectrum, no matter how small or large the investment activity/transaction. If your client only invests small sums of money but does so frequently and diligently following a buy/sell strategy, this may be seen as a business given the repetitive and systematic quality of the activity. On the other hand, if your client is a share trader hoping to offset losses from a share sale against their other income, those losses may be quarantined under the capital gains provisions if the shares to which they relate can be distinguished from other trading stock.

Moreover, a taxpayer's status as a share trader/speculator can change from year to year, or even within the same income year depending on their circumstances. Therefore, advisers should continue to raise this issue with clients during the tax planning season (at a minimum) to ensure that clients are aware of the risks involved with their investment activity and how these risks may be managed.

Holding stock on both capital and revenue account

Importantly, the existence of a share trading business does not automatically disqualify a taxpayer from accessing the CGT discount. In some cases,[4] the ATO has acknowledged that share trading businesses can also be speculators. This means that it is possible for share traders to hold stock on both capital and revenue account.

However, at a minimum, a separate strategy, accounting and record-keeping for the different share activities would be needed and there needs to be a real difference in the two portfolios (ie the activities are not artificial or contrived for a tax benefit only). Some practical tips on how to maintain documentation are discussed further below.

Choosing the right structure

Some clients may find it hard to imagine that the ATO could consider their activities as constituting a share trading business. Accordingly, it is the duty of advisers to communicate this risk upfront to clients. Starting with the end in mind will help advisers and their clients to identify potential risks to their investment returns in the future.

Depending on where your client is on their investment journey, this will help identify the appropriate structure for their investment activity. For example:

1. Are they investing as a hobby and a way to build a passive revenue stream to save for a first home deposit?
2. Are they an investment banker/stockbroker by trade, looking to use the skills they have honed from their day job to fund their next holiday?
3. Are they setting aside some of their retirement savings for capital growth, to be passed down to their children some day?

If (3) above applies to your client, it may make sense to set up a family trust/corporate trustee structure, with their children as beneficiaries of the trust and shareholders of the corporate trustee. This is a common structure recommended by many advisers to take advantage of lower tax brackets across family members, and to help access the CGT discount.

However, accessing the CGT discount will not always be the deciding factor when choosing the right structure for your client's investment activity. A company structure may be more suitable to cap investment gains at the corporate tax rate and to provide flexibility with how those profits are extracted in the future. Moreover, although a company cannot access the CGT discount, it can still be eligible for other CGT relief, such as applying the replacement asset CGT roll-over to defer the notional capital gain arising from a takeover event occurring to a company that your client had a speculative investment in.

As advisers, understanding context is key, and asking the extra question will help you and your clients narrow down the right structure for their investment activity.

Documenting your activity

Whether your client is a trader, a speculator or both, it is important for them to define and document their intention for each buy/sell transaction as this will help you assess the strength of your client's position. As your client's intention regarding a particular parcel of shares or their investment activity in general may change over time, keeping a contemporaneous record of these changes would be extremely useful if they are ever reviewed/audited by the ATO in the future.

If your client holds some shares for short-term resale and others for long-term capital growth (as is common in most diversified portfolios), it is important to distinguish between these two categories in their personal records and the financial statements of the client's investment entity. A simple example of this would be separating non-current speculative investments from trading stock on the balance sheet.

Accordingly, tax advisers have an obligation to scrutinise how assets are categorised on financial statements and especially how gains/losses are reported on the tax return to ensure that trading and speculating activities are appropriately disclosed.

Conclusion

As illustrated in this article, having a holistic view of your client's investment activity is crucial, no matter where they sit on the speculator–trader spectrum.

In particular, if your client's investment activity is conducted through an entity that prepares financial statements, it is important that the accounts reflect the underlying nature of the shares (as trading stock or CGT assets). How and where this activity has been reported in the entity's tax return should also be considered carefully.

It may be a worthwhile exercise for advisers to identify existing clients who are quasi-traders and speculators to determine whether their financials and tax returns accurately reflect assets held on capital versus revenue account. Having the correct and appropriate level of documentation will provide options moving forward, especially if you ever need to apply for a private ruling or object to an ATO decision.

Jordan Phung
Manager
HLB Mann Judd

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1 *TT88/98 and FCT* [1988] AATA 367.
2 *Re Taxation Appeals* [1990] AATA 249.
3 PBR 1012998424429.
4 See, for example, PBR 1012047019192.

Higher Education

Practical learning for a tax accounting career

One of the duxes of CTA1 Foundations Study Period 2 2022 discusses key learnings from the subject, as well as top tips for juggling parenthood alongside work and studies.

Michael Walkom
Accountant, AFM Services, South Australia

Please provide a brief background of your career in tax.

After graduating from Adelaide University in 2017, I spent the first four years of my working life in the commerce sector as an accountant for a not-for-profit organisation. During this time, I undertook and completed my CPA studies. From mid-2021, I made the move to the public sector, working as an accountant in the compliance team for AFM Services, and I've been here for just over 12 months.

Why did you choose to study with The Tax Institute Higher Education?

Having had no previous experience in the tax accountancy industry, I wanted to undertake a course that would fast-track my learning. After some research and discussions with the owner of AFM Services, I chose the Chartered Tax Adviser (CTA) Program as it seemed the most practical choice.

What skills and knowledge have you taken away from the CTA1 Foundations subject? Have you applied this new knowledge to your role?

As I am at the beginning of my tax accounting career, I found CTA1 Foundations to be a very practical subject and was able to immediately transfer each topic of study to my day-to-day work. From things like preparing individual and company tax returns to being able to apply small business entity CGT concessions to real-life scenarios (eg the retirement exemption). It is difficult to choose a specific time that I have applied the new knowledge to my work as it has been relevant to everything I do on a day-to-day basis. However, straight after completing the superannuation topic, I completed my first ever SMSF using the knowledge gained in my studies to develop an understanding of how SMSFs operate from a tax perspective.

How did you juggle study, work and other commitments?

As I have a two-year-old son, my main priority is to not let my studies affect my time spent with him. I found that I was able to do this by getting up at around 4:30 am to complete my daily study before he was awake. Yes, it may have meant a little less sleep, but it helped me to know that my studies were not getting in the way of my most important job – being a dad!

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

I will continue studying the remaining three subjects of the CTA course over the next year or so, while also building up the three years of the required experience needed to receive the CTA designation. I will then look at undertaking an MBA program at some point down the track.

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

I would highly recommend the Chartered Tax Adviser Program – while I have only undertaken the first subject, it has provided a solid foundation for my future studies and career. The program is structured appropriately to follow alongside work and other commitments.

Resolving transfer pricing disputes

by Tamara Phillips, Barrister, Sixth Floor Selborne Wentworth Chambers, and Anthony Seve, Partner, Ernst & Young

Transfer pricing controversies often involve significant issues relating to the core profit-making elements of an organisation. Such cases can be complex, time-consuming and expensive to resolve. By their nature, it is rare that transfer pricing disputes yield a single obvious outcome that clearly favours one of the parties. As a result, it is important that parties are alive to all dispute resolution avenues and that one avenue is not prematurely dismissed in favour of another. This article explores some themes to be borne in mind by practitioners engaged to assist clients with their transfer pricing disputes, and how to prepare such disputes, both for potential contested litigation and for reaching an eventual settlement.

Overview

A substantial amount of preparation is required to progress a transfer pricing matter so as to be litigation ready. However, the majority of cases settle prior to the commencement of litigation. In general, an early rather than later settlement will be advantageous to the parties, insofar as this minimises litigation expenditure and crystallises litigation (and attendant financial and corporate) risk.

Entities engaged in a transfer pricing dispute should therefore seek to optimise their prospects in any litigated proceeding while balancing their interest in doing so against their interest in achieving an early settlement on mutually acceptable terms. This article provides some insights into how these interests might be concurrently pursued by parties and their advisers. The observations made are necessarily general, noting that each matter is different and requires a tailored approach informed by appropriate bespoke advice.

Evidence and transfer pricing litigation

Recent cases have reinforced the importance of marshalling comprehensive, persuasive evidence in support of a transfer pricing position, which is addressed to the appropriate statutory question(s). It is prudent for steps to be taken to prepare evidence that is supportive of a party's anticipated position in litigation well before such litigation is on foot, including at the audit and/or objection stage.

The preparation of contemporaneous transfer pricing documentation is often market practice before a significant intra-group transaction is implemented. Such documentation can have an important bearing on the ATO's risk assessment for a transaction. For present purposes, however, the focus is on evidence that is prepared *after the fact*, once the boundaries of a transfer pricing dispute have crystallised and the potential for litigation in due course has become apparent.

Lay evidence

Lay evidence tendered in transfer pricing cases generally consists of affidavits of personnel involved in the relevant business at the relevant time, and which may seek to explain and give colour and context to applicable contemporaneous documents, the import of which may not be discernible on their face. The lay witness(es) selected should be in a position to provide the court with an understanding of the actual circumstances of the taxpayer entity, including the functions it performed and the risks it faced leading up to and during the relevant income years with regard to the tested transaction, in the context of the broader operation of the business or industry in question.

Expert evidence

Expert evidence tendered in transfer pricing litigation may take various forms. It can involve "industry expertise", consisting of the factual account and opinion of a person experienced in the relevant field as to how a particular business, transaction type, or method of risk allocation ordinarily operates in an arm's length scenario.

It is also common for expert reports to be prepared for litigation purposes by transfer pricing economists or valuers. Such experts use the taxpayer's own financial information, industry data and/or various financial metrics to seek to ascertain an applicable arm's length price for the tested transaction, informed by the OECD methodologies.

It is imperative that any expert evidence is given by individuals with appropriate expertise in the relevant area – the courts have been dismissive of so-called experts whose field of endeavour is not directly aligned with the subject-matter they are giving evidence on.

Both lay and expert evidence can involve an extensive lead time, but generally the lay evidence should be "front loaded", at least to the extent necessary to identify relevant factual assumptions and briefing material that can be provided to the experts.

Locating relevant documents

Transfer pricing disputes may crystallise some years after the events in question and recollections of key personnel within the taxpayer's business and/or of industry experts may need to be refreshed by taking them through relevant documents. This requires some effort to be undertaken to locate relevant documents. Advisers on transfer pricing disputes often spend considerable time mining documentary databases so as to obtain an accurate chronological account of the taxpayer's affairs at the relevant time, in addition to market information from the relevant period and/or any relevant comparable uncontrolled transactions.

If documentary reviews of this kind are progressed at an early stage in a dispute, a taxpayer can commence developing a "case theory" to support their transfer pricing position for any future litigation. Equally, thorough documentary searches enable a taxpayer to obtain a better understanding of the types of documents that might need to be produced to the Commissioner pursuant to s 353-10 notices that may be issued as part of the audit/objection process or that might in due course be discovered in litigation. This in turn can enable the taxpayer to conduct an early appraisal of their dispute risk and engage in a preliminary assessment of desirable settlement outcomes.

Taxpayers should therefore be strategic when marshalling relevant documents. Considering the documentary base of a transfer pricing case in a holistic way – and not merely on an "as needs" basis which responds to the particular questions that may be asked by the ATO in various formal and informal information requests – has the following additional advantages:

- a clear understanding at an early stage as to how particular documents came to be created in the context of a larger transaction makes it easier to substantiate any legal professional privilege claims that may in due course be advanced and to manage issues related to waiver;
- an understanding of the documentary base as a whole allows taxpayers to better develop strategies in responding to ATO questions, particularly where areas of weakness are identified at an early stage; and
- an early identification and examination of relevant documents, in conjunction with the development of a case theory, may minimise the potential for adverse consequences to a taxpayer arising from the admissibility restrictions in s 325-30 of Sch 1 to the *Taxation Administration Act 1953* (Cth) (and/or equivalent provisions under the diverted profits tax regime) being engaged where offshore material is not produced.

Identifying applicable lay witness(es) and preparing lay evidence

The documents surrounding a particular transaction will often provide a useful guide to the persons who may be appropriate lay witnesses in a transfer pricing case. Given that there is no requirement for a taxpayer to provide evidence as to the related parties' motive for entering into the tested transaction,[1] witness searches should extend beyond the particular individuals who were responsible for entering into the transaction in question. In appropriate cases, there may be benefit in selecting lay witnesses who can give evidence from the perspective of each party to the related party transaction, which evidence may inform the court's assessment of how the respective counterparties might have behaved in an arm's-length dealing. There can often be difficult conceptual questions underlying the choice of approach, related to how one ought to conceptualise the hypothetical arm's length transaction whereby the actual parties retain their characteristics but are independent of each other. Although guidance may be sought from the authorities, care must be taken before extrapolating the approach to the counterfactual in one case to quite different factual settings.

The witnesses best placed to give lay evidence in transfer pricing litigation inevitably varies depending on the facts and circumstances of each case and the exigencies of each individual. The kinds of strategic and forensic questions that the litigation team may consider, in this respect, can include the following:

- If witness A was to give evidence on fact X and witness B was to give evidence on fact Y, is there a risk of inconsistency?
- Would witness C be compelling in court or are their independent recollections too vague or imprecise as to be of assistance?
- Now that witness D has retired or left their role at the taxpayer's business, are they likely to cooperate in the lengthy process of preparing a witness statement and giving oral evidence in court on behalf of the taxpayer?
- If witness E was not present at the company for the tax periods in issue, can they nevertheless give evidence relevant to the applicable time frame? How can any such evidentiary/timing gaps be filled?
- Is there a risk that witness F's evidence will expose matters related to tax planning which are not necessary for the purposes of satisfying the objective transfer pricing test?[2]

First-time litigants and witnesses can be surprised at the amount of time it takes to put together a witness statement, particularly where the evidence that is being furnished covers a wide-ranging time frame and/or complex business operations in a specialised field. A long lead time is required to ensure that a comprehensive account is recorded, in a form that would be admissible in court. There are often a series of conferences between the witness and legal team resulting in several draft statements being prepared and progressively refined over a period of months or even longer.

Identifying relevant experts and preparing expert evidence

Once a picture has been established as to how the relevant transaction was undertaken and in what market circumstances, it may become more apparent how an expert's evidence might contribute to supporting the relevant transfer pricing position.

The process of identifying suitable independent experts can take some time, and may involve participating in numerous scoping calls and following various leads before an expert with an applicable skill set can be identified. Careful thought needs to be put into the preparation of factual assumptions that are provided to any expert, including whether such assumptions are able to be proved by admissible evidence, and the extent to which the expert's opinion will be required to accommodate changes in the assumptions as further information comes to light. If this is not done, the final expert opinion may be addressed to an inappropriate set of facts.

It is not problematic, per se, for an expert to change and update their opinion as the underlying facts emerge and/or change. That is especially so if their initial views are expressed in qualified rather than trenchant terms that accommodate new perspectives or approaches depending on how the facts may fall. Where difficulties can occasionally arise, however, is if the final opinion that a particular expert is prepared to give on the basis of the facts that are ultimately disclosed by the lay evidence turns out not to be supportive of the entity's ultimate transfer pricing position. If this is discovered at a late stage in the dispute timeline, a party can be disadvantaged in their preparation for the litigation.

Although the preparation of expert evidence tends to follow lay evidence, it is helpful to engage with potential experts at an early stage as they will be able to provide insight into the type of documents and information that will be needed for them to formulate an opinion on the question(s) to be asked.

It is also necessary for care to be applied in the drafting of questions for the expert, so as to ensure that these faithfully track the language of, and/or enquiry that is required by, the applicable transfer pricing legislation.

Most "professional experts", such as valuers or transfer pricing economists, are familiar with the process that is involved in the preparation of an expert report and giving of oral evidence in court. However, industry experts may be unfamiliar with litigation and court process and/or the mechanics of report writing more generally. The process of ensuring that their report properly sets out their reasoning and is in an admissible form can become quite time-consuming. It is also critically important that expert witnesses and practitioners working with experts remain focused on their duty to the court.

Early progression of both kinds of expert evidence (at least to a draft stage) allows parties to obtain considered advice as to the prospects of their transfer pricing position being accepted by a court, well in advance of litigation commencing.

The proposed questions for the experts and the material provided by way of assumptions can of course be refined once litigation has commenced and the matters in issue have further crystallised. While it is not uncommon for parties to retain different experts "pre-litigation" and for the purposes of litigation, this often is not necessary so long as care is taken to preserve the independence of any expert engaged at the pre-litigation stage. The preservation of such independence is facilitated where experts are asked to opine on objective facts (or factual assumptions) rather than on the positions on contentious points that have been articulated by the parties to the dispute in position papers, submissions and similar documents.

Settling transfer pricing disputes

In recent years, a number of transfer pricing disputes have been characterised by the respective parties adopting markedly different starting point positions and maintaining such positions over a considerable period. For example, the taxpayer might seek to wholly defend a transaction/structure and/or value proposition under scrutiny and the Commissioner may place significant weight on anti-avoidance provisions to respond to such a transaction/structure. The entrenchment of polarised positions from an early stage can generate frustration, increase negotiation tension, devolve into unproductive interactions, and diminish overall settlement engagement. Where this happens, it is seldom in the best interests of either party.

Given the prevalence of disputes where there is early posturing from quite divergent standpoints, it is particularly important for the purposes of settlement engagement that there is a clear plan or framework in place to allow the parties to reserve their opening positions (and ability to progress with litigation preparation as referred to above) while proactively seeking a negotiated outcome. The prospects of an early settlement may be significantly improved by adopting one or more of the measures outlined below.

Framework for separate settlement strategy

The establishment of a separate settlement strategy and workstream, with dedicated experts to drive the settlement process, can be critical to achieving an efficient settlement. Although there is necessarily a strong connection between litigation and settlement strategy, they are distinct processes with different objectives and timelines and require distinct strategies, skills and workplans. This distinction is often not acknowledged and dedicated settlement capability is not adequately resourced, to the detriment of the parties.

That said, no reasoned settlement strategy can be put in place without an eye to the evidence that is being prepared or marshalled for the purposes of any eventual litigation. That evidence will necessarily inform a party's assessment of the strength of their position and any external advice that is sought, which is vital for formulating a logical settlement position.

Managing different propositions

Litigation requires the parties to identify and consolidate a definitive position (or a series of alternative positions) reflective of their case theory, whereas settlement negotiations involve exploring options with a view to finding compromise. As a result, it should be expected that the litigation process and the settlement process may involve the advancement of different propositions, by the same party. A few points arise from this.

- The risk associated with these differences can often be addressed by relying on the so-called "without prejudice privilege". Section 131 of the *Evidence Act 1995* (Cth) operates, in general terms, to render inadmissible communications made in connection with an attempt to negotiate a settlement of a dispute or a document prepared in connection with an attempt to negotiate a settlement of a dispute.

- However, and irrespective of the inadmissibility in subsequent proceedings of "without prejudice" communications, raising certain sensitive subject matter in the context of settlement negotiations can sometimes provide the counterparty with knowledge that leads to enquiries that otherwise might not arise.
- There is therefore a need to carefully balance the potential incremental risk associated with withholding or disclosing information in settlement negotiations, in terms of how this may impact on litigation positions and/or potentially advance or hamper any settlement. Care needs to be taken to ensure that evidence or arguments presented on a without prejudice basis do not undercut the cogency of a position that a party may wish to adopt at litigation. As against this, sufficient disclosure is needed to support achievement of a settlement, particularly given that the Commissioner may expect the taxpayer to warrant (as a term of any settlement deed) that all relevant and material facts have been disclosed.

Managing differing timelines

Litigation and settlement processes will typically occur under quite different timelines. Developing a position (or a cascading series of positions) for litigation can be a lengthy process, and the strategy may develop in conjunction with discussions with potential lay experts and witnesses. As noted earlier, finalising evidence for the purposes of litigation, including lay affidavits and expert reports, can take a significant period of time, often years. Opportunities for settlement engagement may arise while such evidence is being prepared. The situation that arises from these different timelines is that there may be a disjunct between a party's interest in advancing sufficient evidence at a preliminary stage to support an early settlement and their interest in ensuring that the evidence ultimately furnished in any litigation is as robust as possible.

On the one hand, being highly restrictive in the evidence furnished at an early stage (for example, withholding key contemporaneous documents or draft expert opinions) can reduce the efficacy of any settlement discussions. Evidence that is not completely "ready" for litigation can be highly influential in moving settlement negotiations forward.

On the other hand, being more comprehensive in the presentation of evidence at an early stage can yield tactical disadvantage in the context of litigation. For example:

- there can be cases where the provision of particular evidence at an early stage can be counterproductive, such as where the very nature of the evidence reinforces a key "gap" in the relevant party's case or case theory, or where the development of a party's case theory in a particular direction may be affected by that party having made some earlier disclosure or submission;
- an expert's final report served at the litigation stage may be viewed as less robust if the prior draft has been disclosed and some material inconsistency has been discerned; and
- the provision of draft lay evidence that is not finalised and which might be contradicted as part of later diligence activity, and on this basis needs to be retracted, potentially impacts on the witnesses' perceived reliability.

The potential counterparty advantage that can be obtained where a party serves different sets of evidence at different stages of a dispute can be mitigated (but arguably not eliminated) to the extent that the settlement is conducted on "without prejudice" terms. Taxpayers should make very clear in correspondence what material is being provided in the context of settlement discussions so that it may be accorded applicable protection going forward (noting that information will not be "without prejudice" merely because it has been marked as such). The relevant risk can also be mitigated to some extent if, when "draft" evidence is served on a counterparty to support an early settlement, the serving party candidly discloses any limitations in the nature of verification that has been conducted.

Opening areas of potential compromise

Identify, reserve or clear binary areas

Settlement engagement should aim to focus on addressing areas of the dispute that provide options for compromise.

Although it is important for the parties to articulate and understand each other's position and level of resolve in all key controversy risk areas, once this has occurred (often through an exchange of preliminary position papers or like documents), it is inefficient to spend substantial "settlement face time" engaging in protracted technical debate with the aim of convincing the other party to retreat from their position on a binary issue associated with the dispute.

Binary issues are ones in respect of which the parties are either "right" or "wrong", and yield limited obvious compromise position, for example, whether anti-avoidance provisions apply to a transaction. In contrast, in transfer pricing cases, the valuation-based elements of the dispute often provide a useful settlement lever, insofar as it may be relatively easy to agree that there are at least reasonably arguable "upper" and "lower" values within a possible arm's length range arising from different methodologies or integers being applied.

To the extent practicable, binary issues should be identified, reserved and put to one side in settlement negotiations so that energy can be focused on areas where moderation and compromise are more achievable. Conversely, discussion around the different assumptions and methodologies that can be applied to the valuation-based elements of a transfer pricing dispute can be key to opening areas of potential compromise between the parties. Early engagement with experts and consideration of the application of the statutory tests and OECD guidelines to the facts at hand can assist in identifying potential "levers" for settlement, in the sense of issues that can be approached in a range of different ways to achieve an overall position of compromise.

It must be acknowledged, however, that there are some instances where "clearing" as opposed to "reserving" a binary issue is the only viable option for progressing meaningful settlement discussions. One issue that can fall into this category is the application of the reconstruction provisions in Subdiv 815-B of the *Income Tax Assessment Act 1997* (Cth) (see s 815-130(2), (3) and (4)). Due to the potential for such an issue to create a settlement deadlock before any momentum can be established, work in this area needs to be given early priority. From a taxpayer's perspective, it may be critical to invest heavily in this area so as to be able to provide compelling evidence as to what a party independent of the transaction counterparty would have done (within the guidance provided by the applicable authorities, whether on the same provisions or other parts of the legislation, eg *SNF*[3] and *Glencore*[4]).

Reaching a shared understanding as to such matters can be critical to moving the case forward. Failure to do so can devolve into the counterparties disagreeing as to what transaction should be valued. However, this is not necessarily fatal to a negotiated outcome. For example, the "compromise" for one party's preferred transaction being adopted as the correct one to "price" can be a level in the valuation range for such a transaction that considerably favours the other party, or, alternatively, there may be scope to "split" the structural disagreement about the transaction between past years and on a go-forward basis.

Prioritise key evidence

Having (ideally) reached a position as to the appropriate form of the subject arrangement in the relevant period, the next important step in the settlement process is to seek to achieve agreement as to what, in substance, the taxpayer (and/or relevant associated entities) actually did in connection with the relevant transaction. Consideration of the facts as to what the relevant entities actually did is often referred to by transfer pricing professionals as the appropriate "functional analysis".

The functional analysis is often very comprehensive, covering wide-ranging business interactions and numerous entities and individuals performing differing roles and responsibilities. This is an area where settlement interactions can become "bogged down" because of the sheer volume of information that is collected through the course of the dispute, the characterisations of which may be available to be debated. However, the risk of protracted engagement related to the correct functional analysis can be minimised by spending time analysing and prioritising key areas of evidence.

In most cases, there are a limited number of factual propositions (perhaps less than 10) that will be material hinge points, both from a settlement perspective and, ultimately, for the purposes of any contested litigation. It follows that the vast majority of the extensive facts collected as part of the preparation for transfer pricing litigation are unlikely to be material to "moving the dial" for the settlement and should not be the focus of settlement exchanges.

Nonetheless, in many cases, extensive time can be spent debating areas that are only incrementally relevant to the transfer pricing settlement outcome, adding expense and prolonging any overall settlement of the dispute. To avoid this occurring, it is important to ensure that the relevant settlement team incorporates professionals who have expertise in determining what the critical facts are and what evidence needs to be presented to properly establish these facts, and who have the skills to explain this position in a compelling manner to the negotiation counterparty. This can assist in significantly reducing any misplaced focus on what are properly viewed as more peripheral areas of the dispute.

Where this type of strategic prioritisation is absent from a settlement framework, effective and efficient progression of the negotiations may be difficult to achieve.

Confronting underlying concerns

Although it may not be expressly articulated, there is sometimes an underlying commercial issue or strategic imperative at the heart of the ATO's concern in a transfer pricing case, which might underlie at least part of the ATO's position. For example, the ATO may be uncomfortable with intellectual property (and associated profit) moving to jurisdictions outside Australia where historically such functions have been based in Australia.

Irrespective of the view taken by the taxpayer as to the cogency of the ATO perspective, it is important to be cognisant of what the concerns may be and it can be powerful and potentially disarming to discuss these aspects openly and directly.

Among other things, the temporal aspect of transfer pricing disputes supplies a useful lever for approaching any thematic concerns held by the ATO. Although past positions usually cannot be altered, there may be an opportunity to consider compromises on how particular issues might be handled in the future, which can be helpful to the overall negotiation position.

Counterparty relationship

To facilitate productive early settlement engagement, it is important to establish and maintain a positive and open relationship between the relevant taxpayer/advisers and the ATO counterparties.

There are several aspects to be considered in this regard, including:

- dealing with the ATO in face-to-face interactions (in a COVID-safe format) as often as possible. Litigation controversy engagement is often conducted relying heavily on an exchange of formal solicitors' letters. However, direct interactions can facilitate more comprehensive explanations of positions and enable the free-form exploration of alternative options, which can facilitate compromise;

- coming to the table with a flexible open posture. This minimises the risk of deadlock; and
- understanding the personalities of people involved in the negotiation and acting to build an open dialogue and trust between the parties. This element, while perhaps self-evident, is fundamental to any productive negotiation and, among other things, can provide critical insight as to how to best advance the resolution of material issues.

Identifying and involving key stakeholders in the settlement

When establishing the settlement framework, it is important to identify the role of key stakeholders involved in the negotiation. There may be senior ATO officers who are closely involved in guiding the settlement but who are sometimes not a party to the direct face-to-face discussions.

It is in the interests of all parties that these stakeholders and their roles are recognised in connection with any negotiations. For example, a policy level issue may be heavily influenced by a senior ATO officer whose understanding of the case dynamics may be improved through direct interaction with the taxpayer/advisers. Further, as the Economist Practice area of the ATO may have a significant influence on the transfer pricing positions adopted, involvement of this group can be beneficial in moving issues towards a resolution.

Know and apply the legal principles and guidance

The domestic and international rules and guidance materials underpinning the transfer pricing framework gives concrete direction to the process of resolving issues in the context of settlement discussions.

Even where following the applicable legal framework yields a range of potential outcomes, the transfer pricing rules, if carefully applied, will often signal where in a range of outcomes the most appropriate answer will lie. Maintaining a close focus on the legal principles and guidance can provide clear direction (and apply useful pressure on a resisting party) as to the most appropriate settlement outcome within a range of options.

Nonetheless, there are circumstances where a party involved in settlement discussions may seek to avoid meaningful engagement with the transfer pricing rules. Sometimes this is done overtly for the stated purpose of finding a "simple" way to cut through the complexity or to gain an advantage that a reasonable application of the rules would prevent.

Whatever the rationale for it, this type of "free-form" negotiating strategy should be approached with considerable caution. From a governance perspective, both taxpayers and the ATO usually require any settlement outcome to have a principled foundation. That is not to say that flexibility and compromises are not appropriate, but resolution of disputes is best facilitated where parties ensure that the settlement framework is clearly identified and recorded and that the resulting compromises are properly acknowledged, understood and valued by both parties. By referencing compromises to a supported settlement framework, the degree of proposed compromise can be properly assessed by stakeholders who are not directly involved in the settlement engagement but who are ultimately responsible for approving settlement outcomes, whether on behalf of taxpayers or the ATO.

Conclusion

Giving early attention to compiling detailed documentary evidence, carefully constructed lay evidence and properly informed expert evidence is integral to optimising both litigation strategy and prospects of success, in addition to settlement strategy and prospects of reaching a mutually acceptable negotiated outcome. The manner in which such material is deployed in settlement discussions can involve some difficult judgment calls, but parties should seek to remain nimble in terms of how their litigation preparation dovetails with their settlement efforts. Thinking flexibly about such matters, while viewing "preparation for settlement" as distinct from but as intersecting with "preparation for litigation", can be in the interests of each of the parties to a transfer pricing dispute.

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This article is an edited and updated version of "Resolving transfer pricing disputes: evidence for litigation and settlement strategy" presented at The Tax Institute's NSW Tax Forum held in Sydney on 19 to 20 May 2022.

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2 See, for example, *Chevron Australia Holdings Pty Ltd v FCT* [2015] FCA 1092 at [137]–[159].

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UK pension transfers: part 2

by Jemma Sanderson, CTA, Director, Cooper Partners Financial Services

Part 1 of this series considered the Australian taxation treatment of a UK pension transfer. Part 2 discusses the pension transfer options from a UK perspective, how the Australian contribution provisions operate with respect to a UK transfer, and the strategies available once both the UK and the Australian tax and superannuation provisions have been considered. While numerous strategies are available, it is imperative to consider the individual's personal circumstances, as well as the correct way to implement the strategy, as this will be vital in mitigating any adverse implications. Such strategies require immense patience and attention to detail in order to be implemented correctly. It is important to read part 1 of this series as it provides the background and context for part 2.

UK considerations

Options to access benefits

In accordance with the UK tax and pension provisions, once a UK pension member has attained age 55 (to increase to age 57 for those born in 1970 and later), they can withdraw their benefits from their UK fund in the following ways (depending on the fund, some options may not be available):

- as an annuity;
- as a flexible access drawdown (FAD);
- as an uncrystallised funds pension lump sum (UFPLS); and
- as a roll-over to a recognised overseas pension scheme (ROPS).

A UK pension member may be able to request a UFPLS, which could be as a one-off payment or as a regular withdrawal from their UK pension scheme. The member can only receive a UFPLS where the account has not been crystallised/utilised to commence an annuity or has not entered into a drawdown scheme (such as an FAD, or with respect to the subsequent 75% balance remaining after a pension commencement lump sum (PCLS)).

Where a member is eligible to receive a UFPLS from the UK pension account, any applicable fund earnings with respect to the account would be taxed at the individual's marginal tax rate in Australia. If the money was transferred directly to an Australian ROPS, an election can be made to tax the applicable fund earnings in the fund at 15%, which is generally less than the marginal tax rate.

Most FAD accounts have the ability to request payment of the balance of the account as a single payment. Generally, given the UK tax implications (25% is tax-free and the remaining 75% is taxed at UK marginal tax rates), this is not a regular occurrence.

Establishment of an Australian ROPS fund

For a UK scheme to transfer benefits to an Australian superannuation fund with no tax implications in the UK, the Australian fund must be listed as a ROPS, which requires an application to HM Revenue and Customs (HMRC) for a ROPS number. For an Australian superannuation fund to be listed on the ROPS list, the fund is required to limit the membership to members who are UK pension age and over (in order to satisfy the UK pension age test and pension access conditions). The requirement to limit the fund membership to members who are 55 and over (the current pension age limit) must be drafted into the fund's trust deed to satisfy the UK rules.

Aside from the use of a self-managed superannuation fund (SMSF), there is only one publicly available ROPS in Australia, being the Australian Expatriate Superannuation Fund.

There are various obligations for a ROPS to report to HMRC on the happening of an event or change in circumstances (specific forms are required to be completed in such circumstances). The ROPS reporting obligations are outlined in *The Pension Schemes (Information Requirements – Qualifying Overseas Pension Schemes, Qualifying Recognised Overseas Pensions Schemes and Corresponding Relief) Regulations 2006* (UK). The most common events being reported are the commencement of a pension (only the first payment is required to be reported), a lump sum payment, or re-certification in five years from ROPS application.

Other considerations with respect to establishing a new SMSF and registering as a ROPS in the UK, and ensuring that a transfer from the UK can occur, include:

- to prevent the incurrence of the overseas pension charge on transfers from the UK to a foreign ROPS, the ROPS and the member must be resident in the same country, both at the time of the transfer and for an additional five UK tax years;
- once the transfer has been made from the UK pension fund to the new SMSF, the fund would be subject to reporting requirements to HMRC for at least 10 years; and
- the investment restrictions in the UK are more comprehensive than in Australia, prohibiting a ROPS from investing in residential property, as an example.

Double taxation

Where an individual receives a payment from a UK scheme when they are a permanent resident of Australia, the Australia–UK double tax agreement (the DTA) determines who has the taxing right.

Article 17 of the DTA provides that:

> "Pensions (including government pensions) and annuities paid to a resident of a Contracting State shall be taxable only in that State …"

Accordingly, where an Australian resident receives a pension from the UK, Australia will have the taxing right in accordance with the DTA.

A UFPLS is taxed as follows in the UK (pursuant to s 636A of the *Income Tax (Earnings and Pensions) Act 2003*):

- 25% of the payment is not liable for tax; and
- 75% of the payment is taxed as pension income in the same way as a pension paid under a registered pension scheme.

As mentioned above, a UFPLS can be a one-off payment or multiple ad hoc payments:

- a one-off payment: notwithstanding that such a payment is taxed like a pension in the UK on the 75%, it is the view of HMRC that one UFPLS payment would not satisfy the requirements under art 17, and accordingly the UK would assert the taxing right; and
- multiple ad hoc payments: where more than one UFPLS payment is received, it is HMRC's view that such payments would satisfy the requirements under art 17, and therefore Australia would have the taxing right.

As is evident above, there are a plethora of rules to navigate to ensure that the transfer of any benefits to Australia is undertaken correctly, with full cognisance of the law.

Foreign income tax offset

Where an individual makes the decision to receive from their foreign pension scheme a lump sum payment, pension payments, or they have UK benefits that are in excess of their lifetime allowance (LTA) in the UK whereby the LTA charge would apply, it is important to consider whether the individual is eligible for a foreign income tax offset (FITO).

Section 770-10(1) of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) states that you are entitled to a tax offset for an income year for foreign income tax, if you paid it in respect of an amount that is included in your assessable income for the year.

Section 770-15(1) ITAA97 defines "foreign income tax" as follows:

> "***Foreign income tax*** means tax that:
>
> (a) is imposed by a law other than an Australian law; and
>
> (b) is:
>
> (i) tax on income; or
>
> (ii) tax on profits or gains, whether of an income or capital nature; or
>
> (iii) any other tax, being a tax that is subject to an agreement having the force of law under the *International Tax Agreements Act 1953*.
>
> Note: Foreign income tax includes only that which has been correctly imposed in accordance with the relevant foreign law or, where the foreign jurisdiction has a tax treaty with Australia (having the force of law under the *International Tax Agreements Act 1953*), has been correctly imposed in accordance with that tax treaty."

Accordingly, with respect to any payment from a scheme in another country, would FITO be available? This also includes with respect to any LTA charge.

This question was asked of the Commissioner of Taxation in PBR 78681:

- the taxpayer was subject to an unauthorised payment charge and a scheme sanction charge in the UK on a lump sum payment;
- the charges were 40% and 15%, respectively;
- the lump sum was included in the assessable income of the taxpayer in Australia;
- the taxpayer was questioned as to whether the 40% and 15% charges were eligible for FITO; and
- the taxpayer was eligible for FITO with respect to the unauthorised payment charge only, on the following basis:
  - as the unauthorised payment charge is a charge to income tax that is imposed on the individual personally; it is a creditable foreign tax offset under s 160AF(1) of the *Income Tax Assessment Act 1936* (Cth) (ITAA36); and
  - although the scheme sanction charge is a charge to income tax, as it is imposed on the pension scheme in the UK and not the individual, it is not a creditable foreign tax offset under s 160AF(1) ITAA36.

With respect to the LTA charge, s 214 of the UK *Finance Act 2004* states that the LTA charge is:

> "(1) A charge to income tax, to be known as the lifetime allowance charge …"

Further, s 217 of the *Finance Act 2004* provides for who is liable to the LTA charge:

> "(1) The persons liable to the lifetime allowance charge are –
>
> (a) the individual; and
>
> (b) the scheme administrator of the pension scheme,
>
> and their liability is joint and several …
>
> (5) A person is liable to the lifetime allowance charge whether or not –
>
> (a) that person,

(b) any other person who is liable to the lifetime allowance charge, and

(c) the scheme administrator (if not so liable),

are resident … or domiciled in the United Kingdom."

In light of the above, with respect to the Australia–UK DTA:

- where the individual nominates a pension, under the DTA, Australia has the taxing right. Therefore, given the UK should not be taxing the payments (which would only occur where the DT-Individual form was completed when a pension starts), there would be no foreign tax to pay, and therefore no FITO. Further, if the UK was withholding tax, that would not be in accordance with the DTA and, pursuant to the note in s 770-5(1), FITO would also not be available;
- FITO is only available to the extent that an amount is included in the assessable income of a taxpayer. Accordingly, if the individual is only subject to tax on 5% of a lump sum payment, any FITO will only be available with respect to 5% of the foreign tax paid;
- FITO is only available to the extent that the individual is subject to tax in the foreign jurisdiction. Accordingly, if the lump sum is transferred directly to an SMSF ROPS, as it is the SMSF that is taxable on the applicable fund earnings (AFE) and not the individual, no FITO would be available; and
- where the LTA charge is imposed, it would be eligible for FITO to the extent that a payment is taxable in Australia to the individual as it is a charge to income tax in the UK imposed on an individual.

UK defined benefits

Where an individual has a defined benefit pension in the UK and the cash equivalent transfer value is greater than £30,000, in order to transfer that account out of the defined benefit scheme, the individual is required to obtain accredited advice from a Financial Conduct Authority adviser in the UK. The advice requirements on the adviser are quite onerous, so attending to that advice can be a time-consuming and expensive process.

However, this advice *must* be obtained if the individual wants to transfer their benefits to Australia and they currently have a defined benefit scheme which is greater than £30,000. All of the excellent strategies from an Australian perspective are useless if the money cannot be extracted from the defined benefit scheme. There have been rumours that this threshold may be increased; however, at the time of writing, no such proposal has been announced in this regard.

Australian contribution provisions

A transfer from an overseas pension fund to an Australian superannuation fund is classified as a contribution for Australian superannuation purposes. Accordingly, where any foreign pension account is transferred to an Australian superannuation fund, it is important to consider the contribution provisions under Pt 3-30 ITAA97 and Pt 7 of the *Superannuation Industry (Supervision) Regulations 1997* (Cth). This article will not be outlining the Australian contribution provisions in detail, only the treatment of a UK transfer under those provisions.

This article also considers those pension schemes that may not be in the UK but are registered as ROPS or qualifying ROPS in the UK. The article also assumes that the requirements in s 305-80 ITAA97 are satisfied. This section will apply where a UK pension transfer results in there being no balance remaining in the originating scheme, such that the individual can elect for the fund to include in its income the AFE. Refer to part 1 of this article for more details in this regard.[1]

Contribution treatment: within six months of transfer

On the transfer of a UK benefit to an Australian superannuation fund within six months of an individual becoming an Australian resident for tax purposes, the entire transfer would be classified as a non-growth component (non-assessable non-exempt income), and treated as a non-concessional contribution (NCC). Accordingly, the NCC provisions relevant to the particular individual would need to be considered to ascertain whether they are in excess of their cap or not.

Contribution treatment: beyond six months of transfer

On the transfer of a UK benefit to an Australian superannuation fund after six months of an individual becoming an Australian resident for tax purposes, the transfer would be split into two separate components (on the basis that the requirements in s 306-10 are met):

1. the assessable/growth component: this is the AFE amount (subject to any relevant election made); and
2. the non-growth component: this is the balance of the benefit being transferred and is non-assessable and non-exempt income.

When transferred to an Australian ROPS, the amount of AFE is taxed at 15% in the fund (as discussed above) and it does not count towards either the concessional contribution cap or the NCC cap. The balance (non-growth component) is classified as an NCC and is subject to the relevant cap for the individual.

Where the NCC component of the transfer is above the member's NCC cap (which can range from $0 to $330,000, depending on the circumstances), the excess above the cap will be subject to the excess NCC provisions. This requires the excess above the cap to either be:

- refunded to the member (with an associated earnings amount subject to tax at the member's marginal tax rate, with a 15% tax offset); or
- subject to excess NCC tax at 47% if left within the superannuation environment. This option is very rarely implemented given the prohibitive tax rate. Further,

such a tax payment by the fund may be treated as an unauthorised payment by the ROPS, and subject to additional tax in the UK of between 40% and 55%. Accordingly, this is not the suggested solution.

It is also important to note that, where a member's total superannuation balance exceeds the relevant upper threshold that is currently set at $1.7m (due to the receipt of the UK transfer), the member will be unable to make any further NCCs to superannuation in the current or in subsequent years without them being entirely excessive, unless their balance falls below the $1.7m threshold in a later income year.

As outlined previously, where eligible, the member can make an election that all or part of the AFE can be included in the assessable income of the fund. Where an amount is not so included, it would then be assessable to the individual at their marginal tax rate. Further, the amount of AFE not included in the fund's income would be treated as an NCC in the fund.

ROPS and excess contributions

Where a transfer gives rise to an excess NCC, and the intention is to refund the amount back to the individual from the Australian ROPS that received the foreign transfer:

- there would be reporting requirements to HMRC by the Australian ROPS; and
- this refund may also be treated as an unauthorised member payment for UK purposes and may be subject to tax in the UK at up to 55%.

Accordingly, it is not recommend refunding the balance of the excess contributions from the Australian ROPS fund. However, the following is noted:

- some UK tax advisers have been comfortable with the release of an amount from an Australian ROPS where the underlying funds have been sourced from the UK to refund the excess NCC, and for there to be no HMRC reporting requirements;
- the author is yet to have complete confirmation of this with HMRC and, until such time, is reluctant to undertake this strategy due to the tax risk; and
- although the author has not had confirmation from HMRC with respect to this strategy, equally, it has not been requested for any particular matter as it has not been required, and therefore it is unclear what the position may be.

To mitigate the UK reporting and the unauthorised tax charge, the refund could be sourced from other Australian superannuation benefits where there are sufficient benefits to facilitate a refund.

Section 305-80 ITAA97 not satisfied

Where s 305-80 ITAA97 is not satisfied, which is generally where a partial transfer has been made (that is, there is a balance remaining in the originating scheme after a transfer to a ROPS in Australia), the entire balance that is transferred would be classified as an NCC.

Further, the individual is ineligible to make an election that any part of the AFE is included in the assessable income for the Australian fund, and is liable for the tax personally.

Strategies

There are numerous strategies available to transfer UK benefits to Australia. Many are outlined below, with combinations of them available to achieve the optimal outcome for an individual (as such, the discussion below is not exhaustive). The strategy implemented will depend on the preferences regarding tax, timing, costs of advice, money in superannuation, estate planning, exchange rates, and investment opportunity costs (which all need to be navigated exceptionally carefully to ensure that there are no adverse implications).

Regular pension payments

Where an individual has a UK benefit, the option to take a regular pension out of their account is available. Generally, this is not the preferred scenario for a number of reasons, including:

- payments are fully taxable in Australia at the individual's marginal tax rate. However, a deductible amount could be available, depending on the history for the member;
- if the member has a defined benefit pension and it is reversionary to a spouse, only between 65% and 70% of the pension account is paid to the reversion;
- with a defined benefit pension, no benefits are paid when the member and the reversion die – no capital sum is then available to the next generation;
- there is an ongoing link to the UK and foreign exchange, which may not be ideal, particularly if this is volatile and the individual is receiving income in a currency that is different to where they are spending; and
- an FAD also falls into this category where the individual has an account not that dissimilar to an Australian account-based pension, where they can elect to receive a certain level of payments each year, with the following similarities and differences:
  - there is no yearly minimum (unlike Australia);
  - there is a capital sum supporting the account, so there is an asset when the member dies; and
  - there are potential tax considerations on death for the family to the estate.

Given the above, the more common strategy is for the transfer of benefits to Australia as one or more lump sums, which incapsulates a transfer to superannuation in Australia or a transfer directly to the individual.

Transfer under the NCC cap

Where the individual has a benefit value in their UK pension scheme account at their date of residency (plus any contributions since they became an Australian resident) that is within their NCC cap, it is not overly onerous for that pension scheme account to be transferred into a ROPS in Australia for the following reasons:

- the AFE can be taxed at 15%;
- the benefit is within their NCC cap, so there are no excess issues;
- the individual can use an SMSF with ROPS status, or consider the Australian Expatriate Superannuation Fund;
- the UK scheme is familiar with the transaction and, as the fund is a ROPS, the UK scheme is ticking the boxes from a UK compliance perspective; and
- the time to accomplish this is not generally swift (it may take six months) but is not unreasonable.

Over the NCC cap

Where the individual is over their NCC cap, there are a number of options available for them to transfer their benefits, with the option chosen dependent on their circumstances.

Excess to the NCC cap … with caution

Where an excess to the NCC cap is the outcome, it is important to be aware of the implications:

- There are two options to deal with an excess to the NCC cap (as outlined previously):
  - the incurrence of excess NCC tax (47%) on the excess, plus potential tax in the UK — this is not generally desirable, although money can remain within the superannuation fund; or
  - the release from the fund into which the transfer was made (the ROPS) to the individual member via the ATO — this could be reportable to HMRC and then potentially taxed at up to 55% in the UK.
- Does the member have other Australian superannuation benefits?
- Can the excess to the NCC cap plus a proportion of the associated earnings from that account be released?
- Are there sufficient superannuation benefits to undertake that strategy?
- Both the UK and the Australian implications must be satisfied.

Multiple self-invested personal pension accounts in the UK

Where the individual has benefits that are greater than their NCC cap, they could all be broken down into multiple self-invested personal pension (SIPP) accounts in the UK to ensure that only an amount is transferred to Australia that would be within the NCC cap. Further, with the intention of ensuring that the AFE can be taxed at 15%, splitting the accounts into separate SIPPs (with different providers) would allow there to be a nil balance in the originating fund on each transfer.

The breakdown of the amounts could look as follows:

- SIPP2: the growth component (the AFE) plus the NCC amount within the cap;
- SIPP1: the balance, subject to a maximum of $330,000;
- SIPP3: the balance, subject to a maximum of $330,000;
- SIPP4: the balance, subject to a maximum of $330,000 etc.

However, the individual needs to be mindful of the timing issues in terms of when the money may be transferred into superannuation in Australia:

- SIPP2: year 1;
- SIPP1: year 4;
- SIPP3: year 7;
- SIPP4: year 10 etc.

The timing of the transfer of all of the benefits to Australia under the above strategy is not ideal. Further, where the individual's total superannuation balance in Australia is more than the upper threshold (currently $1.7m) by the time of the third or fourth transfer, they would have an excess to the NCC cap with respect to a transfer subsequent to that time, so the overall intention may not be able to be met. That is, they would not be able to get the benefits all transferred to Australia within their NCC cap.

Uncrystallised funds pension lump sum

Rather than transferring the benefits to superannuation in Australia entirely, there are strategies available to mitigate an excess to the NCC cap. One such strategy is payment directly from the UK pension scheme to the individual in the form of several UFPLS payments:

- where there is more than one UFPLS, Australia has the taxing right;
- the process for the payments to be subject to tax in Australia rather than the UK is cumbersome and not timely — it could be 12 months from the first UFPLS to the second to mitigate withholding tax in the UK;
- there are tax implications in Australia with respect to the AFE, for example, where an UFPLS is paid, the AFE would be taxed at the individual's marginal tax rate, with relevant considerations as follows:
  - if the amount of the AFE is not substantial, the member could be comfortable with the outcome in terms of that amount being taxed at their marginal tax rate;
  - the benefits are then entirely out of the UK system, with no reporting back to HMRC;
  - an individual receiving UFPLS payments only is not generally the option that most people select, unless they have only just become residents of Australia and the AFE is not substantial; and
  - this option is difficult to achieve within the six-month timeframe given the UK considerations, particularly as tax is withheld by the UK pension scheme at source until the relevant UK nil tax code is in place.

Combination of options

A combination of the above options could be considered to achieve an optimal outcome, with that optimal outcome considering the timing, tax and transaction costs.

There is a multiple-step process to consider:

1. What is the growth/AFE and non-growth component of the benefit?
2. If the non-growth component of the benefit is greater than the NCC cap, consider splitting the UK account into multiple SIPPs, for example:
   a. SIPP2: the AFE plus the NCC cap;
   b. SIPP1: the balance (which would be comprised of the non-growth component only).
3. Transfer SIPP2 to an Australian ROPS.
4. Receive multiple UFPLS payments from SIPP1, with the following outcome:
   a. there would be no further tax in Australia (except on any growth/AFE earned between the transfer from SIPP1 to SIPP2 and the UFPLS payments);
   b. all UK benefits would be transferred to Australia within 18 to 24 months; and
   c. when compared to previously outlined strategies, while this particular process can be cumbersome, the timing of the benefits all being in Australia is often a preferred outcome than in four or more years.

Where the benefits are over the lifetime allowance

Where an individual has benefits in the UK scheme that are greater than their LTA in the UK, and where those benefits are paid out (whether transferred to a ROPS in Australia or paid to the individual), the amount above the LTA is subject to the LTA charge in the UK of 25%.

If a UFPLS payment is made from benefits that are greater than the LTA, tax is withheld on such a payment at 55% by the UK scheme, even where a nil tax code is in place. Accordingly, a UFPLS strategy cannot be implemented with respect to these amounts (greater than the LTA), as the withholding tax in the UK would be prohibitive.

However, a strategy could be implemented (as already outlined above) with respect to amounts up to the LTA (splitting the AFE to SIPP2, receiving UFPLS payments). The consideration is the extraction of the amount above the LTA from the UK. It should be noted that this can be delayed for a period of time; however, if benefits remain in the UK, on an individual attaining age 75, the balance at this time is tested against the LTA and the 25% LTA charge would be incurred.

A strategy for the extraction of the amount above the LTA is a one-off FAD payment. *However*, the challenge with an FAD is that, in Australia, such payments could be fully taxable at the individual's marginal rate, which is not ideal. On the other hand, there is an argument that a one-off FAD is a lump sum in Australia and not a pension, which means that it would be taxed on any AFE, which may be nil on the basis that other steps have been implemented prior to such a payment.

It is recommended that such treatment is confirmed with the ATO via a private binding ruling that would apply specifically to the relevant individual. The individual would then have certainty with respect to the treatment of the FAD. There is a substantial difference between the two potential outcomes, where such a payment could be treated in Australia as being 100% taxable at the individual's marginal tax rate, or only any AFE on the payment could be taxable in Australia at the individual's marginal tax rate.

The above discussion is succinct, with many subtleties to navigate between the two jurisdictions in this scenario. However, the author has had numerous successes with such strategies. It should be noted that the LTA charge is unavoidable, and therefore the consideration is whether to transfer benefits to Australia sooner rather than later.

Already crystallised benefits

As outlined previously, where benefits have been crystallised (for example, an FAD has commenced, or a PCLS has been taken), it can be a challenge to transfer the balance to Australia as a crystallised account cannot be split, or a UFPLS paid. Therefore, the only options are for a 100% transfer to superannuation in Australia (which may result in an excess to the NCC cap) or for an FAD payment (which could be fully taxable in Australia).

Accordingly, a similar strategy to that in the situation with an excess to the LTA is available, with a private binding ruling recommended regarding an FAD payment. The withholding tax in the UK remains a consideration, with that component needing to be managed as part of any implementation.

Conclusion

The extraction of benefits out of UK pension schemes is a complex area that requires navigation through the UK and Australian legislation, taxation authorities, schemes and the involvement of many parties.

It is not a swift process, and constantly changes with the view of the regulators in each jurisdiction. Expectations need to be set with clients regarding the timeframes and complexity.

The implementation of any of the strategies outlined above is of the *utmost importance* – the advice is worthless if it is not implemented correctly. This is where numerous parties may need to be involved in each jurisdiction, with a collaborative approach, which would increase the costs of a transfer. However, the costs incurred mean that the individual can end up with 95% of their benefits in Australia (gross of tax), rather than 100% of their benefits remaining in the UK with other implications.

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Reference

1 J Sanderson, "UK pension transfers: part 1", (2022) 57(4) *Taxation in Australia* 219.

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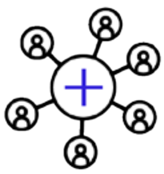

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Duties: land-owning unit trusts

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The stamp duty implications of acquiring ownership interests in a unit trust which owns land is a complex subject. Different rules in each Australian state and territory can lead to varying and, at times, materially adverse outcomes, especially for the unwary. This article explores the various widely held and wholesale unit trust stamp duty concessions that are available to land-owning unit trusts in each relevant state and territory, with a particular focus on the rules in Victoria and Queensland where the basic thresholds for dutiable relevant acquisitions are lower than the 50% threshold in other jurisdictions. The benefits of obtaining these concessions, the criteria that must be satisfied to qualify for these concessions, and some common issues in practice are explained. This article also includes summary tables for ease of identifying key criteria and issues in each relevant state and territory.

Overview

The question of whether duty applies to the acquisition of units in a unit trust can turn on a multitude of variables, including whether and where land of the trust is located, the timing between unit and land acquisitions, the category of trust under the duties rules, the percentage of ownership, and the relationships between investors.

This article focuses on practical considerations to keep in mind when establishing a landholding trust, including qualifying for the various unlisted public unit trust concessions, and practical considerations for planning and implementing those requirements.

This article considers:

- the landholder and trust acquisition regimes in relevant jurisdictions;
- the public unit trust rules in the various jurisdictions, with a particular focus on unlisted trusts in Victoria and Queensland; and
- practical considerations when establishing an unlisted trust, raising funds and dealings in units.

Why does this matter?

The acquisition of units in a land-owning unit trust can potentially be subject to duty under the landholder duty rules in all jurisdictions and the onerous trust acquisition duty rules in Queensland.

However, investors in land-owning trusts which are genuine pooled investment vehicles will generally not trigger duty on their day-to-day dealings in their units, provided the trust qualifies for concessional treatment under the various regimes available in each jurisdiction. These concessions are summarised as follows:

- **listed trusts**: in all jurisdictions, listed trusts are subject to a higher 90% significant interest acquisition threshold. Except in Western Australia, dutiable acquisitions in listed trusts also benefit from a concessional duty rate (or exemption in the case of the Australian Capital Territory);
- **widely held trusts**: in most jurisdictions (except WA and the Northern Territory), widely held trusts are subject to a higher 90% significant interest acquisition threshold, and also a concessional duty rate (or exemption in the case of the ACT); and
- **wholesale trusts**: Queensland and Victoria have a lower threshold for taxing dealings in private unit trusts. The wholesale unit trust concessions in these jurisdictions brings the treatment of these entities in line with the taxation of private unit trusts in other jurisdictions.

In Victoria, a trust that qualifies for any of these concessions is also excluded from the land tax absentee owner surcharge.[1] The absentee owner surcharge applies where a unit trust has foreign beneficiaries and is currently charged at the rate of 2% of the unimproved value of the land, in proportion to the trust's underlying foreign ownership.

This article will focus on the two unlisted trust categories above.

Landholder duty (all jurisdictions)

This article largely assumes a detailed knowledge of the landholder duty rules in each jurisdiction. By way of a brief overview, the key common elements of the landholder duty regimes of Australian jurisdictions are summarised as follows:

- a landholder is a unit trust or company that holds, directly or indirectly, land in a jurisdiction that exceeds a certain threshold value (generally, $1m or $2m);
- when determining an entity's landholdings, tracing rules apply to look through subsidiaries and partial interests in entities. Generally, there is no tracing through minority interests of less than 50% (or 20% in the case of Victoria). Further, property subject to a contract for sale is generally deemed to be included;
- duty is imposed on certain relevant acquisitions of interests in the landholder, eg through acquiring units in a trust, and the interest is either itself a significant interest, increases a significant interest, or amounts to a significant interest when aggregated with pre-existing interests or interests held by associates or acquired through associated transactions. A significant interest

is generally 50% in most cases for private unit trusts (except it is 20% in Victoria); and

- the rate of landholder duty is the same as the general rate applicable to transfers of land and is charged based on a proportion of the market value of the landholder's underlying landholdings referrable to the proportionate interest acquired in the landholder.

Queensland trust acquisition duty

The Queensland model for taxing acquisitions of interests in trusts is completely different from other jurisdictions. In Queensland, landholder duty only applies to *listed trusts*. Dealings in units in unlisted trusts are taxed under the trust acquisition (and trust surrender) rules or majority trust acquisition rules. These rules have very little in common with landholder duty, and perhaps deserve their own article. The key elements are summarised below.

Trust acquisition

The trust acquisition rules are particularly onerous due to the lack of a "significant interest" threshold or any limitations on tracing through trust interests. If establishing a pooled investment vehicle that will invest in Queensland, it may be critical that the trust qualifies for a concessional category of trust unless it is a closed fund that does not contemplate any changes in its unitholding:

- the trust acquisition rules apply to unlisted trusts which are not public unit trusts (which include the widely held and wholesale trust categories discussed in this article);
- there is no "significant interest" concept. As such, any dealing of units in a landholding trust will be dutiable. This includes transfers, issues and surrenders. The acquirer is generally liable, but in the case of surrenders, the trustee would also be jointly liable;
- there are no apparent tracing rules when determining a trust's indirect interest in dutiable property. Tracing is required where "there is a connection between the trust and dutiable property" through a trust interest or partnership interest (or a series of trust interests or partnership interests).[2] Property subject to a contract for sale is also included. This can lead to the bizarre and frankly unworkable result of tracing through fractional indirect interests in trusts (including listed trusts) of which the trustee has no control or even knowledge; and
- all dutiable property held by a trust is relevant – not just land. In Queensland, dutiable property is defined broadly and includes intangible business assets such as goodwill and debts. For many real estate investment trusts, this distinction may be of little practical consequence but should be kept in mind for funds which are not "stapled" groups and carry on a business, such as in the retirement living, aged care and student accommodation sectors.

Majority trust acquisition

The majority trust acquisition rules should generally prevent the application of the more onerous aspects of the trust acquisition rules on a day-to-day basis, as a majority trust acquisition only applies to the acquisition of a trust interest of 50% or more, provided no investor has a 50% or greater trust interest. However, there are still some strange results that can arise in practice:

- the majority trust acquisition rules only apply to wholesale unit trusts and pooled public investment unit trusts that hold or have an indirect interest in land in Queensland. There is no equivalent concept of a dutiable trust surrender under these rules (provided the trust satisfies these concessions both *before* and *after* the relevant trust acquisition or trust surrender);
- there are still no tracing rules when determining a trust's indirect interest in land in Queensland. Therefore, this can lead to the same bizarre result of tracing through fractional indirect interests in trusts;
- a majority trust acquisition only occurs on the acquisition of a trust interest of 50% or more, or the acquisition of a trust interest that is, when aggregated with trust interests already held by the person and related persons of the person (whether alone or jointly), 50% or more;
- although the majority trust acquisition rules only apply to landholding trusts, if a dutiable acquisition does occur, duty will be assessed on all dutiable property held directly or indirectly by the trust – not just land;
- for the purposes of the majority trust acquisition rules, an indirect trust interest is also taken to be a trust interest, and the acquisition of an indirect trust interest is taken to be a trust acquisition.[3] When determining an indirect trust interest, the legislation purports to trace through corporations, partnerships and trusts;[4] and
- if an investor holds a 50% or greater interest in the trust, it is not apparent that they would be entitled to a credit for that interest on the acquisition of a further interest,[5] even if they acquired their interest pursuant to an exempt transaction or if they had held their interest since the trust was established.

Widely held trusts

All jurisdictions except WA and the NT offer a concessional regime for unlisted widely held trusts. Qualifying for these regimes will have the consequence of:

- raising the significant interest threshold to 90%; and
- reducing the duty payable on a relevant acquisition to 10% of the duty that would be payable on an acquisition in a private landholder, or an exemption in the case of the ACT.

It should be noted that, in Victoria, a public unit trust (which includes listed trusts, widely held trusts, and declared public unit trust schemes) is also excluded from the land tax absentee owner surcharge.

The criteria for unlisted widely held trusts are summarised below. Please also refer to the comparison summary in Appendix 1 to this article.

ACT, NSW and South Australia

There is a similar definition of "widely held trust" in the ACT, New South Wales and South Australia.[6] The trust must satisfy two conditions:

- the trust must have at least 300 unitholders; and
- no single unitholder, individually or together with any associated person, is entitled to more than 20% of the units in the trust.[7]

In practice, the application of this test is often uncontroversial as most trusts with any possibility of having at least 300 unitholders will be retail funds with a very large number of unitholders, and with no apparent connection between the unitholders.

The legislation does not define "unitholder".[8] It is not apparent whether there is any practical difference between these expressions, and the authors understand that this should generally be accepted to mean the unitholder registered on the unit register. This is supported by the interpretation rule in the legislation treating trustees as a separate unitholder in relation to each trust of which they are a trustee.[9]

The closely held limb of the test brings in the concept of associated person. An examination of these rules, which differ slightly between each jurisdiction, is beyond the scope of this article. Greater care may need to be taken in the context of the initial sell-down or demerger by the original landowner.

Victoria

Widely held trust test

There is a similar definition of "widely held trust" in Victoria as for the jurisdictions mentioned above (the ACT, NSW and SA),[10] although Victoria uses the expression "registered unitholder" rather than "unitholder". Otherwise, the above commentary applies equally to Victoria.

Declared public unit trust schemes in Victoria

In Victoria, an unlisted trust that does not qualify as a "widely held trust" may consider seeking registration as a "declared public unit trust scheme" under s 89R of the *Duties Act 2000* (Vic). A declared public unit trust scheme is entitled to the same duty treatment as a public unit trust.

Section 89R sets out limited restrictions on the Commissioner's discretion to permit registration as a declared public unit trust scheme, other than that:

- the scheme "should be" registered as a declared public unit trust scheme; and
- registration must not be for a purpose of avoiding landholder duty.

It should be noted that, prior to 19 June 2019, the definition of "public unit trust scheme" in s 3 of the *Duties Act 2000* (Vic) excluded any unit trust scheme that was at any time eligible for registration as a wholesale unit trust scheme. The definition now only excludes unit trusts registered as wholesale unit trust schemes.

The Commissioner has issued Revenue Ruling DA.063v2 setting out the factors that the Commissioner will take into account when determining whether a trust should be registered as a declared wholesale unit trust scheme. In that ruling, the Commissioner accepts that the purpose of ss 89Q and 89R is:

> "These sections allow a unit trust scheme to overcome anomalies associated with its status under the Act when it is effectively public in nature and purpose but fails to meet the necessary criteria for recognition as such."

The factors referred to in the ruling are set out as follows:

- the purpose and nature of the scheme and whether it is effectively public;
- whether units in the scheme were offered to the public, or an appreciable section of the public;
- whether the scheme was established for a particular investor or group of investors;
- the degree of ownership and/or control that a particular investor or group of investors has/have over the scheme;
- the total number of unitholders in the scheme and whether units are widely held by persons who are not associated with each other;
- the reasons why the scheme is unable to qualify as a public unit trust scheme and whether this is due to factors beyond its control; and
- whether the unit trust scheme is registered as a wholesale unit trust scheme, an imminent wholesale unit trust scheme, or a declared wholesale unit trust scheme.

Section 89R(3) gives the Commissioner broad discretion to impose conditions on registration.

If a registered declared public unit trust scheme ceases to meet the relevant criteria for registration, or a condition of registration, the trust is taken to be a private unit trust scheme from the date on which the disqualifying circumstance occurred, and any acquisition in the trust on or after that date will be assessed according to the lower significant interest threshold of 20%.[11]

Further, if a disqualifying circumstance has occurred, the trustee must give the Commissioner notice within 28 days. A failure to comply can lead to double duty in respect of any relevant acquisitions in the period since the disqualifying circumstance by way of a penalty imposed on the trustee under s 89X(5).

Queensland

In Queensland, a widely held unit trust is not subject to the trust acquisition or majority trust acquisition rules under Ch 2 of the *Duties Act 2001* (Qld), or the landholder duty rules in Ch 3.

However, a unit trust is not a widely held unit trust if it does not satisfy the widely held and not closely held conditions both *before* and *after* any trust acquisition or trust surrender.[12] Therefore, a trust acquisition or trust surrender giving rise to duty in a widely held unit trust will be assessed at the standard rate, rather than at the concessional rate for listed landholders.

Widely held unit trusts

Table 1 sets out the criteria which must be satisfied to be a widely held unit trust in Queensland and some practical observations.

Table 1. Widely held unit trust criteria

Criteria	Observations
The unit trust must be a registered managed investment scheme (MIS)	The authors have not experienced any practical difficulties when determining whether or not this limb of the test has been satisfied.
Units in the trust have been issued to the public	"Issued to the public" is not defined. Advisers may wish to have regard to the case law discussion on the meaning of public and public offer.[13]
50 or more persons are beneficially entitled to the units in the trust	"Beneficially entitled" is not defined.[14] Particularly as the Queensland legislation otherwise generally only uses "entitled", it is arguable that trustees and custodians should not be regarded as "beneficially entitled", thereby possibly permitting a look-through of the unit register to an underlying beneficiary.[15] A trustee may of course have practical difficulties in looking through the unit register with any certainty as it is only able to rely on the information provided by the unitholder. Further, this test is difficult to apply to a unitholder that is a trustee of a unit trust or superannuation fund. Generally, a unitholder in a unit trust or beneficiary in a superannuation fund would not have any entitlement to specific assets in the trust. On one interpretation, this could have the effect of leaving nobody "beneficially entitled" to such units. Section 70(5) of the *Duties Act 2001* (Qld) is intended to apply a grouping rule for related persons (although, if applied literally, perhaps it does not have this effect). "Related person" is defined in s 61 of the *Duties Act 2001* (Qld), which is a test that is difficult to apply.
More than 20 persons are beneficially entitled to at least 75% of the total units in the trust	The intention of this limb is presumably to operate as a "not closely held" test, although s 70(1)(c) is not sensible if read literally. If applying this test for its apparent intended purpose, presumably this will be satisfied if the top 20 unitholders hold less than 75% of the units in the trust. The authors also make the same observations as above regarding the meaning of "beneficially entitled".

As a general comment, key terms used in this test are undefined, although advisers should consider whether judicial commentary about the meaning of some of these expressions in other contexts might be relevant. There are a number of ambiguities in the drafting of this test which permit a wide variety of interpretations. Finally, as with many of the Queensland rules, the test can potentially be difficult for a trustee to rely on with any certainty.

The authors understand that the concession is, in practice, generally self-assessed. However, it should also be possible to seek a ruling from the Commissioner to confirm whether a particular trust satisfies the requirements for widely held unit trust status.[16]

Start-up phase concession

If a trust does not immediately satisfy the criteria to be a widely held unit trust, it is possible to apply for the Commissioner's discretion to be treated as a widely held unit trust during an initial "start-up period".[17]

The Commissioner must be satisfied that:

- units in a unit trust (the start-up units) will be issued to the public to an extent, and with the entitlements mentioned in s 70(1), within one year after the first issue of units to the public; and
- the start-up units are the only units in the unit trust to be issued from and including the first issue to the public until the unit trust becomes a widely held unit trust (the start-up period).[18]

However, where the requirements are not satisfied, the Commissioner must be notified, and the concession will be revoked. Duty is then assessed on any trust acquisitions or trust surrenders in the start-up period as if the trust were not a widely held unit trust in the period.[19]

Tasmania

Tasmania also has a landholder duty concession for certain unlisted widely held unit trusts contained in the definition of "public unit trust scheme". There are several categories, although the most readily applicable to new investments requires satisfying the following criteria:[20]

- the unit trust must be a "managed investment scheme" within the meaning of Ch 5C of the *Corporations Act 2001* (Cth);
- some or all of the units have been offered to the public; and
- no fewer than 50 persons hold units in it.

Chapter 5C applies to both registered and unregistered MIS (although it generally deals with registration). Therefore, an unregistered MIS should arguably qualify as a "public unit trust scheme".[21] However, the authors are not aware of the Commissioner publishing a view on the matter.

The definition of "public unit trust scheme" also includes categories that refer to repealed provisions of the old corporations law contained in s 82 of the *Corporations Act 1989* (Cth). These categories still require an offer to the public and 50 or more unitholders, but have not been explored further for the purposes of this article.

There is also a start-up phase concession. A person may apply for an opinion from the Commissioner that a trust will satisfy the requirements of being a "public unit trust scheme" within 12 months after the Commissioner gives written notice of that opinion. If the Commissioner gives this opinion, the trust will qualify as a "public unit trust scheme".

Wholesale trusts

If the widely held rules discussed above are not applicable and the trust is expected or may in future own Victorian or Queensland property, regard should be had to the concessional regimes applying to "wholesale" unit trusts. Although the legislation refers to "wholesale", the rules bear little resemblance to the ordinary common use of the term or its meaning for corporations law purposes.

Only Victoria and Queensland have rules for wholesale unit trusts. There is no need in other jurisdictions because the same 50% significant interest threshold applies to all "private" trusts. The benefits in qualifying for the wholesale unit trust concessions are as follows:

- **Victoria**: the threshold for a dutiable acquisition of a significant interest is increased from 20% to 50%. Also, a trust qualifying for this concession will not be subject to the land tax absentee owner surcharge; and
- **Queensland**: trust acquisition duty is only imposed if a unitholder acquires a 50% or greater interest. There is otherwise no significant interest threshold. Any dealing in a private landholding unit trust that does not qualify for this concession is likely to have duty consequences.

The concessional regimes available for wholesale trusts in Victoria and Queensland are summarised below. Please also refer to the comparison summary in Appendix 2 to this article.

Victoria: wholesale unit trust scheme

The Victorian "wholesale unit trust scheme" regime requires registration with the State Revenue Office, has a minimum landholdings requirement, and is only available where certain limited categories of investors hold at least 70% of the units in the trust.

There is also a start-up concession for imminent wholesale unit trust schemes and a broad discretion to register declared wholesale unit trust schemes for trusts that are effectively wholesale but do not quite meet the formal criteria.

Note that the following discussion focuses on considerations in establishing new trusts that are intending to invest in Victoria. In relation to existing trusts, advisers should keep in mind that there are complex transitional rules which may apply, particularly for trusts established prior to the 2012 landholder duty rules.

Criteria for registration

The criteria for registration as a wholesale unit trust in Victoria are as follows:[22]

- the scheme was not established for a particular investor. The authors understand that the Commissioner has accepted that a trust which is established with one initial investor is not necessarily established for that investor, provided the trust's investment strategy was always to offer and seek investment from other investors;
- either of the following must be satisfied:
  - the trustee of the scheme, as trustee, holds directly or indirectly an interest in not less than three parcels of land (whether in or outside Victoria) and at least two of those interests each have an unencumbered value of $10m or more. The Commissioner is entitled to treat two or more parcels as a single parcel if he is satisfied that it is appropriate to do so having regard to the ownership of the parcels, their proximity and use; or
  - at least six of the unitholders in the scheme who are not associated persons each have a subscription under the scheme of not less than $3m;
- not less than 70% of the units in the scheme are held by qualified investors;
- no qualified investor, either alone or together with associated persons, holds 50% or more of the units in the scheme; and
- registration is not being sought for the purpose of, or as part of a scheme or arrangement with a collateral purpose of, avoiding or reducing landholder duty.

Meaning of "qualified investor"

"Qualified investor" is defined in s 89P(1) of the *Duties Act 2000* (Vic). The categories of "qualified investor" are summarised Table 2.

The categories of investors listed in Table 2 are arguably more limited than what might ordinarily be understood to be wholesale, and since the introduction of wholesale unit trust registration, the list has rarely been expanded. Foreign investors are not included, unless approved under s 89P(4). Although perhaps this limited definition is sufficient to serve the original policy rationale of these rules, which was to prevent institutional investors from being turned away from investing in Victoria as a result of the reduction of the significant interest threshold to 20% for private unit trust schemes.[23]

The list is extremely precise as to the capacity in which the units are held, as they refer expressly to "trustee" and "custodian". It may be difficult to argue that a capacity or related body corporate that is not expressly referred to in Table 2 should be a qualified investor. Revenue Ruling DA.061 relevantly states:

> "… the Commissioner will not look beyond the registered unit holders of the scheme. The only exception is where a unit holder is a bare trustee, nominee or custodian separately holding units in the scheme for different beneficial owners (including qualified investors under section 89P of the Act) who could call for the units at any time. In all other cases, the Commissioner will not look through registered unit holders to determine a scheme's status under the Act."

The Commissioner also adopts a strict interpretation of the further capacities that may be approved under s 89P(4). In particular, the authors understand that the Commissioner's practice is not to accept the application of s 89P(4)(b) to an Australian entity, that is, the reference in s 89P(4)(b) to a subsidiary is only a reference to a subsidiary of a foreign equivalent approved under s 89P(4).

Table 2. Categories of "qualified investor"

Qualified investor	*Duties Act 2000* (Vic) reference
Certain large superannuation entities (under the *Superannuation Industry (Supervision) Act 1993* (Cth))	• The trustee of a complying superannuation fund that has no less than 300 members (s 89P(1)(a)). • The trustee of a complying approved deposit fund that has no less than 300 members (s 89P(1)(b)). • The trustee of a pooled superannuation trust (s 89P(1)(c)).
Statutory funds of life companies	• A life company, if its holding of the units in the unit trust scheme is an investment of a statutory fund maintained by it under the *Life Insurance Act 1995* (Cth) (s 89P(1)(g)).
Certain listed or widely held investment vehicles	• The trustee of a public unit trust scheme (being the categories discussed above) (s 89P(1)(d)). • A listed company (s 89P(1)(f)). • As custodian or trustee for an investor-directed portfolio service, within the meaning of the relevant ASIC policy statement, if the custodian or trustee holds its interest in the unit trust scheme for no less than 300 clients as investors through the service, none of whom (individually or together with any associated person) is beneficially entitled to more than 20% of the units held by the custodian or trustee in the unit trust scheme (s 89P(1)(k)).
Other registered wholesale unit trust schemes	• The trustee of a wholesale unit trust scheme (being the categories of registered wholesale unit trust under the *Duties Act 2000* (Vic)) (s 89P(1)(e)).
Certain government entities	• As the Crown in right of the Commonwealth, a state or a territory (including any statutory body representing the Crown in right of the Commonwealth, a state or a territory) (s 89P(1)(h)). • As, for or on behalf of an entity established and wholly owned by a government agency of a state or a territory or the Commonwealth and primarily used for the purpose of meeting statutory government liabilities or obligations (s 89P(1)(i)).
Agent, nominee or custodian for the above	• As agent, nominee or custodian for a person or entity referred to in any of the preceding paragraphs of s 89P(1), in the capacity as such an agent, nominee or custodian and in accordance with the terms of appointment of the agent, nominee or custodian (s 89P(1)(j)).
Further capacities approved by the Commissioner	• Foreign equivalents of the above (excluding the government entity categories) (s 89P(4)(a)). • A wholly owned subsidiary or wholly owned trust of a s 89(1)(a) entity (s 89P(4)(b)).

Registration process

A trust must be registered with the Commissioner in order to obtain wholesale unit trust status in Victoria. There is no self-assessment of this status. A trust that satisfies the criteria but does not obtain registration is not entitled to wholesale unit trust treatment and is treated as a private unit trust.

Registration may be backdated[24] and the Commissioner has outlined the circumstances in which this would be permissible in Revenue Ruling DA.061, relevantly tying this to considerations of whether there is any purpose of avoiding or reducing landholder duty (which is a criteria for registration).

For trusts that do not meet the formal criteria for registration, there are two possibilities (discussed below): (1) a start-up concession for imminent wholesale unit trust schemes; and (2) a discretion to be registered as a declared wholesale unit trust scheme.

Imminent wholesale unit trust scheme

If a trust does not initially meet the criteria for registration as a wholesale unit trust scheme, it may seek registration as an imminent wholesale unit trust if:

- the unit trust scheme will meet the criteria for registration as a wholesale unit trust within 12 months after the day on which the first units in the scheme were issued to a qualified investor;
- the units issued in the trust before the scheme meets the criteria for registration as a wholesale unit trust have been, and will be, issued only for the purpose of the scheme meeting those criteria; and
- registration is not being sought for the purpose of, or as part of a scheme or arrangement with a collateral purpose of, avoiding or reducing landholder duty.

Imminent wholesale unit trust status is intended to provide duty relief for trusts during their initial start-up phase. Therefore, a trust that is registered as an imminent wholesale unit trust is entitled to the same duty treatment as a registered wholesale unit trust scheme.

If an imminent wholesale unit trust ceases to satisfy any of the requirements for imminent wholesale unit trust status or fails to satisfy the criteria for registration as a wholesale unit trust within the relevant 12-month period, any interests acquired in the trust while it was registered as an imminent wholesale unit trust are liable to duty as though the trust were a private unit trust scheme.

Registration as a declared wholesale unit trust scheme

If a trust is unable to be registered as a "wholesale unit trust scheme" or an "imminent wholesale unit trust scheme", there is finally a discretion to register a trust as a declared wholesale unit trust scheme under s 89U of the *Duties Act 2000* (Vic).

A trust initially registered as an imminent wholesale unit trust scheme, but which does not satisfy the criteria of a wholesale unit trust scheme by the end of the 12-month period, might also consider registration as a declared wholesale unit trust scheme.[25]

Section 89U sets out limited restrictions on the Commissioner's discretion to permit registration as a declared wholesale unit trust scheme, other than that:

- the scheme "should be" registered as a declared wholesale unit trust scheme; and
- registration must not be for a purpose of avoiding landholder duty.

The Commissioner has issued Revenue Ruling DA.062 setting out the factors that the Commissioner will take into account when determining whether a trust should be registered as a declared wholesale unit trust scheme. In that ruling, the Commissioner accepts that the purpose of ss 89Q and 89U is:

> "These sections allow a unit trust scheme to overcome anomalies associated with its status under the Act when it is effectively wholesale in nature and purpose but fails to meet the necessary criteria for registration as such."

The factors referred to in the ruling are summarised as follows:

- the purpose and nature of the scheme and whether it is effectively wholesale;
- whether the scheme was established for a particular investor or for a specific type of investor, ie public, professional or institutional investors;
- whether units in the scheme have been offered to retail investors or restricted to professional and institutional investors;
- the degree of ownership and/or control a particular investor or group of related investors has/have over the scheme;
- the percentage of units in the scheme held by qualified investors either alone or together with associated persons;
- the value of each unitholder's subscription under the scheme;
- the direct and indirect landholdings of the scheme, including the unencumbered value of each landholding; and
- the factors restricting the scheme's ability to satisfy the criteria of a wholesale unit trust scheme and whether the scheme is eligible to be registered as an imminent wholesale unit trust scheme.

Section 89U(3) gives the Commissioner broad discretion to impose conditions on registration. In some circumstances, the authors are aware that the Commissioner has imposed a condition that the trust must satisfy the criteria of a registered wholesale unit trust scheme within a certain timeframe.

Consequences of ceasing to meet the criteria for registration

A "disqualifying circumstance" occurs under s 89X(1) of the *Duties Act 2000* (Vic) if a registered trust ceases to meet the relevant criteria for registration, or a condition of registration (subject to a "just or reasonable" discretion by the Commissioner).[26] Section 89X appears to apply only to trusts which are registered; it is not apparent on its face that it should apply where registration merely lapses.

The consequences can be harsh. The trust is taken to be a private unit trust scheme from the date on which the disqualifying circumstance occurred,[27] and any acquisition in the trust on or after that date will be assessed according to the lower significant interest threshold of 20%.[28] This would appear to apply to any acquisition triggering the disqualifying circumstance, although s 89X(3)(c) appears to apply only to acquisitions that are themselves of an interest of 20% or more.[29]

Further, if a disqualifying circumstance has occurred, the trustee must give the Commissioner notice within 28 days. A failure to comply can lead to double duty in respect of any relevant acquisitions in the period since the disqualifying circumstance by way of a penalty imposed on the trustee under s 89X(5).

Given these potentially serious consequences for investors and the trustee, as a practical matter, trustees may wish to consider incorporating restrictions in their constitutions or in investor side letters restricting dealings in units which may cause the trust to cease to qualify as a wholesale unit trust scheme.

Queensland: wholesale unit trust

Queensland has two relevant regimes applicable to non-widely held unlisted unit trusts,[30] which are discussed in turn. The first is a "wholesale unit trust", which is easier to satisfy but can potentially be difficult to apply in practice. In contrast to the pooled public investment unit trust rules (discussed below), it is not apparent that lawyers had any input into the drafting, but helpfully the authors suggest that this leaves the provisions capable of more flexible application.

A wholesale unit trust will be a "landholding trust" if it holds interest in land and therefore the majority trust acquisition rules would apply.

Criteria for wholesale unit trust

There are two tiers for determining whether a unit trust is a wholesale unit trust:

- if a trust *does not hold land* in Queensland (whether directly or indirectly),[31] it is sufficient that the unit trust is "established and managed by a funds manager" and its units are "predominantly acquired by, for or on account of wholesale investors"; and
- if a trust *holds land* in Queensland (whether directly or indirectly), in addition to the above, it must be established and continue "solely for the investment of funds placed with it by wholesale investors using the funds manager's funds management and investment services".

Table 3 sets out the criteria which must be satisfied by a landholding trust to be a wholesale unit trust in Queensland and some practical observations.

Meaning of "wholesale investor"

Section 74 of the *Duties Act 2001* (Qld) sets out four categories of wholesale investor. These categories are exhaustive. The four categories do not align with the ordinary commercial understanding of a wholesale investor, or the *Corporations Act 2001* distinction between a sophisticated investor and a retail investor:

1. a funds manager, other than the funds manager that established and manages the trust, investing funds of another wholesale unit trust managed by the funds manager;
2. the trustee of another wholesale unit trust investing funds of another wholesale unit trust managed by the trustee;
3. the trustee of a superannuation fund under the *Superannuation Industry (Supervision) Act 1993* (Cth) having more than $10m in assets; or
4. a person who has more than $10m invested in wholesale unit trusts.

There is a helpful circularity in some of these categories. In particular, if the trustee of a fund ensures that each investor has at least $10m invested in the fund, it should be certain that each investor is a wholesale investor on the basis that the trust itself then satisfies the definition of being a wholesale unit trust – pulling itself up by its bootstraps. This offers a trustee some certainty, without having to rely on representations by their investors.

If relying on this last limb of the definition, it is recommended that a $10m minimum investment is enshrined in the constitution. This may also assist in evidencing the wholesale purpose test discussed above.

There are no clear tracing rules in this test. Although the provisions make no reference to units or unitholders, except to units being "acquired by, for or on account of" in s 72(1)(b) of the *Duties Act 2001* (Qld) which suggests that it is permissible to look through registered unitholders to identify an underlying "wholesale investor". Similarly, s 74(a) refers to the wholesale investor as the "funds manager" rather than a "trustee" which might ordinarily be the unitholder.

Meaning of "funds manager"

A funds manager is a body corporate that provides (or is a member of a corporate group of a financial institution or insurer that provides) funds management and investment services to wholesale investors and manages funds of more than $500m invested with it.

The Commissioner may treat a particular body corporate as a funds manager for these purposes if he is satisfied that the body corporate will provide funds management and investment services to wholesale investors to the extent referred to above within one year after a wholesale investor first acquires a trust interest in a unit trust established and managed by the body corporate.

No registration required

Registration is not required, and in practice the authors understand that this concession is commonly self-assessed by taxpayers. However, it should also be possible to seek a ruling from the Commissioner to confirm whether a particular trust satisfies the requirements.[32]

Table 3. Wholesale unit trust criteria

Criteria	Observations
Must not be a listed unit trust	This is likely to be uncontroversial.
Established and managed by a "funds manager"	The "funds manager" requirements are discussed below. "Managed by" presumably can be demonstrated by the appointment of the funds manager under some form of services agreement. It is not clear how a trust is "established" by a funds manager, and whether this requires the initial units to be held by the funds manager.
Not established or managed for a particular person	This limb of the test may make it practically difficult for an existing land-owning sub-trust to become a wholesale unit trust, and may require the creation of a new unit trust (thereby triggering duty).
Units which are predominantly acquired by, for or on account of wholesale investors	The meaning of "wholesale investor" is discussed below. For landholding trusts, this test is superseded by the "solely" test. This limb of the test helpfully refers to units being acquired by, for or on account of wholesale investors. The wholesale unit trust test does not otherwise have any rules for determining who should be tested as a relevant investor in the trust.
The trust must have been established, and continue, solely for the investment of funds placed with it by wholesale investors	This test is potentially open to various constructions. On one extreme, it is necessary for the trust to have always (from establishment) and at all times (any slips being fatal) had only wholesale investors as unitholders. On the other extreme, this is merely a purposive test and is satisfied provided the fund operates only *for* the investment of wholesale investor money. This purpose might be demonstrated notwithstanding the incidental presence of potentially non-wholesale investors. The authors suggest that the latter interpretation may have merit, given the practical focus of these rules on the funds manager – and the relevant criteria should therefore sensibly be within the funds manager's control.

Start-up phase concession

There is no relevant start-up phase concession, other than to qualify as a funds manager (as discussed above).

Consequences of ceasing to meet the criteria for registration

The wholesale unit trust criteria must be satisfied *before* and *after* a relevant trust acquisition or surrender, or the concession is taken not to apply.[33] Trust acquisition duty is therefore likely to apply unless another concession is available.

As there is no "significant interest" threshold for a unit trust that ceases to qualify for wholesale unit trust status (or other public unit trust concession), this can potentially be very serious. Any acquisition or redemption of units by an investor would trigger Queensland stamp duty. Trustees may therefore wish to consider incorporating restrictions in their constitutions, such as a minimum holding requirement, or in side letters with investors restricting dealings in their units which may cause the trust to cease to qualify as a wholesale unit trust.

Queensland: pooled public investment unit trust

The second Queensland category is "pooled public investment unit trust". This offers a possibly clearer pathway to the wholesale trust concession, although the criteria are more narrow because they require either a public offer or that certain limited categories of investors hold at least 75% of the units in the trust.

A pooled public investment unit trust will be a "landholding trust" if it holds interest in land and therefore the majority trust acquisition rules would apply.

Criteria for pooled public investment unit trust

Table 4 sets out the criteria which must be satisfied to be a pooled public investment unit trust in Queensland and some practical observations.

Meaning of "qualified holder" and "large qualified holder"

Each of the following persons is a qualified holder:

- a trustee of a listed unit trust, widely held unit trust, wholesale unit trust or declared public unit trust;
- the trustee of a complying superannuation fund;
- the trustee of a complying approved deposit fund; or
- a life company if the units held represent an investment of its statutory funds maintained by it under the *Life Insurance Act 1995* (Cth).[34]

A large qualified holder is a "qualified holder" with more than 50 members.[35]

The Commissioner may also approve a class of foreign unitholders[36] or a particular foreign unitholder[37] to be a qualified holder for the purposes of these rules. The rules otherwise do not apply to foreign investors.

Table 4. Pooled public investment unit trust criteria

Criteria	Observations
The unit trust must not be: • a listed unit trust • a widely held unit trust • a wholesale unit trust, or • a declared public unit trust	The availability of the "widely held unit trust" and "wholesale unit trust" criteria might not necessarily be clear. However, as the concession under those regimes is either the same or better, this would seem unlikely to cause any concern in practice if relying on this test.
The unit trust must be either: • a registered MIS • an exempt MIS, or • a pooled superannuation trust	Relevantly, this concession can apply to certain MIS that are exempt from registration under s 601ED(2) of the *Corporations Act 2001.*
Either units in the trust have been issued to the public, or at least 75% of the units are held by two or more "large qualified holders"	"Issued to the public" is not defined. Advisers may wish to have regard to the case law discussion on this. If units in the trust have been issued to the public, in many cases, the trust may qualify as a widely held unit trust (and not qualify as a pooled public investment unit trust on that basis). The meaning of "large qualified holder" is discussed below. "Holder" is defined in s 77 of the *Duties Act 2001* (Qld) and appears to permit tracing through custodians.[38]
At least 50 persons are entitled to units in the trust	"Entitled" is defined in s 78 of the *Duties Act 2001* (Qld) and permits tracing through certain qualified holders to their "members". "Member" is defined to include a unitholder, beneficiary and a policy owner. Section 78(3) is intended to apply a grouping rule for related persons (although, if applied literally, perhaps does not have this effect). "Related person" is defined in s 61 of the *Duties Act 2001* (Qld), which is a test that is difficult to apply.
More than 20 persons are entitled to 75% of the units in the trust	The intention of this limb is presumably to operate as a not closely held test, although s 75(1)(a)(ii) of the *Duties Act 2001* (Qld) is not sensible if read literally. If applying this test for its apparent intended purpose, presumably this will be satisfied if the top 20 unitholders hold less than 75% of the units in the trust.

No registration required

Registration is not generally required, and as with wholesale unit trusts, the authors understand that this is self-assessed by taxpayers. However, it should also be possible to seek a ruling from the Commissioner to confirm whether a particular trust satisfies the requirements.[39]

Start-up phase concession

There is no relevant start-up phase concession for pooled public investment unit trust treatment.

Consequences of ceasing to meet the criteria for registration

The pooled public investment unit trust criteria must be satisfied *before* and *after* a relevant trust acquisition or surrender, or the concession is taken not to apply.[40] Trust acquisition duty is therefore likely to apply unless another concession is available.

As there is no "significant interest" threshold for a unit trust that ceases to qualify as a public unit trust, this can potentially be very serious. Trustees may wish to consider incorporating restrictions in their constitutions on dealings in their units, such as maximum holdings, or side letters with particular investors (if relying on their large qualified holder status), which may cause the trust to cease to qualify as a pooled public investment unit trust.

Common issues arising in practice

Timing of acquisitions of land

As a general rule of thumb, in order to avoid double duty, it is always preferable to have units issued in the intended investor proportions before any agreement is entered into to acquire land.[41] This is because, in all jurisdictions, a purchaser under a contract for sale is deemed to own the land. Further, in WA, this should be extended to any agreements to obtain an interest in a landholder.[42]

Even though most jurisdictions have a "significant interest" concept, if investors are acquiring units in the same capital raising, there could be a risk that their interests are aggregated under the relevant "one arrangement" or "associated person" rules in each jurisdiction. The scope of such rules deserves its own article as they are complex and may not necessarily apply intuitively. There may also be concessions to prevent double duty arising in some circumstances.

Corporate reconstruction rules and clawbacks

The availability of corporate reconstruction exemptions or concessions may be an important consideration in packaging up assets for establishing a new pooled investment vehicle. A restructure may also be necessary in order to satisfy the Victorian and Queensland wholesale trust tests that require a fund not to be established for a particular investor. However, many jurisdictions have rules revoking the corporate reconstruction relief (or simply denying the relief) if any of the relevant entities leave the group (or are expected to leave) within a specified timeframe.

A detailed discussion of the corporate reconstruction rules is beyond the scope of this article. Generally, the jurisdictions where corporate reconstruction relief might be available for a restructure to establish a new pooled investment vehicle are NSW, SA, Victoria, and to a limited extent WA. In Queensland, a concession for trust cloning may be relevant.

Sibling trusts for different jurisdictions

Establishing a new trust can sometimes be required in order to qualify as a concessional trust category, particularly where the requirement is to have been established for a particular purpose.

Stapling transactions are also a convenient means of effecting a merger of funds without a direct transfer of the underlying land or a takeover. The "associated person" rules should, however, be carefully examined when considering the duty implications of these transactions.

Appointment of custodians

In order to satisfy certain regulatory requirements, or simply as a result of historical circumstances or through inheritance, property is often held for a trustee by an appointed custodian. In the authors' experience as stamp duty advisers, custodians tend to create complexity when attempting to rely on duty exemptions such as for changes of trustee or corporate reconstructions. Further, changing or removing custodians can be very complex, particularly when not dealing with a registered managed investment scheme (including if a trust is a wholly owned sub-trust of a registered managed investment scheme).

Although the duties legislation of a number of jurisdictions, particularly NSW, has improved in recent years to better accommodate property held through custodians, there are still some quirks which are likely unintended. The language of any exemption and the mechanics of each transaction must be closely considered.

Conclusion

The unit trust is a pooled investment vehicle that is commonly used for investing in land, but without proper preparation or understanding of Australia's stamp duty laws, this can lead to issues for investors and fund managers.

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2 S 58 of the *Duties Act 2001* (Qld).

3 S 81 of the *Duties Act 2001* (Qld).

4 See the definition of "indirect trust interest" in the Dictionary in Sch 6 to the *Duties Act 2001* (Qld).

5 S 82 of the *Duties Act 2001* (Qld).

6 In SA, landholder duty is only imposed in respect of non-residential, non-primary production land.

7 Dictionary to the *Duties Act 1999* (ACT); Dictionary, s 3(1) of the *Duties Act 1997* (NSW); s 97(1) of the *Stamp Duties Act 1923* (SA).

8 The jurisdictions use "registered unitholder" when referring to trustee unitholders.

9 Dictionary to the *Duties Act 1999* (ACT); Dictionary, s 3(2) of the *Duties Act 1997* (NSW); s 97(2) of the *Stamp Duties Act 1923* (SA); s 3(5) of the *Duties Act 2000* (Vic).

10 S 3(1) of the *Duties Act 2000* (Vic).

11 S 89X(3) of the *Duties Act 2000* (Vic).

12 S 70(2) of the *Duties Act 2001* (Qld).

13 *Corporate Affairs Commission (SA) v Australian Central Credit Union* [1985] HCA 64; *Commissioner of State Revenue (Vic) v Australand Investments Ltd* [2012] VSCA 152.

14 The pooled public investment unit trust rules have definitions for "entitled", but these are not stated to apply to the widely held unit trust test (s 78 of the *Duties Act 2001* (Qld)).

15 *Commissioner of State Revenue v Landrow Properties Pty Ltd* [2010] VSCA 197; *Commissioner of State Revenue v Challenger Listed Investments Ltd (as Trustee for Challenger Diversified Property Trust 1)* [2011] VSCA 272; *FCT v Linter Textiles Australia Ltd (in liq)* [2005] HCA 20; *White v Commissioner of Stamp Duties* [1968] Qd R 140; *Trust Company of Australia Ltd v Commissioner of State Revenue* [2006] VSC 64.

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18 S 71(1) of the *Duties Act 2001* (Qld).

19 S 71(3) of the *Duties Act 2001* (Qld).

20 See the definition of "public unit trust scheme" in s 3 of the *Duties Act 2001* (Tas).

21 *Lend Lease Funds Management Ltd v Commissioner of State Revenue* [2009] VSC 360.

22 S 89S of the *Duties Act 2000* (Vic).

23 The second reading speech to the State Taxation Acts (Tax Reform) Bill 2004.

24 S 89V(1) of the *Duties Act 2000* (Vic).

25 In particular, see example 3 of Revenue Ruling DA.062.

26 S 89X(1) of the *Duties Act 2000* (Vic).

27 An imminent wholesale unit trust scheme failing to meet the criteria within 12 months is taken to be a private unit trust scheme from the beginning of that 12-month period.

28 S 89X(3) of the *Duties Act 2000* (Vic).

29 S 89X(3)(c) of the *Duties Act 2000* (Vic).

30 There is also a category of "declared public unit trust" for certain trusts listed in the *Duties Regulations 2013* (Qld) (generally being Queensland Investment Corporation managed funds).

31 Under the trust acquisition rules, there is no apparent threshold at which to stop tracing through a chain of trusts.

32 Public Ruling DA000.1.3, dated 25 June 2014, para 4(c).

33 S 72(3) of the *Duties Act 2001* (Qld).

34 S 76(1) of the *Duties Act 2001* (Qld).

35 S 76(2) of the *Duties Act 2001* (Qld).

36 S 78A of the *Duties Act 2001* (Qld).

37 S 78B of the *Duties Act 2001* (Qld).

38 There is a specific definition of "custodian" for eligible superannuation entities. Note that para (a) of the definition of "custodian" in the Dictionary in Sch 6 to the *Duties Act 2001* (Qld), which only refers to registered MIS, should not apply to s 77 because it is stated to apply to Ch 2, Pts 12 and 13.

39 Public Ruling DA000.1.3, dated 25 June 2014, para 4(c).

40 S 75(2) of the *Duties Act 2001* (Qld).

41 Also, in some jurisdictions, including NSW and Victoria, put and call options are treated as contracts for sale.

42 S 154B of the *Duties Act 2008* (WA).

Appendix 1. Widely held unit trust rules summary

	ACT, NSW, SA and Vic	Qld	Tas	WA and NT
Must be registered scheme?	No	Yes	No	N/A
Offer to the public?	Not required	Units have been issued to the public	Some or all of the units have been offered to the public	N/A
Widely held test	≥ 300 unitholders	≥ 50 persons "beneficially entitled" to the units	≥ 50 persons hold units	N/A
Concentration of ownership test	No unitholder, together with associates, is entitled to more than 20% of the units in the trust	Top 20 unitholders "beneficially entitled" to < 75% of the units	–	N/A
Benefits of concession	90% significant interest threshold Concessional rate of duty (or exemption in ACT)	Not subject to landholder or trust acquisition rules but must be widely held before and after the acquisition	90% significant interest threshold Concessional rate of duty	No concession for unlisted trust
Start-up concession?	No (but see declared public unit trust scheme in Victoria)	Yes	Yes	N/A

Appendix 2. Wholesale unit trust rules summary

	Vic	Qld (wholesale unit trust)	Qld (pooled public investment)
Must be registered scheme?	No	No	No (but must be an exempt MIS, ie only issues units to wholesale clients)
Establishment test?	Scheme must not be established for a particular investor	• Must have been established and be managed by a funds manager • Must not have been established or be managed for a particular person	No
Self-assessable?	No, requires registration	Yes	Yes (unless relying on foreign qualified holders)
Who can invest?	≥ 70% of units must be held by qualified investors (broadly includes certain large Australian institutional investors, and approved foreign equivalents)	Solely for investment of funds by wholesale investors (includes a person who has more than \$10m invested in wholesale unit trusts)	Either units have been issued to the public, *or* ≥ 75% of the total units in the trust held by two or more large qualified holders (broadly includes certain large Australian institutional investors, and approved foreign equivalents)
Minimum investment?	Yes, must either: • hold interests in three parcels of land (whether in or outside Victoria), at least two of which have an unencumbered value of \$10m or more; *or* • ≥ 6 unitholders (who are not associated persons) each have a subscription of ≥ \$3m	No, unless relevant to establishing that all investors are "wholesale investors"	No
Spread of ownership restrictions?	No qualified investor (alone or with its associates) can hold 50% or more of the units in the scheme.	No	• ≥ 50 persons "entitled" to units in the trust • > 20 persons are "entitled" to at least 75% of the total units in the trust
Rules for determining who is the investor?	No, qualified investor is defined precisely by reference to custodians and trustee entities	Not clear, but s 72(1)(b) of the *Duties Act 2001* (Qld) refers to "units in which are acquired by, for or on account of" wholesale investors	"Holder of units" is defined to trace through custodians of qualified holders "Entitled" is defined and permits tracing through large qualified holders
Funds manager requirement?	No	Yes, must be established and managed by a "funds manager", which broadly requires: • manages > \$500m funds invested with it; • business not conducted to provide the services only to particular wholesale investors; and • recognised by other funds managers as a competitor	No
Start-up concession?	Yes, registration as an imminent wholesale unit trust scheme	No, except to become a funds manager	No

A Matter of Trusts

by Jan Harnischmacher, Sladen Legal

Owies: removal of trustee and voidable transactions

In light of the *Owies* decision, this article examines when a trustee decision is void or voidable and when the court may remove a trustee.

Overview

Fundamental to the concept of a trust is the personal obligation imposed on the trustee to deal with the trust property for the benefit of the beneficiaries.[1] The obligation is one recognised and enforceable in equity. For example, where the trustee acts in breach of trust, the court may remove the trustee[2] and/or the trustee's decisions may be rendered void or voidable.[3]

The recent decision of the Victorian Supreme Court of Appeal in *Owies v JJE Nominees Pty Ltd*[4] (*Owies*) provides an important reminder to trustees of their fiduciary duty to beneficiaries. In our previous article, we considered two of four legal issues, that required determination in *Owies*, in relation to the trustee's discretion and their obligations to identify, and enquire about, the trust's beneficiaries.[5]

In this article, we consider two other important findings in *Owies*. That is, the court's finding that the trustee distribution determinations were voidable but not void (issue 3) and the court's decision to overturn the finding of Moore J, at first instance, that the corporate trustee was capable of properly administering the trust into the future under the then directorship, and the ordering that the trustee be removed and an independent trustee be appointed (issue 4).

The distributions were not void but voidable

The underlying claims in *Owies* arose out of a dispute between siblings in relation to the annual income distributions of their parents' family trust. In *Owies*, the late John and Eva Owies had three children, Michael, Deborah and Paul.

Each of the five members of the Owies family was a beneficiary of the family trust. Paul and Deborah brought proceedings against the trustee company, JJE Nominees Pty Ltd. They claimed that the annual distributions of trust income were made without proper consideration, with the consequence that the distributions were void as they were made in breach of trust. They therefore sought orders that, in default of appointment of income, the three children, as default beneficiaries, were entitled to one-third of the annual income for each of the relevant years.

When considering this issue, the Court of Appeal considered the decision in the Supreme Court of the United Kingdom case, *Pitt v Holt* (*Pitt*).[6] That decision draws a clear line between an error by trustees in going beyond the scope of a power ("executive execution") and an error in failing to give proper consideration to relevant matters when making a decision which is within the scope of the relevant power ("inadequate deliberation").[7] A purported distribution to an entity that is not a beneficiary under the trust and a fraud on power, such as a fraudulent appointment and an improper exercise of a trustee's power, would appear to fit within the first category.[8]

In *Re Pauling's Settlement Trusts*,[9] "a power ostensibly exercisable for the benefit of young adult beneficiaries used to distribute trust capital to be frittered away on their improvident parents' living expenses" was found to be an improper exercise of a trustee's power.

An example of the second category is "a distribution that is made to a beneficiary within the terms of the trust, but where there has been a failure by the trustee of its duty to give proper consideration to relevant matters".[10] In *Klug v Klug*,[11] where the trustee disapproved of her daughter's choice of husband, and for that reason refused to exercise a power of advancement in her favour, the court held that the trustee failed to give a proper consideration to the welfare of her daughter.

As to the consequences of an inadequate deliberation, the trustee's act is not void, but may be voidable at the instance of a beneficiary who is adversely affected.[12] It will be voidable if, and only if, it can be shown that the failure to give real and genuine consideration to the exercise of the discretionary power constituted a breach of duty.[13]

A trustee's duty to inform themselves and take relevant matters before making a decision is a fiduciary duty.[14] However, the authorities suggest that, where the trustee has made a minor mistake or, "in the absence of any other basis for a challenge", has acted innocently and conscientiously on advice that was subsequently found to be materially wrong, the trustee is not in breach of their fiduciary duty and the decision of the trustee is not voidable.[15]

If the trustee's decision is rendered voidable, the decision may be set aside subject to equitable defences and the court's discretion.[16] In *Pitt*, Lord Walker found that, in the exercise of discretion to overturn the trustee's decision, a balance must be struck between "the need to protect the welfare of the beneficiaries from 'aberrant conduct' by trustees and not to impose too stringent a test in judging trustee's decision".[17]

In *Owies*, the court held that the distributions were voidable on the basis that the decisions were made with no real and genuine consideration of Paul and Deborah. That was because the trustee did not make any enquiry of either Paul or Deborah and the trustee was not informed to an extent that enabled it to make a genuine decision. However, at trial, the applicants did not seek the relief that the distributions should be set aside.

The court pointed out that a failure to give due consideration to the interests of a beneficiary will not automatically lead to the decision being set aside, and that it is necessary for an aggrieved beneficiary to not only establish that the decision should be set aside, but also to apply to a court for a declaration that a particular transaction should be reversed.

The Court of Appeal affirmed that the parties are bound by an assertion made in a pleading filed by the parties and refused the application to amend the pleading to seek the relief to set aside the distributions.

Removal of the trustee

John and Eva were directors of the corporate trustee from the establishment of the trust until their deaths in 2020 and 2018, respectively. John and Eva's solicitor for many years was purportedly appointed as a director of the corporate trustee in December 2017. Michael was appointed as a director of the corporate trustee in November 2019. The applicants sought the removal of the trustee and an order appointing an independent professional trustee in its place.

In addition to the statutory jurisdiction to appoint a new trustee in substitution for, or in addition to, any existing trustees,[18] the court has inherent jurisdiction to remove a trustee and appoint a new one. Importantly, the power of the court to remove a trustee is discretionary and will be exercised only in "exceptional circumstances" which "afford a ground on which the jurisdiction may be exercised".[19]

The authorities establish that the jurisdiction conferred on the court is remedial rather than punitive, meaning that "the dominant consideration in the exercise of the jurisdiction is the welfare of the beneficiaries,[19] not the imposition of a sanction or punishment on the trustee as a consequence of misconduct".[20] When deciding whether to remove a trustee, the court forms a judgment based on considerations, possibly large in number and varied in character, which combine to show that the preservation of the trust property and the welfare of the beneficiaries are opposed to the trustee's continued occupation of the office.

Examining the leading Australian High Court case *Miller v Cameron*,[21] the court identified the welfare of the beneficiaries as a "safer guide" to the exercise of the power to remove a trustee.[22] One of the key considerations which informs the court when removing and appointing a trustee is that a trustee should act impartially between beneficiaries, particularly in matters concerning the distribution of income and capital unless authorised by the trust.[23]

The duty of impartiality requires the trustee to "not promote the interests of some of the beneficiaries against the wishes of the settlor or the interests of other beneficiaries".[24] This has its basis in the rule of avoiding conflicts of interest.[25]

In *Owies*, the court found that the trustee had, over a number of years, failed to act impartially by not giving real and genuine consideration to the interests of two of the primary beneficiaries, Deborah and Paul.

Based on the history of breaches in the administration of the trust deed, the state of hostility and the irreconcilably damaged relationships between the beneficiaries and the directors of the trustee, the court concluded that it would not be for the welfare of the beneficiaries as a whole for Michael and the solicitor to remain in control of the trustee. This was despite the court noting that it would be unrealistic "in the context of many family trusts, to ignore the fact that the trustee will often be imbued with the vagaries of the family dynamic, its antagonisms and alliances", and that impartiality "does not require the trustee to bring a blank slate to the exercise of its powers".

Conclusion

Discretionary family trusts have been a common business and investment structure over the last few decades. One of the reasons for their popularity is that they can offer both asset protection and flexibility of distributions of income and capital.

The *Owies* decision illustrates what can go wrong with the administration of a discretionary trust when the trust is inextricably bound up with family disputes, and how the court will deal with situations which would appear to favour some "vulnerable" family members who are "in need" over others.

A failure to give real and genuine consideration to the interests of a beneficiary or object of a power might amount to the trustee breaching its fiduciary duty, resulting in the distributions being declared voidable and the trustee being removed even where the trust deed explicitly confers absolute and uncontrolled discretionary powers on the trustee.

While a trustee has the protections afforded under the trust, and at law, if the trustee is found to be in breach of trust or fiduciary duty, the trustee can be held personally liable for any loss. Trustees must look at any risks on the horizon and take proactive steps to emerging issues, such as undertaking a claim-staking process to identify potential beneficiaries and inform them of their circumstances prior to making a decision to distribute income or capital of the trust. If the trustee has concerns about whether a particular decision would be a breach of trust, to limit its personal liability, the trustee may approach the court for judicial advice on the interpretation of a trust deed and the actions that it can or should take.[26]

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Superannuation

by William Fettes and Daniel Butler, CTA, DBA Lawyers

Failing to pay minimum pension payments before 30 June

Advisers assisting clients with pensions need to ensure that their clients are aware of the importance of paying the annual amount prior to each 30 June – and the downside if they do not.

Introduction

An SMSF member who is in pension phase has numerous advantages, such as the fund obtaining an income tax exemption for exempt current pension income (ECPI) where no tax is payable on income and capital gains to the extent that the fund's assets are funding a pension in retirement phase. However, the relevant rules in the *Superannuation Industry (Supervision) Regulations 1994* (Cth) (SISR94) regulating the pension must be complied with on an ongoing basis for the life of the pension.

This article examines the potentially significant and costly issues that can arise for failing to pay the required minimum payments for a pension before 30 June. For simplicity, this article focuses on account-based pensions (ABPs) and does not cover other pensions, such as transition to retirement income streams, market-linked pensions, allocated pensions or lifetime or similar "legacy" pensions.

Why does the minimum have to be paid prior to each 30 June?

Regulation 1.06(9A)(a) SISR94 requires that the rules governing the pension ensure that payments of the pension are made at least annually and that the total of payments in any year (excluding payments by way of commutation but including payments under a payment split) is at least the amount calculated under cl 1 of Sch 7 SISR94. Put simply, this requires at least the minimum annual payment to be made each financial year prior to 11:59 pm of each 30 June. Given the time that electronic transfers of money take these days, clients should be encouraged to pay no later than mid-June.

What happens if you fail to pay the minimum?

In TR 2013/5, the ATO states:

> "100. If a purported [ABP] fails to meet these requirements in a financial year, the [ABP] will be taken to have ceased at the start of that income year for income tax purposes. Therefore, from the start of that income year the superannuation interest is no longer supporting [an ABP] and the payments made from that superannuation interest are not [ABP] benefits. Therefore, any payments made during that income year are superannuation lump sums.
>
> 101. If in the following year the relevant rules are again complied with this in effect results in the commencement of a new [ABP] and the proportioning rule must be applied to that new [ABP] when it commences."

Put simply, the pension ceases with effect from the start of the relevant financial year (ie 1 July) in which the minimum was not paid for ECPI purposes.

Does the ATO provide any exceptions to a pension stopping?

Due to the potentially significant and costly issues that can arise for failing to pay the minimum annual pension payment, the ATO provided some administrative concessions in 2013 based on its general power of administration (GPA). This guidance was designed to mitigate the harsh outcomes that would otherwise apply in certain cases, eg in relation to a strict application of the law where trustees made even small errors or where an underpayment was outside the trustee's control.

Small underpayments: first-time offenders can self-assess

If the minimum is underpaid by less than one-twelfth of the annual minimum amount as calculated under Sch 7 SISR94 (around an 8% leeway), and provided the SMSF trustee is a first-time offender, the trustee can self-assess in accordance with the ATO criteria in QC 39769.[1] The key criteria include:

- failure to pay the minimum amount is due to an honest mistake or it is outside the SMSF trustee's control;
- a catch-up payment is made as soon as possible (generally within 28 days of becoming aware) and the catch-up is treated as relating to the prior financial year; and
- the SMSF otherwise satisfies all of the other pension criteria (but for underpayment).

Interestingly, it appears that the ATO assumes that SMSFs pay regular equal monthly pensions in respect of a financial year given this concession is based on a one-twelfth underpayment. Most cases that we have been engaged to assist with have involved significantly greater underpayments.

Other underpayments: apply for ATO discretion

If an SMSF trustee is not eligible for the above self-assessment concession, they must apply to the ATO to obtain any relief. Broadly, the ATO needs to be satisfied that the trustee's failure to pay the required minimum amount for the financial year was outside the SMSF trustee's control and the fund has a clear compliance history. The ATO states in QC 39769:

> "Where the underpayment exceeds one-twelfth of the minimum pension payment the trustee will need to provide details of the circumstances that affected their ability to make the minimum pension payment. Each case will be considered separately on its own merits."

The ATO provides a number of examples of where it might, or might not, exercise its discretion based on particular background facts in QC 39769, including:

- where the members of an SMSF were involved in a car accident and spent extended periods of time in hospital recovering from their injuries just before the final pension payment for the relevant income year and the catch-up payment was made in August of the following income year – the ATO may exercise its discretion favourably;
- where the SMSF trustee was overseas – the ATO would require further evidence of why failing to pay the minimum was outside the trustee's control; and
- a financial institution error – the ATO may approve.

Applying for ATO discretion under its GPA

Naturally, a well-written submission outlining all of the relevant facts and providing appropriate supporting evidence would generally be required to obtain a favourable result from the ATO. In particular, the submission would need to outline how the underpayment occurred, any reasons why that was beyond the control of the trustee, and any other special facts that may explain the underpayment.

Naturally, the ATO will also want to ensure that the fund's compliance and documentation are in order and that the administration of the fund is appropriately managed. We regularly observe cases where pensions are poorly documented and where pension documents are lacking or there is no product disclosure statement (PDS). If there is any doubt whatsoever, we recommend that confirmation documents for the relevant pension are put in place.

What if the SMSF is unsuccessful?

If an application to the ATO is unsuccessful (and assuming the client does not want to escalate the matter further via an SMSF lawyer/expert to see if they can obtain a more favourable outcome), the following consequences will typically follow:

- the SMSF is not entitled to its ECPI concession for the relevant financial year and the period of the subsequent financial year until a new pension is commenced. The ATO's view in TR 2013/5 is that the pension has stopped for ECPI purposes until a new pension is commenced;
- the affected member's transfer balance account (TBA) will receive a debit that is reflective of the market value of the assets that supported the pension at 30 June of the financial year in which the underpayment occurred;[2]
- any "purported" pension payments during the period from when the prior pension ceased until the new pension commences will be treated as lump sum payments;
- a new pension would need to be commenced which, among other things, may give rise to:
  - if the affected member has an accumulation balance as well as the prior pension account balance, the tax-free and taxable components of these interests would merge and any favourable planning opportunities previously in place relating to the tax-free component might be undone;
  - typically, interim financial statements must be prepared at the time the new pension commences reflecting the market value of the fund's assets and reflecting the accrued net earnings in relation to the fund up to the time the new pension commences;
  - new pension commencement documents need to be implemented, together with appropriate trustee resolutions, a PDS and related notices to members and other interested parties; and
  - the financial services law implications under the *Corporations Act 2001* (Cth) of commencing a new pension must also be considered, as the member may need to have a statement of advice prepared prior to the commencement of the pension; and
- if the original pension commenced prior to 1 January 2015, it will likely lose its "grandfathered" status for Centrelink income test purposes for the Commonwealth age pension and for qualifying for the seniors health card.

As will be appreciated from the above, the potential costs and consequences from failing to meet the minimum annual payment can be substantial. Timely action should be taken if any underpayment is detected to establish what, if anything, can be done to minimise any potential consequences. In particular, it should be noted that often the underpayment is not discovered until after the end of the relevant financial year when the SMSF accounts are being prepared or audited. Thus, the ECPI concession may be at risk not only for the prior financial year, but also for a good part of the following (or current) financial year.

How long will the ATO take to respond?

The ATO could take some time to respond to an application for favourable exercise of discretion, and this results in growing uncertainty. While we would generally expect the ATO to respond within one to three months, we have been informed that one response took over 12 months. Any delay can result in further uncertainty and risk.

Note that any backdating or fabrication of documents is a serious matter that can result in severe penalties.

What if the failure related to an adviser's error?

If the underpayment relates to an adviser's error or negligence, given that accountants and financial advisers should be reasonably competent and familiar with the tax and superannuation rules, the adviser may not be given the same "sympathy" as a typical SMSF trustee/member.

Moreover, advisers who do not hold an Australian financial services licence (AFSL) need to be careful not to recommend a financial product, such as commencing a new pension.

Advisers who do have an AFSL need to consider whether a statement of advice or other steps need to be completed to comply with their AFSL and related legal and professional obligations.

Advisers may be without any professional indemnity cover if they provided unlicensed or legal advice.

Conclusion

The importance of paying the required annual minimum payments for a pension cannot be understated given the potentially severe consequences. Advisers assisting clients with pensions need to ensure that their clients are aware of the importance of paying the annual amount prior to each 30 June – and the downside if they do not. Seeking timely action if there is any underpayment and seeking expert advice where needed are also a key to minimising any unfavourable consequences.

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1 ATO, *SMSFs: Minimum pension payment requirements – frequently asked questions*. Available at www.ato.gov.au/super/self-managed-super-funds/in-detail/smsf-resources/smsf-technical/smsfs--minimum-pension-payment-requirements---frequently-asked-questions.

2 See item 6 of the table in s 294-80(1) of the *Income Tax Assessment Act 1997* (Cth) (ITAA97), and para 3.143 of the explanatory memorandum to the Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016 (which introduced the transfer balance cap and the TBA from 1 July 2017). Note that the assumptions that apply under s 294-50 ITAA97 ensure that the original credit to the member's TBA for the pension is not nullified by virtue of the pension's failure.

Alternative Assets Insights

by Patricia Muscat, CTA, and
Natalie Stewart, PwC

ATO guide: market valuations for tax purposes

Updated ATO guidance on market valuations for tax purposes should help taxpayers reduce the tax risks associated with valuations.

Overview

The ATO has released an updated guide on market valuations for tax purposes.[1] Market valuations are relevant for a wide range of tax matters, including CGT, employee share schemes, GST and tax consolidations, to name just a few. The guide is intended to help taxpayers reduce the tax risks associated with valuations, as failing to engage an appropriately qualified valuer can lead to the incorrect reporting of tax outcomes, and the potential for administrative penalties and interest.

In detail

In the updated guide, the ATO has outlined its views on the meaning of "market value", who can determine market value, and the processes and evidence that the ATO expects to see to support a valuation.

As highlighted on the ATO's website, taxpayers may need a market valuation for tax purposes in a range of circumstances, including:

- individuals, where property or shares are transferred between related parties;
- employees, where shares or options are received under an employee share scheme;
- small businesses, in order to apply certain asset threshold tests for CGT concessions;
- property developers who apply the GST margin scheme; and
- corporate groups which consolidate for income tax purposes.

What is "market value"?

The concept of "market value" is not defined for all purposes in the tax law, although there are some provisions which provide for a specific meaning of market value. Where market value is not defined or otherwise qualified in a particular provision, it takes its ordinary meaning. The ATO guidance highlights the principles established in case law, and those set out by the International Valuation Standard Council (IVSC) are relevant in determining the ordinary meaning of market value.

The key judicial determination for determining the ordinary meaning of market value is the High Court decision in *Spencer v Commonwealth of Australia*.[2] In this case, the High Court held that, in valuing an asset, a valuer is to assume a market with hypothetical buyers and sellers such that the "market value" is the price negotiated between the buyer and seller to achieve a notional sale in the hypothetical market. The notional sale is assumed to be made after voluntary bargaining between a willing but not anxious seller and purchaser, rather than a forced sale, and with both parties being fully informed about the advantages and disadvantages of the asset being valued and aware of the current market conditions.

The IVSC defines market value as "[t]he estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion". The ATO considers that the definition provided by the IVSC is consistent with the judicial definition.

The market value of an asset will generally reflect its "highest and best use". This is the use that maximises its potential and that is possible, legally permissible and financially feasible. Market value does not reflect attributes of an asset that are of value to a specific owner or purchaser that are not available to other buyers in the market.

Who can determine market value?

For tax purposes, the acceptability of a valuation usually depends on the process undertaken to obtain the valuation, rather than who conducted it, although there are some exceptions where the law requires a professional valuer to provide the valuation (for example, for the GST margin scheme).

A reasonable estimate of market value requires skill, knowledge and experience, and as such, a valuation carried out by a suitably qualified professional following commonly accepted industry standards and codes of conduct is generally considered more reliable by the ATO.

Valuation fundamentals

The ATO has outlined the following eight fundamental principles for valuations for tax purposes:

"1. A valuation should be specific to the tax and superannuation provision to which it is being applied and consider any requirements of the relevant provisions, considered case law and relevant ATO guidance.

2. Market value is conceptually distinct from historical cost (the original price that is paid for goods or a service, or the amount paid to produce the goods or services by the relevant entity).
3. The nature and source of the valuation inputs must be consistent with the bases of value (relevant facts and assumptions) and the valuation purpose (tax or superannuation provision).
4. The valuer should adopt the most relevant and appropriate valuation methodology based on industry standards and practice. This may be influenced by:
   - the data available
   - the circumstances relating to the market, and
   - industry practice and standards for the asset being valued.
5. International valuation standards recommend that valuers consider using more than one approach. For tax purposes, the ATO recommends that (where possible) a secondary or cross-check methodology should be applied to provide additional support for an estimated value from the primary methodology.
6. The process of valuation requires the valuer to make impartial judgments as to the reliability of inputs and assumptions. For a valuation to be credible, it is important that those judgments are made in a way that promotes transparency (for example, state the inputs and any assumptions made) and minimise the influence of any subjective factors on the process.
7. The valuer should assemble and record evidence by means such as inspection (as required), enquiry, computation and analysis to ensure that the valuation is properly supported.
8. An estimate provided for a future date (prospective value) is frequently sought in connection with projects that are proposed, under construction or under conversion to a new use. Market value for tax purposes requires valuation for a date specified by the legislation and a prospective assessment will not be considered reasonable or acceptable."

The ATO guide notes that there are three internationally defined valuation approaches:

- **the market approach:** this approach relies on applying market transactions for comparable assets at the valuation date. An estimate of market value is determined with reference to market prices in actual transactions and the advertised price of assets currently for sale. This process compares the asset to be valued with similar assets available on the market;
- **the income approach:** this method estimates the risks and returns of the asset at the date of the valuation by estimating the expected income and cashflows that the asset is expected to generate in the future; and
- **the cost approach:** this approach involves estimating the market cost of replicating the asset in a similar condition at the valuation date. This method is often used when plant and equipment are part of a larger transaction to allocate a proportion of the enterprise value to the plant and equipment.

The valuation approach utilised in any given scenario must be reasonable based on the asset and information available, supported by evidence, suitable for tax purposes, replicable, and well-documented. Greater credibility is placed on valuations that are undertaken by valuers following professional standards.

Obtaining valuation reports

When obtaining a valuation report, it is a taxpayer's responsibility to ensure that the valuer is suitably knowledgeable and experienced, receives appropriate instructions, remains reasonable and objective, is not presented with obstacles or limitations that may inhibit their work, and provides a reasonable market value that is supported by credible evidence using an appropriately recognised valuation method (as listed above). The onus for providing a replicable and defensible valuation remains with the taxpayer even if a professional is engaged to provide a valuation.

The ATO's guide outlines the minimum information that it expects to be contained in a valuation report, including, among other things:

- the scope and purpose of the valuation;
- details of the asset being valued, and any information, facts, inputs and assumptions relied on;
- the standards governing the engagement;
- the valuation assessment date, and the date that the valuer inspected the asset (if applicable);
- the valuation approaches and methodologies used, including the reasons for selection; and
- the valuer's identity, status and qualifications, and a declaration of the valuer's independence.

Common issues with valuations

The ATO has noted the following issues that commonly arise when it conducts reviews of market value estimates:

"• inappropriate choice of methodology given the circumstances and information available
- incorrect application of methodology according to industry and professional standards
- the valuation approach, including the bases of a valuation, does not align with the relevant tax and superannuation provision, case law or ATO guidance
- unreasonable or incorrect assumptions and inputs and the use of proxies based on historical performance
- omission of relevant information available on the valuation date
- inconsistencies with evidence (for example, legal documentation)

- reliance on post-valuation date information and future events that cannot be reasonably foreseeable at the valuation date
- inappropriate apportionment of value across assets (bases, evidence, calculation)
- inappropriate choice of comparable assets on which to base valuation (chosen entity, assets)
- lack of support for size, risk and other adjustments to the chosen discount rate or capitalisation multiple
- lack of appropriate analysis and scrutiny of base information
- inappropriate use of averaging
- insufficient market evidence for inputs and assumptions
- failure to verify inputs (subjective and unqualified)
- insufficient or incorrect documentation, and
- omission of assumptions from the valuation report."

Other issues raised in the guidance

Taxpayers are able to request the ATO to provide a private ruling on an asset's market value where it is relevant to a question about the tax law. If a private ruling is requested relating to market valuation, the ATO may engage a professional valuer to conduct a valuation of the asset or to review a valuation provided by the taxpayer, in which case, the fee for the valuer is passed onto the taxpayer.[3]

The ATO's updated guide also outlines the process for ATO reviews of valuations, noting that the likelihood of a review is greater where the asset's value is high or the methodology used is contentious. The guide sets out the supporting documents that a taxpayer may be asked to provide during a valuation review.

In addition, the guide contains signposts to other ATO guidance on market valuations that is currently available, including, for example, the tax consolidation valuation shortcuts which are available to determine the market value of certain assets for consolidation purposes.[4]

The takeaway

There are a range of circumstances where the market value of an asset is required for tax purposes. The ATO recommends that valuations be conducted by suitably qualified valuers using one of the ATO's accepted valuation methods to ensure that the tax position adopted for the relevant tax years provide sufficient penalty protection and are reasonably arguable. This is particularly important for high-value assets, or where an asset's valuation is likely to be contentious.

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1 ATO, *Market valuation for tax purposes*, October 2022. Available at www.ato.gov.au/law/view/document?DocID=SGM/market_val&PiT=99991231235958.

2 [1907] HCA 82.

3 For further information, refer to *Private rulings and valuations*, available at www.ato.gov.au/law/view/document?DocID=AFS/rulings-valuations/00001&PiT=99991231235958.

4 Available at www.ato.gov.au/Business/Consolidation/In-detail/Consolidation-valuation-shortcuts.

Events Calendar

Upcoming months

FEBRUARY
16–17
Thu–Fri

QLD

Private Business Tax Retreat

13 CPD hours

MARCH
1
Wed

VIC Online

Tax Disputes Masterclass

7 CPD hours

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

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Giving back to the profession

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

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