THE JOURNAL FOR MEMBERS OF THE TAX INSTITUTE

Taxation in Australia

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Employment taxes

The Tax Institute

Supporting an optimal workforce today and into the future

Superannuation death benefits: some discrete issues

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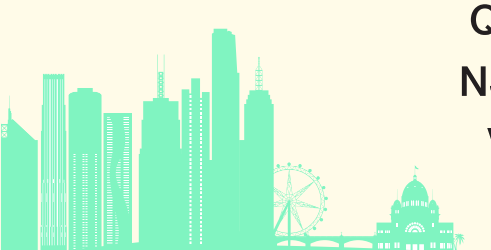

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Early bird pricing ends on Friday, 22 April.

Find out more at
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THE TAX INSTITUTE

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Tax News – at a glance

by TaxCounsel Pty Ltd

February – what happened in tax?

The following points highlight important federal tax developments that occurred during February 2022. A selection of the developments is considered in more detail in the "Tax News – the details" column on page 459 (at the item number indicated).

COVID-19 test expenses

In a media release on 8 February 2022, the Assistant Treasurer announced that the government is taking action to ensure that COVID-19 tests (including polymerase chain reaction tests and rapid antigen tests) are tax deductible (and exempt from fringe benefits tax for businesses) where they are purchased for work-related purposes. **See item 1.**

Amending legislation

An amending Bill introduced into parliament on 9 February 2022 proposes a number of amendments to the tax law. **See item 2.**

Commercial debt forgiveness: natural love and affection

The Commissioner has issued a final determination to the effect that, in the context of the commercial debt forgiveness rules, the exclusion for debts forgiven for reasons of natural love and affection requires that the creditor be a natural person (TD 2022/1). **See item 3.**

SMSF auditor number misuse

The Commissioner has recently issued follow-up reminders to his September 2021 self-managed superannuation fund (SMSF) auditor number misuse mail-out to approved SMSF auditors for SMSF annual returns lodged during the period 1 July 2020 to 30 June 2021. **See item 4.**

Client identity verification

In a joint media release issued on 8 February 2022, the ATO and the Tax Practitioners Board announced that new guidelines on client identity verification have been developed. **See item 5.**

"First uses"; "for exploration"

The Full Federal Court (Allsop CJ, Davies and Thawley JJ) has unanimously dismissed the Commissioner's appeal and allowed the taxpayer's cross-appeal from a decision of Colvin J which involved the construction and application of the provision of the *Income Tax Assessment Act 1997* (Cth) that effectively allows an immediate depreciation write-off for certain exploration or prospecting assets (*FCT v Shell Energy Holdings Australia Ltd* [2022] FCAFC 2). **See item 6.**

Tax agent registration

The AAT has affirmed a decision of the Tax Practitioners Board (TPB) to cancel the registration of a tax agent on the basis that, among other things, the TPB was not satisfied that she was a fit and proper person, but has reduced the period that she should be precluded from reapplying for registration from five to four years (*Cerrah and Tax Practitioners Board* [2022] AATA 7). **See item 7.**

Appeal news

The Commissioner is appealing to the Full Federal Court from the decision of Logan J in which his Honour allowed appeals by the taxpayer against assessments made by the Commissioner on the basis that there was a "reimbursement agreement" that fell within s 100A of the *Income Tax Assessment Act 1936* (Cth) (ITAA36) or, if that were not so, the general anti-avoidance provisions of Pt IVA ITAA36 operated. The decision of Logan J is *Guardian AIT Pty Ltd ATF Australian Investment Trust v FCT* [2021] FCA 1619.

President's Report

by Jerome Tse, CTA

Good tax policy is fair – for everyone

Calling for a focus on inclusive and fair tax policy in the upcoming Federal Budget 2022-23.

As you know from my comments last month, diversity and inclusion are a priority for The Tax Institute this year, not only internally, but also from a policy and advocacy standpoint. We are living in historically significant times, with serious challenges at home and around the world. In these times, our focus on embracing difference and addressing imbalances is fitting.

The upcoming Federal Budget is an opportunity to address some actual or perceived inequalities in the way our tax and transfer systems operate. Those of you who have read our Federal Budget 2022-23 submission know that we have used this opportunity to highlight how the COVID-19 pandemic and the turbulence of the last few years have exacerbated existing pressures on our tax system.

When our tax system functions well, it is a key support pillar for our economy and our community. It supports our business owners, provides the government with an opportunity to lower the national debt level, and allows for economic growth. Crucially, it supports some members of our population who need it most: working parents, people living with disability, and those saving for and transitioning into retirement.

With that in mind, I'd like to expand on two points made in our submission.

First, our Budget submission addressed the need to better utilise the Child Care Subsidy as a tool for positive social and economic outcomes. Although we acknowledge and welcome the recent measure which removes the annual cap and increases the subsidy for families with two or more children under age five in care, further changes to the subsidy are needed to support the families who most need financial assistance as they grow and adjust.

We are advocating to boost the subsidy to 95%, regardless of the number of children in a family. In light of COVID-19 and the increasing cost of child care, we would also like to see the hourly rate cap reviewed.

Although the Child Care Subsidy benefits all secondary earners, we know that, in practice, it primarily affects working mothers in Australia (though hopefully that will change as "stay at home" fathers become more common). The adjustments we have proposed would provide genuine financial assistance to these women as they transition back into the workforce. Not only does that promote increased workforce participation and assist economic recovery by immediately boosting family income, but it also enriches our working world and business space through increased gender diversity. As working mothers feel more and more financially secure returning to work, they will be better represented at higher levels of business, which benefits not only them and their families, but also the organisations that can then embrace more diverse perspectives and experiences.

This is a fantastic example of how tax policy, the work you do and the work you support as part of The Tax Institute make a real-world impact and shape the social fabric of our community.

The second point I'd like to highlight is the need to address the gender inequality in superannuation balances. The reality is that far more women than men will reach retirement age without a superannuation balance capable of supporting their needs. This is especially true for single women in their early 50s. There are a range of reasons for this discrepancy, from the gender pay gap to the prevalence of women in our part-time workforce, and it is a major problem that should be addressed.

The Tax Institute has previously laid out options for addressing this imbalance in both our *Case for Change* paper and our Federal Budget 2021-22 submission. A few options include:

- a co-contribution by the government of $1,000 provided for all single women on a matched 2:1 basis, where a woman's total super assets equal less than $100,000;
- allowing single women who have a total superannuation balance of less than $100,000 from the age of 60 to claim the age pension; and
- recognising the family unit for superannuation contribution purposes (dual thresholds) where one spouse is unpaid or partly paid because they provide primary care to a dependant.

The most appropriate solution for Australia would, rightfully, be the subject of much consultation to achieve the fairest outcome, but the priority is to address this problem sooner rather than later. A system that puts up to half of the population at a disadvantage is not fair or inclusive. It's not good tax policy.

We are a leading voice on these important topics within the profession and the wider policy environment. Our Tax Policy and Advocacy team, alongside our dedicated committee volunteers, continue to both educate our members in all aspects of tax and to liaise with policymakers and political leaders to make our ideas and priorities understood and considered. I sincerely hope that, regardless of the politics of the Federal Budget and indeed regardless of the outcome of this year's Federal Election, the conversation we are currently leading around a fairer, more robust tax system will become action.

CEO's Report

by Giles Hurst

Leadership with vision

CEO Giles Hurst reflects on what it means to be a leader and our members' place in shaping our profession.

> The Tax Institute is the leading forum for the tax community in Australia. We are committed to representing our members, shaping the future of the tax profession and continuous improvement of the tax system for the benefit of all, through the advancement of knowledge, support for members and advocacy.
>
> – The Tax Institute vision statement, 2018

The unprecedented challenges we currently face on a local, national and global scale, have shone a spotlight on the absolute importance of strong leadership. The Tax Institute's vision is to be the leading forum for the tax community in Australia. As we face challenges, whether professionally or on a wider scale, and when we think about the Institute's role, it's important to keep in perspective the true meaning of what it is to lead.

To be a leader doesn't necessarily mean being the biggest, the loudest, or the one with all the answers. As our understanding of human nature and leadership dynamics has improved over the years, the myth of the exceptional individual who achieves great feats all on their own is less and less compelling. Instead, it has become clear that leadership is more often about inspiring the actions of a group of people, than it is about the leader's own extraordinary capabilities.

Many modern leaders and leadership specialists talk about the importance of surrounding yourself with smart, talented people and guiding them to do fantastic things. Steve Jobs famously surrounded himself by what he called "A" players to create products that have reshaped the world. Eleanor Roosevelt, the driving force behind the UN Charter of Human Rights, said: "A good leader inspires people to have confidence in the leader. A great leader inspires people to have confidence in themselves." Three-time Super Bowl champion Joe Gibbs said: "You don't win with X's and O's. What you win with is people."

This is as true, if not more so, for the Institute as it is for Apple or a champion football team. We know that a strong membership of diverse voices, experiences and opinions is what makes us a leader within the profession. One of the things we are most proud of, particularly lately when global circumstances have made connecting with colleagues a tricky feat, is how robust our member network is. Being connected to the Institute is being connected to an incredible group of A players.

As you know, our President Jerome Tse has voiced his focus on inclusivity this year, both within our ranks and in our advocacy work. In his report this month, Jerome has outlined key positions that the Institute has taken in our recent 2022-23 Federal Budget submission, which demonstrate how our policy expertise and advocacy work can help to further diversity in Australian workplaces.

Our position as a leader in these areas is vitally important in a year that brings us both a Federal Election and a Federal Budget. That position is an enviable one and it has been attained thanks to the dedication and technical prowess of our many volunteers.

Our National Council — comprised of formidable leaders in their own right — has embraced the organisation's vision in modern and meaningful ways, while keeping us true to the pillars that have held us up since 1948. Our various volunteer committees have stepped up to set the agenda for professional development through our nationwide events, as well as lending their considerable insight to regulatory submissions. And internally, our Tax Policy and Advocacy team has done incredible work leading the profession through the challenges of COVID-19 support measures, serving as the voice of the profession in consultations with regulators, and leading the ongoing national conversation around tax reform.

You can see the work and dedication of all these people come together in projects like our *Case for Change* paper, or our Federal Budget 2022-23 submission. Notably, these significant milestones in furthering our organisation's vision were developed in extensive consultation with members who put their hands up to help and shared their insights or experiences. They were the furthest thing from a closed-door effort.

The Tax Institute is the leading forum for the tax community in Australia *because* we are made up of many voices from all walks of life, sharing their different experiences and perspectives. We are thought leaders within the profession *because* our members are academics, subject-matter experts, law practitioners, business owners, students and more, all contributing to our place in the conversation. Every effective leader knows you win with people.

When we face challenges of significant scale, coming together as a strong, united front is vital. So, our next priority is to ensure that our network of volunteers – our A Players – understand how and when they can make an impact by being involved in our work. As we work to make these opportunities clearer, I encourage you to be active in looking for opportunities to step up into leadership roles that play to your strengths and interests. We are excited to welcome new voices, and to explore how your experience, ideas and passion can shape the future of our profession.

Tax Counsel's Report

by Julie Abdalla, FTI

The sharing economy reporting regime

The sharing economy reporting regime is currently before parliament, and with an imminent start date for some platforms, it is timely to consider the journey so far.

What is the sharing economy?

The sharing economy is also known as the gig economy or platform economy and, as the name suggests, it is based on the sharing of access to goods and services (for example, ride-share or food-delivery services) through an online platform.

The sharing economy is not to be confused with the shadow economy, although there is some overlap. The latter relates to those business operations that take place outside of the tax and regulatory systems. In the context of sharing economy platforms, one of the main revenue concerns is the non-reporting or under-reporting of income derived from the provision of services.

The Black Economy Taskforce

The Black Economy Taskforce was formed with the objective of developing a holistic policy response to combat the shadow economy. In its final report, the Taskforce noted the increasing prevalence of the shadow economy and its widespread detrimental impact. Among an extensive list of recommendations, the Taskforce identified opportunities for redress through the tax system. One important such recommendation was the introduction of a sharing economy reporting regime.

Implementing a reporting regime

Consultation

In the 2018-19 Federal Budget, the government announced that it would consult on how the recommendation to introduce a sharing economy reporting regime could be implemented. The first of two consultations on this matter took place in early 2019. In the 2019-20 Mid-Year Economic and Fiscal Outlook, the government announced that it would introduce a third-party reporting regime for the sharing economy. The second consultation, which related to the exposure draft legislation giving effect to that announcement, occurred in July to August 2021.

Policy

At a very high level, the regime requires operators of online platforms within the sharing economy to report seller identification and payment details to the ATO for data-matching purposes. The objective is to help ensure that providers operating in the sharing economy are meeting their tax obligations, both in terms of reporting and ultimately in payment, and do not fall within the cracks into the realm of the shadow economy.

The regime is intended to apply to transactions that relate to the supply of:

– ride-sourcing and short-term accommodation from 1 July 2022; and
– asset-sharing, food-delivery, tasking-based services and other services (except for transactions where only the title or ownership of goods or real property are exchanged, and those which relate to financial supplies) from 1 July 2023.

Legislation

The Treasury Laws Amendment (2021 Measures No. 7) Bill 2021 (the Bill), which contains provisions for the regime, was debated and passed in the House of Representatives on 19 October 2020.

On 26 August 2021, the Senate referred the Bill to the Economics Legislation Committee for inquiry and report by 14 October 2021. On 6 October 2021, stakeholders including The Tax Institute appeared before the Committee. While we broadly supported the measures, we highlighted the importance of trust and integrity in the system, and that the execution of the regime through its practical implementation and administration will be crucial to its effectiveness.

Next steps

The Bill currently remains before the Senate. With few sitting days ahead of July, it will certainly be a challenge to design the reporting system with sufficient time for affected taxpayers to prepare. Among other issues, there are concerns within the market as to data integrity, and whether platforms will be captured or excluded appropriately in accordance with the policy. Questions arise as to whether and how the start date may be delayed in order to allow sufficient preparatory and testing time, for taxpayers and the ATO alike.

We have been working with other professional bodies and look forward to the proposed consultation with the ATO on challenges with the implementation and administration of the regime.

The Tax Institute continues to advocate for holistic tax reform to create a more efficient and equitable tax system. The more that agencies like the ATO can utilise rich data sets, the more that we can reduce the compliance burden on taxpayers. This can help shift our tax return structure away from self-assessments to fully pre-filled tax returns. To achieve this, while ensuring both transparency and data integrity, our tax system needs to become more adaptable to a continuously changing, and an increasingly digitalised, world. Future-proofed implementation of the sharing economy reporting regime is one step in the right direction.

Tax News – the details

by TaxCounsel Pty Ltd

February – what happened in tax?

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

Government initiatives

1. COVID-19 test expenses

In a media release on 8 February 2022, the Assistant Treasurer announced that the government is taking action to ensure that COVID-19 tests (including polymerase chain reaction tests and rapid antigen tests) are tax deductible (and exempt from fringe benefits tax for businesses) where they are purchased for work-related purposes.

To remove any doubt, the government will introduce legislation to make it clear that work-related COVID-19 test expenses incurred by individuals will be tax deductible. This applies both when an individual is required to attend the workplace or has the option to work remotely.

The government will also ensure that fringe benefits tax will not be incurred by employers if they provide COVID-19 testing to their employees for work-related purposes.

This change is to take effect from the beginning of the 2021-22 tax year and will be in place permanently.

2. Amending legislation

An amending Bill introduced into parliament on 9 February 2022 proposes a number of amendments to the tax law. Those of more general interest are briefly noted below.

The amending Bill is the Treasury Laws Amendment (Enhancing Tax Integrity and Supporting Business Investment) Bill 2022.

Assisting businesses to meet record-keeping obligations

Amendments are being made to the *Taxation Administration Act 1953* (Cth) to empower the Commissioner to direct an entity to complete an approved record-keeping course as an alternative to existing financial penalties where the Commissioner reasonably believes that the entity has failed to comply with its tax-related record-keeping obligations.

The tax-records education direction seeks to directly address the knowledge gaps and reduce cases of non-compliance with record-keeping obligations by helping entities better understand their tax-related record-keeping obligations.

Other features of the tax-records education direction are:

- an entity that has received a tax-records education direction must complete, or arrange for an appropriate person to complete, the approved course of education and provide proof of completion to the Commissioner;
- if the entity complies with the tax-records education direction, they will not be liable to the administrative penalty for failing to meet their record-keeping obligations;
- if the entity does not comply with the requirements of a tax-records education direction, they will be liable to the original administrative penalty; and
- the Commissioner may only issue a direction to an entity which the Commissioner reasonably believes is not disengaged from or deliberately avoiding their record-keeping obligations.

The Commissioner will be able to issue a tax-records education direction to an entity three months after the amending Bill becomes law. A tax-records education direction may apply to failures to comply with record-keeping obligations under a tax law that occur both before and after the amending Bill becomes law.

Intangible asset depreciation

Amendments are also being made to the *Income Tax Assessment Act 1997* (Cth) (ITAA97) to provide taxpayers with the choice to self-assess the effective life of certain intangible depreciating assets that they start to hold on or after 1 July 2023, rather than using the statutory effective life currently specified in the law. The intangible assets to which this choice will apply are:

- a standard patent;
- an innovation patent;
- a registered design;
- a copyright (except copyright in a film);
- a licence (except one relating to a copyright or in-house software);
- a licence relating to a copyright (except copyright in a film);
- in-house software;
- a spectrum licence; and
- a telecommunications site access right.

The amendments will also allow the taxpayer to recalculate the effective life in later income years if the effective life that the taxpayer has been using is no longer accurate because of changed circumstances relating to the nature of the asset's use.

If the cost of the asset increases by at least 10% in a later income year, the taxpayer must recalculate the effective life of the asset.

Further, the taxpayer must also recalculate the effective life of the asset for the income year that the taxpayer starts to hold it if:

- the taxpayer is using an effective life because of the associate or same user rule in s 40-95(4) or (5) ITAA97; and
- the asset's cost increases after the taxpayer starts to hold it in that year by at least 10%.

Foreign resident workers

Schedule 6 to the amending Bill and the Income Tax Amendment (Labour Mobility Program) Bill 2022 are making amendments to reduce the effective tax rate on certain income earned by foreign resident workers participating in the Australian Agriculture Worker Program or the Pacific Australia Labour Mobility scheme from 32.5% to 15%. This will ensure that such workers pay tax at an appropriate rate on program income, consistent with similar migration programs.

The amendments are to apply in relation to salary, wages, commission, bonuses or allowances paid to an employee under a relevant program on or after 1 March 2022.

The Commissioner's perspective

3. Commercial debt forgiveness: natural love and affection

The Commissioner has issued a final determination to the effect that, in the context of the commercial debt forgiveness rules, the exclusion for debts forgiven for reasons of natural love and affection requires that the creditor be a natural person (TD 2022/1).

The context of the relevant provision (s 245-40(e) ITAA97) requires a direct causal nexus between the forgiveness and the natural love and affection, and the natural love and affection must arise in consequence of ordinary human interaction. For this to occur, the creditor must be a natural person and the object of their love and affection must be one or more other natural persons. Where the conditions for the exclusion are otherwise satisfied, there is no requirement that the debtor must be a natural person.

It is stated in the explanation section of TD 2022/1 that the ordinary meaning of the phrase "natural love and affection" imports strong emotions of caring, fondness and attachment that arise in consequence of ordinary human interaction. The phrase's legal meaning refers to goodwill towards, or emotional attachment to, another person, particularly that of a parent to their children.

When testing the state of mind of a creditor to establish the presence of natural love and affection, a number of factors may be relevant, including past dealings, existing relationships and future intentions. Whether natural love and affection is present in a relationship can only be determined on a case-by-case basis.

As the natural love and affection required for s 245-40(e) to operate must arise in consequence of ordinary human interaction, the object of the creditor's natural love and affection that is the reason for the debt forgiveness must be another natural person. However, s 245-40(e) does not further require that the object of the creditor's natural love and affection is also the debtor.

Accordingly, s 245-40(e) is capable of applying in circumstances where the debtor is not a natural person (for example, a company). It still remains necessary to establish that the creditor forgave the debt for reasons of natural love and affection, notwithstanding that the debtor was not the object of that sentiment (for example, where a parent forgives a debt owed by a company that is 100% owned by their child).

Creditor is a natural person acting as a trustee or partner

A natural person may forgive a debt in their capacity as a trustee of a trust, or as a partner in a partnership. It is possible that the conditions in s 245-40(e) would be satisfied where the natural love and affection of that person motivates the forgiveness of a debt owed to the trust or partnership, respectively. However, the cases where this could happen would be limited.

Date of effect

Subject to one qualification, TD 2022/1 applies to income years commencing both before and after its date of issue (9 February 2022).

The qualification arises out of the fact that a different view was taken by the Commissioner in ATO ID 2003/589 which was withdrawn on 6 February 2019. The Commissioner will not devote compliance resources to apply the views expressed in TD 2022/1 in relation to debts forgiven prior to 6 February 2019 that would have been covered by ATO ID 2003/589. However, if the Commissioner is asked or required to state a view (for example, in a private ruling or in submissions in a litigation matter), the Commissioner will do so consistently with the views set out in TD 2022/1.

4. SMSF auditor number misuse

The Commissioner has recently issued follow-up reminders to his September 2021 self-managed superannuation fund (SMSF) auditor number misuse mail-out to approved SMSF auditors for SMSF annual returns (SARs) lodged during the period 1 July 2020 to 30 June 2021.

Approved SMSF auditors who register with the Australian Securities and Investments Commission are provided with a unique SMSF auditor number (SAN). A SAN is included in each SMSF annual return to identify who audited the fund.

There have been instances where a SAN is included in an annual return, but:

- an audit has not been completed by the auditor with that SAN; or
- the annual return was lodged prior to the completion of an audit.

This is referred to as "SAN misuse" and the ATO is taking action to stop it. If it is found that a tax agent has purposefully included an incorrect SAN in a SAR, or lodged a SAR prior to completion of an audit, this may result in a referral of the agent to the Tax Practitioners Board which may impose a sanction for any breach of the Code of Professional Conduct that applies in relation to tax agents.

Also, SMSF trustees who have deliberately misused a SAN may be sanctioned.

Since March 2019, and at least once a year, the ATO has issued auditors with a list of all SMSFs that reported their SAN. Even if an auditor's client list is correct and no instances of SAN misuse have been identified, the auditor should still contact the ATO to confirm that all of the information is correct.

Auditors can reduce the number of SMSFs for which they need to confirm audits by lodging an audit complete advice with the ATO.

5. Client identity verification

In a joint media release issued on 8 February 2022, the ATO and the Tax Practitioners Board (TPB) announced that new guidelines on client identity verification have been developed.

These guidelines are:

- proof of identity guidance which the TPB has issued to help tax practitioners verify their clients' identities and thereby reduce the risk of identity theft and tax fraud (TPB(PN) 5/2022); and
- the *Strengthening client verification guidelines* which have been issued by the ATO to complement the TPB's guidance and are intended for registered tax practitioners using online services for agents or practitioner lodgment service software.

The TPB will soon be running a free webinar with the ATO to explain the proof of identity requirements to tax practitioners.

The chair of the TPB said that, in a period where cybercrime is becoming increasingly prevalent, maintaining best practices for client verification is vital. The TPB guidelines outline appropriate requirements for verification, including defining the documents to be sighted, maintaining records, and recommendations about achieving remote verification of clients.

The ATO and the TPB will conduct additional consultation to support tax practitioners with transitioning to the new guidelines, which are intended to become minimum standards in due course.

Recent case decisions

6. "First uses"; "for exploration"

The Full Federal Court (Allsop CJ, Davies and Thawley JJ) has unanimously dismissed the Commissioner's appeal and allowed the taxpayer's cross-appeal from a decision of Colvin J which involved the construction and application of the provision of the ITAA97 that effectively allows an immediate depreciation write-off for certain exploration or prospecting assets (*FCT v Shell Energy Holdings Australia Ltd*[1]).

The provision in issue was s 40-80(1) ITAA97 which provides, relevantly, that the decline in value of a depreciating asset that a taxpayer holds is the asset's cost if the taxpayer "first uses" the asset "for exploration". If s 40-80(1) applies, the taxpayer is entitled to deduct an amount equal to the cost of the asset.

The taxpayer (Shell) and Chevron Australia Pty Ltd (Chevron) were both participants in a petroleum venture known as the Browse Project, along with other parties. The participants in the Browse Project were together the holders of an exploration permit and six retention leases (the statutory titles) granted under the legislation regulating petroleum exploration in offshore areas.

In 2012, Shell purchased Chevron's participating interest in the Browse Project and claimed a deduction under s 40-80 for the cost to it of acquiring an "additional proportional interest in the statutory titles" from Chevron. The Commissioner disallowed the deduction claim and Shell objected. On disallowance of the objection, Shell appealed to the Federal Court and was partially successful on this appeal.

At first instance, Colvin J found that there was use of the additional proportional interest "for exploration". The Commissioner appealed, contending that none of the activities authorised by the additional acquired rights were uses "for exploration" and that Colvin J should have held that none of the cost was deductible under s 40-80.

Colvin J also held that "first use" of the additional proportional interest in the statutory titles for exploration had not been demonstrated. Shell cross-appealed from this part of the judgment of Colvin J, contending that the additional proportional interest in each of the statutory titles was "first used" for exploration when the asset was held ready for use on regulatory approval and registration of the acquisition.

As stated, the Full Federal Court dismissed the Commissioner's appeal but allowed Shell's cross-appeal.

It is of some more general interest to refer to the approach of the Full Court to the concept of "first use". When considering the "first use" issue, the Full Court referred to the so-called "passive use" concept. In this regard, Davies J (Allsop CJ and Thawley J agreeing) said:

> "65 Contrary to the Commissioner's submission, Shell's construction is further supported by case law to the effect that 'passive use' may constitute 'use' within the ordinary and natural meaning of that word: see e.g. *Goldsworthy Mining Ltd v Federal Commissioner of Taxation* [1975] HCA 3; 132 CLR 463, 470. As Ipp J accepted in *Daniele v Shire of Swan* (1998) 20 WAR 164 at 176:
>
>> I accept, with respect, that the mere holding of land 'in reserve', when it is not being altered in character or exploited (whether actively or passively), as in Minister Administering the Crown Lands Act v New South Wales Aboriginal Land Council (No 2), may properly be termed 'passive' use.
>
> Similarly, in *Parramatta City Council v Brickworks Ltd* [1972] HCA 21; 128 CLR 1, Gibbs J said at 21:
>
>> I would agree that the word 'use' in c1. 32 means a present use; it does not include a contemplated or intended use. It is not enough to bring c1. 32 into operation that land has been acquired with the intention of using it for a particular purpose in the future. On the other hand, it is not necessary, to constitute a present use of land, that there should be a physical use of all of it, or indeed of any of it.
>
> In *Duke Group Ltd (in liq) v Arthur Young (Reg) (No. 3)* (1990) 55 SASR 11, Perry J said at 16:
>
>> In my opinion, Nicholson's case (supra) is clear authority for the proposition that incoming material not generated within a business but retained 'for the purpose of recording any matter relating to the business' may be regarded as constituting a business record. The retention of the document in those circumstances is a 'use' of the document in the ordinary course of business for the required purpose.
>
> Although those authorities concern a different statutory context, the point to make is that 'use' is capable of being passive and the legislation does not prescribe that 'use' must be active."

The Full Court also considered an issue that arose under s 40-77 of the *Income Tax (Transitional Provisions) Act 1997* (Cth).

7. Tax agent registration

The AAT has affirmed a decision of the Tax Practitioners Board (the TPB) to cancel the registration of a tax agent on the basis that, among other things, the TPB was not satisfied that she was a fit and proper person, but has reduced the period that she should be precluded from reapplying for registration from five to four years (*Cerrah and Tax Practitioners Board*[2]).

The TPB's opinion that the agent was not a fit and proper person to be a registered tax agent was formed because the TPB had found that the agent had failed to comply with various professional obligations in respect of honesty and integrity, conducting her own affairs in accordance with tax laws, and maintaining her professional skills and knowledge.

There were a number of breaches by the agent of the Code of Professional Conduct that is contained in the *Tax Agent Services Act 2009* (Cth). These included:

– not acting with honesty and integrity in failing to lodge her 2015, 2016 and 2017 tax returns in time and in not declaring all of her assessable income for each of those years. Further, those failures were in breach of her obligation to comply with tax laws in the conduct of her personal affairs;
– being in breach of her obligation of honesty and integrity and her obligation to comply with tax laws in the conduct of her personal affairs because she did not lodge her income tax returns and declare her assessable income for the 2015, 2016 and 2017 years so that she might continue to receive the same level of government benefits she was receiving; and
– breaching her obligation of honesty and integrity in telling the TPB that she had met the TPB's minimum annual continuing professional development obligations when she had not.

In holding that the tax agent was not a fit and proper person, the AAT said that the breaches that had been found involved dishonesty in dealings with the TPB and failures to comply with tax laws in the conduct of the agent's own affairs. The fact of dishonesty was a significant matter affecting the question of fitness and propriety because public trust and confidence in the regulation of tax agents and the tax system relies foundationally on the honesty of the participants.

The most egregious breaches involved telling the TPB that personal tax obligations were not overdue when they were. This was aggravated because an earlier application for registration had been withdrawn on the very basis that it was brought to the agent's attention that she had personal tax obligations that were outstanding and needed to be dealt with before registration could occur.

The breaches of the other obligations that the AAT had found were nonetheless serious, and it should not be thought that the focus on the misleading statements to the TPB and the failures to lodge tax returns and declare assessable income in three income tax years diminished their importance.

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1 [2022] FCAFC 2.
2 [2022] AATA 7.

Tax Tips

by TaxCounsel Pty Ltd

CGT asset identification

The application of the CGT disposal event can, in some cases, raise issues as to what the relevant CGT asset is.

Background

When considering the way that the CGT provisions operate, there are circumstances in which issues may arise as to what the CGT asset is that is relevant for a particular transaction that has taken place, or is to take place. These issues can arise, for example, when applying CGT event A1 (disposal of a CGT asset).

This article considers the issues that may arise where:

– a taxpayer has acquired interests in property (and, in particular, for the purposes of this article, real property) at different times and is selling or otherwise dealing with part of the taxpayer's present interest in the property; or

– a taxpayer has acquired identical assets (and, in particular, for the purposes of this article, shares of the same class in a private company[1]) over a period of time and is selling or otherwise disposing of some of those assets.[2]

What is a CGT asset?

The starting point for the discussion of these questions is the basic concept of a "CGT asset".

For CGT purposes, a CGT asset is defined in s 108-5 ITAA97. Subsection (1) of that section provides:

"(1) A ***CGT asset*** is:

(a) any kind of property; or

(b) a legal or equitable right that is not property."

Subsection (2) is an avoidance of doubt provision which reads as follows:

"(2) To avoid doubt, these are ***CGT assets***:

(a) part of, or an interest in, an asset referred to in subsection (1);

(b) goodwill or an interest in it;

(c) an interest in an asset of a partnership;

(d) an interest in a partnership that is not covered by paragraph (c)."

Note 1 to s 108-5 ITAA97 gives examples of CGT assets and these examples include land and buildings and shares in a company.

Individuals who own a CGT asset as joint tenants are treated for CGT purposes as if they each owned a separate CGT asset constituted by an equal interest in the asset, and as if each of them held that interest as a tenant in common (s 108-7 ITAA97).

Interests in property

That an interest in property may itself be a CGT asset is expressly recognised in the avoidance of doubt provision quoted above. Also, the partnership provisions (s 106-5 ITAA97) recognise this. For example, subs (2) of that section provides that each partner has a separate cost base and reduced cost base for the partner's interest in each CGT asset of the partnership.

Part of an interest in a CGT asset

The avoidance of doubt provision quoted above also makes it clear that a part of an asset is a CGT asset and, by extension, that part of an interest in a CGT asset is a CGT asset (see para (a)).[3]

Example

In August 2003, Pam and George acquired a parcel of land as tenants in common in equal shares. If Pam were to dispose of a quarter of her tenant in common interest in the land to Sally, Pam would have disposed of part of her CGT asset, that is, her tenant in common interest in the land.

More than one interest

The fundamental issue that is relevant for present purposes is what the position is if a taxpayer were to acquire interests in a CGT asset at different times and the taxpayer were to subsequently dispose of something less than the whole of those interests.

From a property law perspective, the fact that an owner of an interest in property (say, for instance, an undivided fee simple in land) may have that interest as a result of several transactions is not relevant when considering what the owner may dispose of. This, however, is not the case for the purposes of CGT. That a taxpayer may have more than one interest in property (and thus more than one CGT asset) is recognised in the CGT partnership provisions. Section 106-5(3) ITAA97 provides that, if a partner leaves a partnership, a remaining partner acquires a separate CGT asset to the extent that the remaining partner acquires a share of the departing partner's interest in a partnership asset.

Further, where an owner has more than one CGT asset in land, different CGT consequences may follow depending on which interest is disposed of. For example, where:

– the owner may have acquired one interest in land pre-CGT and another interest post-CGT;

– the owner may have acquired one interest in land more than 12 months previously and another interest within the previous 12 months;

– a capital gain from one interest in land may qualify for the CGT small business reliefs but a capital gain from another interest may not; and

– a capital gain may arise from the disposal of one interest in land but a capital loss may arise from the disposal of another interest.

Example

Two individuals, Barry and Robert, acquired land as tenants in common in equal shares in February 2005. In December 2021, Barry acquired Robert's interest. If Barry were to sell a one-half tenant in common interest in the land in June 2022, a capital gain in respect of the disposal of Barry's interest in the land acquired in February 2005 would qualify for the discount capital gain concession, but a capital gain in respect of the interest acquired from Robert in December 2021 would not. The relevant issue for present purposes is whether Barry could treat the June 2022 transaction as a disposal of the interest acquired in February 2005 and, so, attract the discount capital gain concession to the capital gain.

Binding determination

The Commissioner has issued a binding determination which addresses these issues (TD 2000/31). That determination is to the effect that, where a taxpayer who owns an interest in a CGT asset acquires another interest in that asset, the interests remain separate CGT assets for CGT purposes; they do not become a single asset. This is so whether the first interest was acquired before 20 September 1985 (a pre-CGT interest) or was acquired on or after 20 September 1985 (a post-CGT interest).

TD 2000/31 then goes on to state that the consequences are that, on the occurrence of CGT events affecting the interests (for example, CGT event A1 (disposal of a CGT asset)):

– there is a separate date of acquisition for each interest;

– there is a separate cost base for each interest; and

– capital proceeds are determined separately for each interest.

TD 2000/31 then gives the following example.

Example

Sam and Terry jointly purchased land in 1982 to build a holiday house. Terry sold his 50% interest to Sam in 1998. Any capital gain or capital loss Terry makes is disregarded for capital gains purposes because his interest is a pre-CGT interest.

If Sam later sells the land, the sale proceeds are attributed 50% to the pre-CGT interest and 50% to the post-CGT interest. Any capital gain or capital loss Sam makes on his pre-CGT interest in the land is disregarded for capital gains purposes. If Sam makes a capital gain on his post-CGT interest in the land it would be taken into account in calculating his net capital gain or net capital loss for the income year.

Importantly for present purposes, this example in TD 2000/31 goes on to consider what the position would be if Sam decided to sell only a 50% interest in the land. The determination states that, in that scenario, Sam could:

– sell either his (50%) pre-CGT interest or his (50%) post-CGT interest; or

– he could sell two 25% interests in the land (being 50% of his pre-CGT interest and 50% of his post-CGT interest).

It will be noted that the way that the example in TD 2000/31 is worded appears to give only two possibilities, namely, that there is a disposal by Sam of either of his 50% interests or a disposal by Sam of a one-half of each 50% interest. But is this correct? Could Sam dispose of, say, 70% of his pre-CGT interest and 30% of his post-CGT interest?

Further, to go back to the example given above involving Barry and Robert, assume that the June 2022 transaction involved Barry selling 70% of his interest in the land. Would Barry be able to treat the transaction as involving a disposal of his original 50% interest acquired in the February 2005 transaction and a 20% interest acquired in the February 2005 transaction? The example in TD 2000/31 suggests not, but it is submitted that this is not correct.

It is to be hoped that the Commissioner provides guidance on this issue. Arguably, because the pre-CGT interest and the post-CGT interest are, as accepted in TD 2000/31, to be treated as separate CGT assets, the taxpayer could determine what parts of those separate CGT assets are disposed of.

Identical assets

The other question raised at the beginning of this article is whether a taxpayer who owns a number of shares of the one class in a private company that cannot objectively be separately identified and have been acquired at different times can, when disposing of some of the shares, treat particular shares as being the ones disposed of.

A simple example will demonstrate the issue.

Example

Ken and his spouse Amber decided to commence a business and for this purpose incorporated a private company (KAM Industries Pty Ltd) on 18 March 2002 to carry on the business. The issued shares of KAM Industries Pty Ltd on its incorporation were 100 fully paid ordinary shares which were allotted equally between Ken and Amber who each held the shares allotted to them beneficially.

In August 2007, a further 50 fully paid ordinary shares in KAM Industries Pty Ltd were allotted to Amber.

In March 2009, it was decided to bring their son (George) into the business, and for this purpose, Amber sold 30 of her shares to George. In July 2021, George decided to go overseas for an extended period and Amber reacquired the shares he held. Amber later sells 20 of her shares in KAM Industries Pty Ltd to their other son (Martin). Which shares did Amber sell to Martin?

This issue is considered in CGT Determination 33 which, however, is not a public binding ruling.[4] Relevantly, the determination states:

> "1. Where a disposal of shares occurs and those shares are able to be individually distinguished e.g. by reference to share numbers or other distinctive rights or obligations attached to them, those shares are identifiable; their date of acquisition and cost base will be a matter of fact.
>
> 2. However, on the disposal of shares which form part of a holding of identical shares i.e. of the same class and in the same company, which

are acquired over a period of time, it may not always be possible for a taxpayer to distinguish or identify the particular shares that have been disposed of.

3. In these circumstances, the taxpayer will need to decide which particular shares are being disposed of. Taxpayers in this situation will need to keep adequate records of the transaction so that the decision can be supported should the income tax return be subject to Tax Office scrutiny at a later date.

4. In the past, where unidentifiable shares have been disposed of, the Commissioner has accepted 'first-in first-out' as a reasonable basis of identification. For CGT purposes, the Commissioner will also accept the taxpayer's selection of the identity of shares disposed of ..."

It is the second sentence in para 4 of CGT Determination 33 that is relevant for present purposes.

Record-keeping

It will be appreciated that, in cases of the kind discussed above, care needs to be paid to the keeping of adequate records. The importance of this is emphasised by the fact that, in the kinds of case envisaged, it will usually be of no concern to the other party to the transaction what the taxpayer's CGT position is, which means that the documents that effect the transaction are unlikely to be of any real assistance in resolving the taxpayer's CGT issues.

The CGT provisions themselves contain record-keeping provisions in Div 121 ITAA97. The following provisions may be particularly noted:

- a taxpayer must keep records of every act, transaction, event or circumstance that can reasonably be expected to be relevant to working out whether the taxpayer has made a capital gain or capital loss from a CGT event (s 121-20(1) ITAA97);
- the records must show details (including relevant amounts) of how the act, transaction, event or circumstance is relevant (or can reasonably be expected to be relevant) to working out whether the taxpayer has made a capital gain or capital loss from a CGT event (s 121-20(4) ITAA97); and
- if the necessary records of an act, transaction, event or circumstance do not already exist, the taxpayer must reconstruct them or have someone else reconstruct them (s 121-20(5) ITAA97).

It is suggested that, in the kinds of case discussed in this article, relevant identification of assets may be made by referring to particular transactions. For example, in the case of shares in a private company that have been acquired over time, reference could be made to, say, 10 of the shares issued to (or otherwise acquired by) the taxpayer on a particular date.

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References

1 It is assumed that the shares are not numbered and cannot otherwise be objectively distinguished.

2 There are provisions in the *Income Tax Assessment Act 1997* (Cth) (ITAA97) that, where they apply, operate to treat a physical asset as being more than one CGT asset for CGT purposes (see Subdiv 108-D ITAA97). These provisions are not considered in this article.

3 The so-called "identity" issues that arose in relation to the former s 26(a) of the *Income Tax Assessment Act 1936* (Cth) obviously do not arise in relation to CGT.

4 It is in fact a CGT Cell Determination which was issued on 19 December 1991.

Higher Education

Combining experience and qualifications

The dux of Advanced Superannuation for Study Period 1 2021, and active candidate in the Graduate Diploma in Applied Tax Law Program, shares how study has cemented her knowledge.

Natalie Metcalfe, Senior Analyst, Tax & Legal, Deloitte, Western Australia

Please provide a brief background of your career in tax.

I started my professional practice career at RSM Bird Cameron, where I specialised in SMSFs for seven years. I then went to London for five years and contracted with several major banks, specialising in fund accounting. After that, I spent some time working for the government and large corporates, before taking on the role of Fund & Tax Accountant with WA Super until it merged with Aware Super. I recently joined the FSI tax team at Deloitte, specialising in industry superannuation tax consulting.

Why did you choose Advanced Superannuation as a subject?

I have a passion for superannuation and wanted a qualification to add to my practical experience. I am currently enrolled in the Graduate Diploma in Applied Tax Law (GDATL).

What skill or knowledge areas have you gained from the Advanced Superannuation subject?

Advanced Superannuation cemented my knowledge in superannuation and covered topics that include contributions, taxation of superannuation funds, exempt current pension income, investment provisions, pre-retirement and retirement, and benefits on death.

What skill or knowledge areas have you gained from CTA3 Advisory?

CTA3 Advisory broadened my experience in researching a particular area of legislation and considering different scenarios that could occur. The exam was based on a late-breaking fact, so I was responding to the facts laid out in the case study but also looking at implications if the facts were to suddenly change.

Have you applied knowledge from the GDATL Program to your role?

I am using the taxation of superannuation funds and exempt pension income calculations to assist my clients in their superannuation taxation requirements. CTA3 Advisory also allowed me to significantly hone in on writing advice, which helped me to recently complete a memo for a client that looked at the tax implications of a transaction.

How did you juggle study, work and other commitments and perform so well?

I have 3, 5 and 7-year-old children who motivate me to do well in my studies. I did spend some intensive weekends completing the assignment, which helped with my preparation for the exam.

My tip on managing the course is to follow the guidance emails sent out by the subject convenor to stay on top of the course work.

Where to now when it comes to continuing tax education?

I recently completed CTA3 Advisory and passed with Merit. I am currently enrolled in Corporate Tax and I will complete the unit and my GDATL in February 2022.

What advice do you have for tax professionals considering the GDATL Program?

I recommend obtaining a qualification with The Tax Institute Higher Education to gain tax knowledge and provide an excellent foundation for a specialist tax career.

Member Profile

This month's column features Brady Dever, ATI, from PwC, NSW.

Member since

2016

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

Honestly, my tax career started by total accident! I studied Comm/Law at university and took a year off to travel when I finished. I ended up missing the deadline on articles clerkships, but a position at PwC was still open so I applied and figured I would spend a year there before jumping into law. And 18 years later, I'm still here! In those earlier years, I worked in GST and, as it was brand new, the challenge and opportunity of being involved in a tax from the ground floor up was super appealing to me. Even today, it is the variety of issues, people and tasks which keeps me so engaged in my work as a tax practitioner.

How is your membership beneficial to your practice and clients?

Being able to stay connected to peers and colleagues through the professional association at The Tax Institute is highly valuable — it allows me to stay on top of policy and technical issues at a time when change has never been more pronounced. This helps keep me across all issues, which also benefits my clients.

What is your most memorable career achievement to date?

While I've been lucky enough to work overseas earlier in my career and to be involved in many unbelievable projects with amazing clients, from a personal perspective, being admitted to the PwC partnership is probably my career highlight to date. Our firm is really big, but it is absolutely true that becoming a partner at PwC means you become part of a family. The way in which 700-odd partners look out for each other and take genuine interest and satisfaction in supporting younger partners through their early years is something which I think makes our partnership so special.

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

Managing resourcing is clearly going to be a challenge for 2022. Lots of people I speak with across the firms and my clients seem to have the same challenge. Many of our people have been through a few really hard years and were hoping to get a break over Christmas, and then COVID came again. So finding a way to manage workloads, staff retention and recruitment is going to be a key priority.

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

I think the attributes for successful leadership today are evolving. Client service and technical excellence were and always will be non-negotiables, just as they were when I first joined the profession and was fortunate to learn my craft from some outstanding client and technical leaders at PwC. But the role of a tax leader is now more multi-dimensional — tax leaders need to be across operational issues and technology advancement, they need to be able to communicate and advise boards and executive stakeholders as tax becomes an even more prominent environmental, social and governance issue. And tax leaders, probably now more than ever, must look after and provide opportunities to their teams. The things that matter to people in my team, in terms of work experience, flexibility, opportunity, progression and remuneration, are not necessarily the same as back in the 90s or 2000s.

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

I guess the best advice I can offer is to have an open and inquisitive mind and to put in as much as you can to professional and technical development — these are the foundations for future success. I would also suggest soaking up all of the practical experience you can get working with clients and your current leaders, the good, bad and ugly, and to work out what works best for you personally.

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

I have three young kids under nine, so they keep me pretty busy outside of work. I try not to work at all on weekends and do my best to do ballet and sports runs at least twice a week after school. I'm a bike rider, golfer and budding wine enthusiast (loving Italian Barolo at the moment!).

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

The award is an unbelievable honour. I was proud and humbled to be nominated by my colleagues at PwC and to be listed alongside the other nominees, some truly outstanding tax professionals. To be fortunate enough to win I think validates that tax advisers do truly have a place in finance transformation and technology projects and that we are on the right path focusing in this area. We're seeing the convergence of several macro trends at the moment — global and local tax law and compliance reporting changes, combined with COVID changing the way we work and think about resourcing, the rapid growth of tax technical solutions, and the once-in-a-generation shift to cloud-based enterprise resource planning. This is a perfect opportunity for tax professionals to drive meaningful change and enhance tax's relevance in wider finance transformation conversations.

Employment taxes

by The Tax Institute

In 2021, governments around the globe were presented with the challenge of how to prepare for a time of transformation following the economic stimulus provided through various programs which left most countries with higher levels of government debt than ever before. In Australia, much of the stimulus was directed at encouraging employers to maintain their existing levels of employment even if at reduced levels of business and employee activity. However, the COVID-19 pandemic has put accelerated pressure on the evolution of the standard work environment and created immense economic pressure. There is no copybook for what future work will be like and previous upheavals from last century won't necessarily provide any indication. Accordingly, we must think and act flexibly. This chapter of the *Case for Change* paper discusses aspects of the Australian tax system that are in urgent need of tax reform to support a more optimal workforce for the current and future economy and, more broadly, for the benefit of society.

Potential for a better workforce and stronger economy

Throughout our various discussions and engagement with hundreds of tax experts and other stakeholders, the following priority issues of the workforce and labour market have come to the fore:

- concerns about inefficiency, lack of fairness and inequality in the present system due to the multiple taxing regimes imposed on all those who deal with the labour market, including pay as you go (PAYG) withholding, superannuation guarantee (SG), fringe benefits tax and payroll tax;
- the rapidly changing nature of employment and the labour market and the emergence of new work relationships from the sharing or 'gig' economy (herein, the gig economy) and concerns of the appropriate tax treatment;
- the decline in the rate of economic growth due to demographic changes in our society, including an ageing population, the impact of COVID-19 etc; and
- Australia's lagging performance as indicated by average tax wedge statistics (i.e. a measure of the difference between labour costs to the employer versus take home income of the employee) and lack of labour market dynamism (for example, differences in the tax treatment of non-standard workers relative to standard employees) in comparison with other OECD countries.[1]

We address these issues in detail below and explore potential options for consideration.

Fringe benefits tax

FBT is payable by employers on the 'taxable value' of fringe benefits provided to employees and their associates (for example, family members). The tax is payable on the 'grossed-up' value of the benefit. The 'grossed-up' value is tax-inclusive as it takes account of the FBT rate and also of the employer's ability to claim GST credits on its acquisitions. The FBT rate is imposed at the highest marginal tax rate plus Medicare levy (currently 47% for the year ending 31 March 2021).

Fringe benefits tax as a revenue source

The FBT legislation was enacted in 1986 as an integrity measure to ensure that all forms of remuneration paid to employees were subject to appropriate taxation[2] and to overcome the perceived deficiencies of both the scope and administration of s 26(e) of the *Income Tax Assessment Act 1936* (Cth). The underlying policy intent being to protect the income tax revenue base and to assess and collect tax from recipients of fringe benefits more efficiently.[3] This section sought to tax, in the hands of the employee, the value to the employee of non-cash benefits received as a result of their employment. The fundamental difference between s 26(e) and the FBT legislation is that (i) employers are taxed (ii) in respect of an objective, grossed-up value of the benefits provided to employees (iii) at the highest marginal tax rate. However, perhaps the most complicating part of the FBT is that the net is cast so widely, many things that are not considered 'benefits' in normal business or commercial terms are prima facie caught by the FBT legislation.

FBT creates a disproportionate compliance burden in comparison to the tax revenue generated. Based on our members' experience, a significant amount of work is required to administer a wide range of benefits where a majority of revenue comes from only a few benefits (e.g. car fringe benefits).

Statistics show the following:

- in 2017–18, FBT made up 0.9% of tax, while individual income tax and company tax made up 51.3% and 20.9%, respectively;[4]
- in 2018–19, the net FBT was approximately $3.82b.[5] ATO statistics further show that FBT forms take over 11 hours on average to complete, compared to less than half an hour on average for a BAS or one-and-a-half hours on average for a superannuation return;[6] and
- FBT has lower levels of compliance compared to other taxes, with ATO statistics showing that FBT has the highest tax gap in comparison to other taxes ($1.06b and 21.2% net gap for the 2017–18 financial year).[7]

Furthermore, there is the additional complexity arising from the application of FBT to the growing unassigned category of workers outside of traditional employee–employer relationships, arising from the gig economy.

Fringe benefits tax and the not-for-profit sector

Not-for-profit (NFP) entities can apply for endorsement for tax concessions, including an FBT exemption or rebate.

FBT has been described as being of substantial importance to such entities, which includes NFPs operating hospitals, ambulances and state[8] governments.[9] The NFP sector maintains that it is often unable to accommodate competitive wages for employees and uses concessional FBT treatment to attract and retain staff. NFP entities have often used fringe benefits as a tax-effective means of increasing their employees' renumeration. Salary packaging utilised as a fringe benefit effectively operates to supplement wages or to effectively lower the average tax rate for NFP employees.

The FBT concessions have a distortionary effect in the marketplace in that the concessions have become a critical tool available to NFPs to remain competitive with the private sector in being able to attract, retain and reward staff.[10]

Payroll tax

Current landscape

Payroll tax is discussed in detail in Chapter 11 of the *Case for Change* paper, however, issues specifically pertaining to the labour force are addressed here.

Payroll tax is a tax on wages, in cash or in kind, provided by employers to their employees. Each of the state-based regimes have nuanced features and different criteria for determining an employer's liability for payroll tax, including different tax-exempt wage thresholds, allowable deductions and rates of tax.

The efficient collection of payroll tax can assist with a stronger economic recovery post-COVID-19. For state governments, payroll tax revenue grows with wages. Without increases to the threshold, average payroll tax rates on businesses will increase as the payrolls of businesses grow.

There is understandable reluctance to reduce or remove payroll taxes as it forms the major source of income for state governments. Nonetheless, state governments effectively forgo payroll tax revenue as a result of adjusting the thresholds and rates. This adds to the confusion and the compliance costs (quite apart from the impact on state governments' budgets).

Issues in the workforce

The long-run economic incidence of a broad-based payroll tax is similar to that of a broad-based tax on consumption, being that it falls on labour income or wages. Similar to FBT, payroll tax is imposed on the employer but the economic incidence of the tax is ultimately borne by employees.

There is some argument that payroll tax is passed onto employees in lower wages, thereby reducing their disposable income available for purchases.[11]

Businesses have genuine difficulties in establishing whether or not they have exposure to payroll tax liability partly due to the lack of harmonisation of the definition of 'employee' across various state payroll tax regimes. The uncertainty of employment status is exacerbated by the emerging 'worker' category from the gig economy. The consequence being that employers are burdened with the 'employee' versus 'contractor' dichotomy in yet another aspect of the tax system. Consequently, employers are exposed to potentially significant payroll tax liability (with penalties and interest). Furthermore, employers operating across several states have different reporting and payment obligations and are then required to deal with different revenue authorities in each jurisdiction.

Payroll tax has the potential ability to distort economic activity and reduce business productivity by influencing behaviours of key participants.[12] As payroll tax is an additional cost, businesses of all sizes (above or below the tax-free threshold) may feel disincentivised to grow and incur a larger payroll tax liability.

Issues

The definition of 'employee'

Inconsistent interpretation and widespread misunderstanding

The impost of each type of employment tax is dependent on the definition of 'employee', however, the meaning of employee is defined differently for each purpose. Further, the existence of multiple different administrators at the federal and state levels results in additional complexity even where the definitions are common. This leads to widespread misunderstandings and errors by employers in relation to the application of each of these imposts, as well as inconsistencies in enforcement by these revenue authorities.

The divergence in the definition of 'employee' for the purpose of the various imposts, as well as inconsistencies in the determination of who is an employee, inevitably leads to errors in compliance with the requirements of the various taxes and charges levied on employers. Based on feedback from our members and the technical committees, most commonly, this manifests itself in the following ways:

- failure to meet payroll tax, PAYG withholding and superannuation obligations in relation to contractors who fall within the extended definitions of 'employee' for those purposes;
- failure to identify that someone describing themselves as a contractor is, in fact, an employee; and
- failure to keep pace with changes in the labour market to encompass the emerging work relationships resulting from the sharing or gig economy.

Each of the above shortcomings exposes employers to tax compliance costs by way of penalties and interest due to failures or delays in lodgment or payment.

Tax systems influence choice of employment form

The OECD recently reported that, across OECD countries, there is a growing share of workers earning income outside of the traditional employee–employer relationship.[13] This trend is driven by various factors, including demographic changes, labour market regulation and incentives embedded in the relevant tax system.[14] It was further observed that, in certain tax systems, potential tax arbitrage opportunities exist for both employers and individuals due to the differences in the tax treatment of traditional employees versus non-traditional workers (e.g. independent contractors). Figure 1 demonstrates tax wedges for employment forms across OECD countries.[15]

For Australia, it is depicted that:

- the tax wedge for employment forms has a moderate degree of dispersion (similar to the UK), demonstrating that there is moderate incentive for businesses to shift between forms; and
- the tax wedge for employees is the highest, which suggests that Australian businesses may lower their tax-related labour costs by choosing an employment form other than standard employment.

Administrative burden

The implementation and administration of employment taxes and the definition of 'employee' needs to be reviewed, simplified and harmonised. There is currently a significant administration and red tape burden on businesses. A few common issues arising for employers are listed below.

ATO employee/contractor decision tool: Although designed to assist businesses to determine the working arrangement and classification as an employee/contractor, the tool has limited use or binding guidance for taxpayers. Its flaws include:

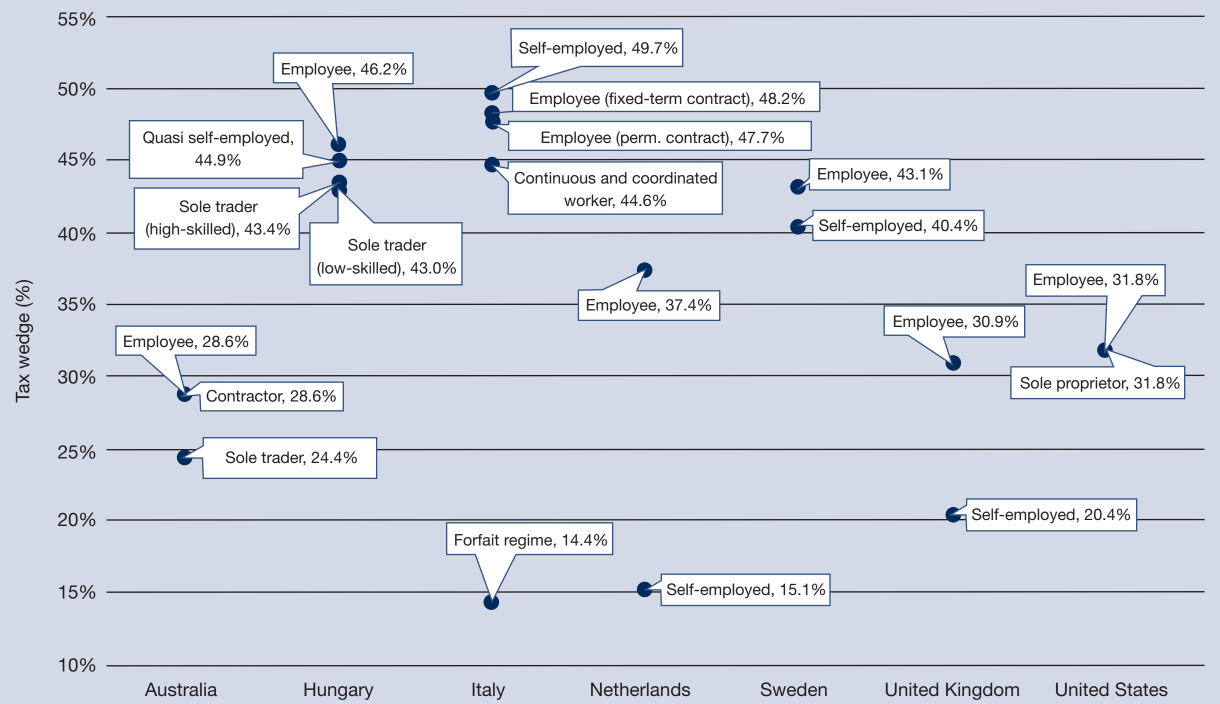
- the exclusion of working arrangements that are prevalent and increasing — for example, labour hire firms, individual workers and workers in connection with ride-sourcing arrangements;
- the capability of being gamed — the tool can easily be manipulated to provide an engineered outcome that is preferred. For example, by purposely overstating or understating one of the ATO's six factors of consideration in determining whether a worker is an employee or contractor;[16] and
- the lack of consideration of other obligations — for example, payroll tax or WorkCover obligations.

Payroll tax groups: The lodgment of multiple state returns for essentially the same information for different members of the group is highly inefficient (from both a business resource and costs perspective) and administratively cumbersome.

Payroll system implementation and configuration: Historically, the payroll systems have required additional set-up and continuous monitoring to facilitate the types of employees (full-time, part-time etc), the types of payment (ordinary, overtime etc), and the different state tax rates and thresholds.

The ATO's requirement of Single Touch Payroll (STP) reporting from 1 July 2021 for all employers (except those with closely held payees or an approved deferral/exemption) aims to assist employers to streamline their reporting process to the ATO. Rather than reporting PAYG monthly or quarterly, employers are required to report it after each 'payroll event' along with super contributions. However, this does not eliminate the issue arising from the difficulty of classification of the individual as an employee, contractor or other type of worker. The Tax Institute welcomes the expansion of STP (also known as STP Phase 2) as important progress in the data automation of the Australian tax system and for its role in reducing the reporting burden for employers who need to report employee information to multiple government agencies.

Figure 1. Tax wedges for employment forms across countries



Source: OECD, *Taxing wages* 2020, p. 48.

Pay as you go withholding

The legal framework of the PAYG withholding system requires an entity (employer) to withhold an amount from salaries, wages and similar payments paid to an employee.[17] The requirement to withhold is determined by three main questions, being:

- the definition of an 'employee';
- the type of payments from which an employer must withhold tax (with exemptions including exempt income and fringe benefits); and
- how much tax should be withheld according to the withholding schedules and legislated tax rates.

There is a current design failure with the PAYG withholding system evidenced by the high level of refunds arising from withholding mismatches. The withholding schedules do not take into consideration circumstances, for example, where employees only work part of the year or receive promotions part way through the year. Accordingly, there is a tax process at the end of each financial year to manage deductions and withholding mismatches. However, ATO statistics have reported that tax refunds due to an overcollection of debt is an approach that most taxpayers are reasonably accepting of and happy with.

This raises the question of whether this is a design of the 20th century or whether, with technology, including STP, it could be possible to have a continually adjusting and individualised withholding rate. This would require interaction between the ATO systems and employer systems, but STP has already taken us a long way in that direction by enhancing data collected and ultimately reducing the ATO administrative gap.

Nonetheless, issues with the PAYG withholding system can be reduced where the employee versus contractor distinction is removed. We explore this further below.

Rapidly changing nature of employment

The COVID-19 pandemic has resulted in a profound shift in society, labour and economic activity, including a trend of employees working from home, rapid digitalisation and the emergence of new work relationships, such as the sharing or gig economy. The OECD has reported that industries involving technicians, trade, labour and community services were most affected.[18] Along with COVID-19, our labour supply market is facing the issues of an ageing workforce, the loss of skilled migration, the absence of a temporary workforce of working holidaymakers, and reduced economic activity. All of which require the need for individuals to re-skill to meet new opportunities. The evolution of the labour market is, of course, important in a dynamic global economy and, as such, there has never been a better time than now for policymakers to consider how the tax and benefit systems may need to be reformed.

The design of the Australian tax system has not kept pace with changes in the labour market. The COVID-19 pandemic has brought into sharp relief the flaws in our system which must be addressed now. As mentioned above, the rapidly changing nature of employment and the labour market has seen the rise of the sharing or gig economy. In the context of tax compliance, non-traditional ways of working have introduced a new level of complexity to be carefully considered alongside the traditional dichotomy between an employee and a contractor.

Without clarity (for example, by way of legislated framework) on the fundamental classification of employment status, the rising gig economy presents further issues across all employment taxes.

Clear, harmonious provisions must be introduced across the Australian income tax, employment and superannuation systems in order to address and keep pace with the issues presented by the rapidly changing environment.

Fringe benefits tax

A highly inefficient, antiquated and burdensome tax

The Tax Institute considers the FBT regime as unnecessarily complex, inefficient and administratively onerous. In the current environment, it is appropriate for the government to take the opportunity to fundamentally reconsider the FBT in light of its disproportionately high compliance costs and onerous regulatory red tape.

The FBT regime has long been criticised for being overengineered and misaligned with policy intent. It is labelled as a tax that fails to strike the right balance between simplicity and fairness and there is much need for improvement or, better yet, complete reform. As raised above, the rules regarding the valuation of particular benefit categories and the application of concessions are overwhelmingly complex for a taxpayer and their professional tax adviser.

The government's announcement in the Federal Budget 2020–21 relating to reduced record-keeping requirements for FBT return purposes will assist in reducing the compliance burden and is a step in the right direction. Effective from 1 April 2021, the Commissioner of Taxation has the power to allow employers to rely on existing corporate records (rather than employee declarations and other prescribed records) to finalise their FBT returns. This relieves employers (and in some instances, employees) from the burden of creating additional records to comply with FBT obligations.[19] However, these changes merely seek to redress a fundamental design flaw in legislation that was designed in extraordinary detail and in a pre-digital world. The changes, while welcome, paper over the fact that the FBT law requires a fundamental rethink.

In The Tax Institute's pre-Budget submission 2020-21,[20] we expressed support for the ongoing activity being conducted by the Board of Taxation regarding the FBT compliance cost review.[21] The findings of the review will be an invaluable resource for the government as it works towards holistic tax reform.

An outdated regime and the definition of 'benefit' is too broad

The Tax Institute also raised concern on behalf of our members that the FBT rules have become antiquated.[22] The FBT rules were designed in a paper-based environment where assessment and verification were not supported by digital processes and automated data exchanges. An important design feature of the FBT was to minimise the number of taxpayers that had to be self-assessed, the forms processed in a partly manual way and audit checks performed. To minimise the impact on the ATO and taxpayers, it was determined to levy the tax on the employer. This resulted in a design that had the employer — the payer of the benefits — being taxed. It was also designed in a 'catch all' way that meant everything was to be classified as a 'benefit' until specifically excluded.[23] Thus, counterintuitively, salary and wages are caught within the positive definition of 'fringe benefits' only to be excluded by the negative limbs. This approach resulted in many things that are not considered to be real 'benefits' being caught by the rules and having to be specifically excluded, whether eventually or to remain as outliers in an 'unintended consequences' set of provisions. Even exemptions are often directed at half of such unintended consequences. Further, by being levied on the employer at the top marginal rate with confusing 'gross-up' provisions, not only is the wrong taxpayer being taxed, but it is also usually at the wrong rate. This is even more the case when the top marginal rate faced by approximately 94% of taxpayers will be 30% or less in 2024–25, as part of stage 3 of the government's personal income tax plan.[24] Then, further added to this is the 'grossed-up amount' (i.e. often an inflated amount) being used to assess social security entitlements. The above is a demonstration that FBT needs to be abolished and replaced by a system that targets 'real' benefits and levies tax on the correct person at the correct rate.

Excessive red tape

In order to comply with their FBT obligations, employers undertake an unwieldy and unnecessarily complex administrative process:

– firstly, identify the benefits provided to employees, including those as part of their remuneration package and other benefits provided in connection with the business operations of the taxpayer;
– secondly, analyse the benefits to determine whether an exemption applies and whether all relevant criteria are satisfied;
– thirdly, where an exemption does not apply, calculate the taxable value of that fringe benefit, any reduction in taxable value and the resulting FBT liability. This step requires the consideration of different valuation rules that apply to the different categories of fringe benefits. This often involves analysis of a range of conditions which may be found in different parts of the FBT law, some with multiple valuation options, and some include statutory valuation options. In short, employers are often forced to use a significant amount of internal and/or external resources to obtain sufficient knowledge in order to perform the correct analysis and calculations;
– fourthly, lodge an FBT return and pay FBT; and
– finally, assign benefits to employees under the reportable fringe benefit system and include the amounts on employee payment summaries.

Over time, the government has introduced a raft of exemptions in response to policy objectives, industry, employer and trade union submissions, and case law. While we acknowledge that the design of the FBT regime has required these additional exemptions to appropriately reduce FBT liabilities, it has also made the administration of the FBT law significantly more complicated for taxpayers. It would seem that in an attempt to patch over the unintended consequences of the system, it has come with the cost of even greater complexity.

A more recent introduction to the FBT law has been the concept of preventing the application of certain concessions to salary packaged benefits. However, whilst this indicates some recognition of remuneration arrangements, it highlights the mismatch between the marginal income tax rates applied to remuneration income and benefits versus the FBT rate.

The 'otherwise deductible' rule

The current legislative presumption is that an employer is 'taxable unless proven otherwise'. In other words, the employer is alleviated from FBT only on provision of adequate written supporting evidence by the employee which must be in a prescribed format. This is another example of the unnecessary compliance obligations and the excessive red tape which imposes an onerous burden on Australian business taxpayers. A simpler and more streamlined process is required.

The FBT provisions cannot be easily applied to benefits provided to workers who travel internationally, resulting in excessive red tape in order to qualify for exemptions or concessions. There have been numerous cases which have involved extensive litigation, for example, *John Holland Group Pty Ltd v FCT*[25] which looked at fly-in-fly-out employment arrangements. Here, it was held that the air travel provided by the employer was not exempt[26] because the usual place of employment was adjacent to an 'eligible urban area'[27] as defined. As with all cases and as acknowledged by the ATO, the particular facts may result in different conclusions.[28] In some instances, litigation has resulted in FBT applying more broadly than perhaps initially intended, for example, car parking spaces provided by an employer were held to be a 'car parking fringe benefit' in *FCT v Qantas Airways Ltd*[29] (the Qantas case). The Qantas case is a good example of where the original ATO interpretation was consistent with the intent of the law, but was found to be incorrect by the interpretation of the courts. Similar issues arose in *Virgin Australia Airlines Pty Ltd v FCT*,[30] which at first instance came to the opposite conclusion, although that was reversed on appeal.[31] In spite of this, successive governments have failed to amend the law to reflect the original purpose — another case in point of the lack of maintenance of FBT laws.

The ATO has recently released a stream of further guidance aimed at providing clarity on the interaction between income tax and FBT, including when an employee is able to deduct transport expenses,[32] treatment of car parking fringe benefits,[33] and working from home benefits due to COVID-19.[34] Simultaneously, it is understood that the FBT guide will also be updated to provide further guidance to employers on the potential impact on changed views. The Tax Institute is supportive of the ATO provision of updated guidance to the community, but more must be done.

Vehicular fringe benefits example: Prior to COVID-19, the growth in technology was already creating pressure on the federal government's tax base. This trend is predicted to continue and, from a tax perspective, fuel excise is most imminently under threat over the next decade, with research showing that the electric vehicle share of new car sales in Australia is expected to reach 8% in 2025 and 27% by 2030.[35] Vehicles are becoming more fuel efficient and the adoption of electric vehicles is increasing. Electric vehicles are expected to match petrol vehicles on both upfront price and range by the mid-2020s.

Despite this, the FBT legislation has changed little since its inception and has not kept pace with the evolution of technology and consumer behaviour. The Tax Institute raises concern on behalf of our members that the provisions relating to car fringe benefits[36] are antiquated and have created disadvantages based on vehicle type (in particular, electric vehicles which are subjected to an inequitable FBT outcome in comparison to fuel-powered vehicles). It is time for a clear, coherent and consistent framework which allows for equitable tax treatment.

Electric cars

Principally, the key concerns raised by our members are as follows.

– Under the statutory method, the taxable value of a fringe benefit associated with an electric vehicle is higher than those related to a fuel-powered vehicle on the basis that electric vehicles have a significantly higher cost price. This is an inequitable tax outcome which creates a disincentive for businesses to extend salary sacrificing arrangements to electric vehicles, which also have the broader benefit of environmental sustainability.

– Where the operating cost method is elected, electric vehicles are again at a disadvantage of potentially having a higher taxable value for FBT purposes as record-keeping of the operating costs for electric vehicles are difficult to maintain on an accurate basis. Electric vehicles are charged via electricity (of various forms, such as solar energy or battery power) and thus, in the absence of a separate meter, there is often no record of the cost incurred by the employee, even though the employee has incurred a relevant cost. This is a relevant outgoing that is not taken into consideration for FBT purposes. Further to this, users of fuel-powered vehicles are able to claim deductions against FBT for fuel costs, however the same does not apply for users of electric vehicles as electricity is not currently defined as a 'fuel' for the purposes of FBT.[37]

– Inconsistent FBT outcomes arise in relation to work-related travel due to vehicle type. For example, work-related travel by bus, train or tram produces different FBT outcomes as bus travel can be exempt from FBT (as a motor vehicle) but trains/trams are not. Similarly, bicycles could qualify for an FBT exemption on the basis that they have no motor. Conversely, an e-bike (with a motor) could not qualify for an exemption. A further issue is that 'work-related travel' includes travel to and from work for FBT purposes, however, is treated as a 'private' expense for the remainder of the tax laws.

Payroll tax

Lack of harmonisation of the definition of 'employee'

As mentioned above, there is a lack of harmonisation of the definition of 'employee', leaving employers burdened with the employee versus contractor distinction. Employers must either seek tax adviser assistance, which may lack certainty due to the broad interpretation of payroll tax law (recent case law highlights the confusion amongst businesses, practitioners and state revenue authorities),[38] or incur significant payroll tax liability (retrospective assessment plus penalties).

Anomalies over the various states

There is a different application in each state, even with largely harmonised legislation and closer cooperation of the various revenue authorities. This is mainly due to the fact that each jurisdiction has its own legislative regime, rules and interpretations. Accordingly, a particular allowance or benefit could be subject to payroll tax in one state but exempt in another.

There has been discussion of the removal of payroll tax, which would result in the loss of a major source of income for state governments. However, note that this has the potential for (greater) vertical fiscal imbalance if reformed.

Inefficient and cumbersome

There has been strong criticism of payroll tax as an inefficient and cumbersome tax. Some obvious examples of these weaknesses are listed below:

- members of a payroll group must lodge multiple state returns for essentially the same information;
- broad reach of grouping provisions with exclusion left generally to 'the opinion of the Commissioner'; and
- it is potentially distortive and is an existing disincentive and discouragement of wage growth. This is because the liability to payroll tax is based on wages paid and is unconnected to profit, and it excludes the impact of the economy/natural disasters.

Narrow bases are highly inefficient

Broad-based payroll taxes have similar economic consequences to a broad-based consumption tax, making them a relatively efficient way of raising revenue.[39] While similar in many respects, consumption taxes are, in principle, more efficient than payroll taxes as they tax a broader range of activities. Payroll taxes are also a tax on inputs to production, as opposed to a tax on consumption. Numerous past reviews have suggested broadening existing payroll taxes by lowering the threshold, removing exemptions and cutting rates as potential options.[40]

The current state payroll taxes are not levied on the optimal broad bases, therefore making payroll tax in Australia less efficient and more complicated than necessary. A significant proportion of the payroll base is not subject to tax due to the tax-free thresholds and other exemptions relating to size of payroll, business type and wage type, which may potentially impact on business decisions to expand.[41] Although this may be "sustainable in the short-term in the face of changes to the way work and businesses are currently arranged",[42] this may not be the trend for the long term as the economy and society evolve.

However, these estimates can underestimate revenue foregone because they do not measure the impact of the threshold itself. It was reported by NSW that tax expenditure on payroll tax amounted to $1.67b in 2020–21, or about 19.5% of tax revenue collected.[43] This issue is discussed in further detail in Chapter 11 of the *Case for Change* paper.

Options

Fringe benefits tax

Abolish fringe benefits tax; new rules on a principles-based approach

The current FBT regime could be abolished and a principles-based approach to tax law design be applied in the drafting of the new rules (recommendation 112 of the Henry review).[44] A principles-based approach would assist in consistent interpretation of the laws in alignment with their policy objectives and introduce flexibility into the FBT legal and administration system, "rather than simply describing the legal mechanisms and concepts for producing that objective".[45]

The re-design of the law with simpler valuation principles to provide clear definitions or categories to account for non-cash payments could be a significant improvement. The valuation principles could be incorporated into the income tax law for employees and the benefits subjected to PAYG withholding, rather than continuing to impose FBT on employers at what often represents a penal rate of tax. The PAYG withholding system could apply as it exists by requiring employers to remit the relevant amounts (which are currently reported as reportable fringe benefit amounts) to the ATO. This has the added benefit of not creating additional administration.

The vast majority of Australian individual taxpayers are taxed at a rate below the top marginal tax rate and, based on government projections, in 2024–25, it is estimated that approximately 94% of taxpayers will face a marginal tax rate of 30% or less.[46] This would deliver a favourable outcome which addresses the inequity in the current system of applying an FBT rate equivalent to the top marginal tax rate.

The income tax mechanism should be used for true remuneration benefits. Benefits that are currently caught in the FBT regime that are not part of a salary package should be challenged as to whether they should be subject to tax as a benefit at all. The taxation of non-remuneration benefits needs to be challenged; if a benefit is not remunerative, should it be subject to tax as a fringe benefit? Any benefit that is non-remunerative in nature could be considered in the context of whether the employer should be entitled to a tax deduction (for example, entertainment expenses) but should not be subject to taxation as a form of remuneration. We note that a similar system already exists in New Zealand and we recommend that the New Zealand system be closely examined as a possible framework for Australia.

Further administrative savings – removes the 'otherwise deductible' rule: The recommended option has the potential to result in further administrative savings. The 'otherwise deductible' rule would no longer be necessary where there is an arrangement that taxed the employee on packaged benefits only and treated it as part of the income tax of the employee. The onus would be on the employee to claim any deductions against the benefits.

Fringe benefits tax and the not-for-profit sector

The Tax Institute supports the Productivity Commission's recommendation 8.1 for a review, which should draw on the work already undertaken by Treasury's Not-For-Profit Tax Concession Working Group.[47] The NFP Working Group recommended that the FBT concessions for NFPs be replaced with an alternative support payment to eligible NFPs (limited to salary packaging arrangements). If, after a review is undertaken, the government determines that some/all of the FBT concessions should be removed, appropriate transitional rules for phasing out the concessions would need to be made available to the NFP sector, given their ingrained dependence on being able to provide these benefits to employees. This view is consistent with the recommendation in the Henry review[48] that the caps be phased out over a 10-year transition period.

> *"… the FBT regime is unnecessarily complex, inefficient and administratively onerous …"*

Harmonisation across the Australian tax system

Introduce an all-encompassing concept of a 'worker'

The Tax Institute is supportive of reform to ensure that tax policy and tax legislation keep pace with changes in the labour market. The adoption of a broad and inclusive concept of a 'worker' to encompass the various classifications, including employees, contractors and non-traditional work relationships resulting from the gig economy, could be one such change. The term 'worker' could be defined in legislation and apply consistently across the Australian tax system.

Firstly, an all-encompassing concept of a 'worker' simplifies the tax system by reducing red tape. The 'worker' would efficiently capture all of the existing classifications, working arrangements and relationships. Employers would be alleviated from the initial burden of having to classify the particular individual and ensuring that all employment tax obligations are met based on this classification. Two examples are provided below where the concept of a worker is introduced:

– from a payroll tax perspective, employers must determine the correct rate of deduction (for the non-labour components) applicable to gross payments where the contractor provides equipment and/or material whilst performing a contract. The rate varies with the type of contractor (e.g. architect, carpenter etc); and

– from an SG contribution perspective, employers undergo a process of consideration as to whether the individual is an employee or contractor and the associated contribution requirements associated with this.

Secondly, an all-encompassing concept of a 'worker' has the potential to make the tax system more efficient as there would be reduced revenue loss for the states as the 'worker' term would capture the previously undefined working relationships arising from the gig economy. In addition, there would be reduced opportunities for arbitrage by businesses in their selection of the type of labour contract offered to an individual, or for individuals in their decision to seek work as an employee or seek to operate as an incorporated or unincorporated contractor.

Harmonisation of the definition of 'employee'

An alternative although less efficacious option for reform is the harmonisation of the definition of 'employee' by adopting a common definition for the purpose of the various taxes and charges that employers are subjected to in respect of wages provided to employees. This would, in turn, simplify the application of employment taxes and ease the administrative and compliance burden.

This could potentially extend to the implementation of a statutory definition, rather than relying on the current approach based on a common law definition. Consultation on design should be sought with the relevant expert practitioners and professional bodies. Furthermore, incorporating the definition of 'employee' into STP reporting and the broad implementation of STP will assist the state governments to collectively reduce the regulatory administrative burden on employers.

Payroll tax

Improving the structure of the tax system should begin with recognising that the wellbeing of the Australian people is affected by the taxes of the entire federation. A poorly performing tax affects people no matter which level of government is responsible for it. For example, the states' payroll taxes and the Australian Government's personal income tax both affect the post-tax wages available to workers, which in turn impact on workforce participation decisions.

There is consensus that payroll tax is a relatively efficient, equitable and stable tax but there is scope to broaden the base to improve the revenue of the states, making the tax system more efficient and resilient.[49] Approximately $26b was raised via payroll and labour force tax nationally in 2018–19.[50]

The Tax Institute supports action to further harmonise the payroll tax base across the states. The coordination of all Australian states to adopt a similar, or the same, policy would ensure consistency and uniform payroll tax legislation across the federation. The alignment of all payroll tax definitions to those used for income tax and employment tax rules would reduce the burdens of regulatory interpretation and compliance on employers. In turn, this would:

- reduce complexities in relation to differences in the details of individual taxes from state to state — relating to what is taxable, who is exempt from paying the tax, the rates and thresholds of the tax, and when the tax must be paid;
- ease administrative and compliance obligations for employers to comply with the rules as a result of a consistent and singular interpretation of the rules; and
- eliminate and ensure that the states can maintain adequate revenue streams.

Options for reform

- Redesign the FBT regime on a principles-based approach and tax benefits in the hands of employees.
- Introduce an all-encompassing concept of a 'worker' which would be a broad and inclusive concept capturing the various classifications (i.e. employee, contractor and non-traditional work relationships resulting from the growing gig economy). The term should be defined in legislation and should apply consistently across all Australian taxes and the superannuation system.
- Alternatively, harmonise the definition of 'employee' in order to simplify the application of employment taxes and ease the administrative and compliance burden.
- Centralise the collection and administration of employment taxes by a single regulator (e.g. the ATO).

Conclusion

It is evident that the current structure and imposition of employment taxes is markedly less efficient than it could be, is overly complex and lacks equity. These taxes impose an unnecessarily high compliance burden on employers and advisers and, no doubt, also impose an unnecessarily high cost on state and federal tax administrations.

It is also evident that it does not have to be that way. There are obvious changes that can be undertaken to improve the efficiency and effectiveness of employment taxes, both to the fundamental design and structure of the taxes and the legislative frameworks that drive inequitable and complex outcomes. Further, coordinated and simplified administration supported by modern technology would alleviate red tape which, combined with poor design and legislation, discourage optimal employment outcomes.

The Tax Institute

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Superannuation death benefits: some discrete issues

by Ian Raspin, CTA, Managing Director, and Lyn Freshwater, Senior Tax Adviser, BNR Partners

The authors' two-part article about discrete tax issues affecting deceased estates was published in this journal just as the pandemic descended upon the world. Although many things have changed since then, people's ability to ask tricky tax questions has not. This article considers some discrete issues relating to the taxation of lump sum superannuation death benefits. These include timing issues such as when the status of an individual as a dependant of a deceased member is determined, or when a determination should be made about which estate beneficiary is expected to benefit from a death benefit. Other issues considered are how to determine whether a beneficiary is benefitting from a death benefit or some other amount, and whether a beneficiary can benefit from an amount that is used to meet estate expenses.

Introduction

Superannuation death benefits do not automatically form part of a deceased estate. They will do so only when:

– a valid binding death benefit nomination (BDBN) is made by the deceased in favour of their legal personal representative (LPR); or

– the trustee of the superannuation fund (fund trustee) uses their discretion, or is otherwise obliged under the terms of the fund's trust deed, to pay the lump sum death benefit to the estate.

As fund trustees are only responsible for income tax withholding on death benefits if they pay them directly to beneficiaries, there appears to be a growing trend for industry funds to pay lump sum death benefits directly to a member's estate. This effectively transfers the responsibility for determining any tax obligations from the fund trustee to the LPR.

Death benefits: core concepts

Fund trustees are required to pay out a member's death benefits as soon as "practicable" after the member's death.[1] There is no definition or guidance in the *Superannuation Industry (Supervision) Act 1993* (Cth) or the *Income Tax Assessment Act 1997* (Cth) (ITAA97) as to precisely what this means; ultimately, it will depend on the facts of each case. As a matter of practice, fund trustees appear to adopt a six-month period as a rule of thumb.[2] While there is little evidence of the ATO questioning the time taken to make a payment, it should be remembered that a failure to satisfy the requirement could result in the fund being non-compliant.

When determining to whom a death benefit payment is paid, a fund trustee must ensure that they are authorised by both the trust deed and superannuation law to make the payment. Each trust deed is different, and it is essential that the trust deed be examined carefully.

If permitted by the deed, a member of a superannuation fund may elect to provide the trustee with specific instructions in advance of their death via a valid BDBN. On the member's death, the fund trustee would be obliged to operate in accordance with those directions. Some deeds provide that BDBNs lapse after three years, so it is necessary to refresh these on a regular basis to ensure that the member's intentions in respect of the payment of death benefits are met.

Where a member has left no valid BDBN, the fund trustee has the sole discretion to decide to whom the benefits are paid. A trustee is only able to make a payment to non-dependants after they have made reasonable enquiries to try and locate dependants or the deceased's LPR.[3] Accordingly, the non-existence of specific instructions may lead to a significant delay in the payment of benefits.

How tax is levied

The taxation of superannuation death benefits is governed by Div 302 ITAA97. As noted above, where a fund trustee pays a lump sum death benefit payment to an LPR, the responsibility to assess and pay any associated income tax will rest with the LPR.

Where an LPR receives a superannuation death benefit, it will be taxed in the estate as though it were income to which no beneficiary is presently entitled.[4] No further tax will be payable on a subsequent distribution to a beneficiary or to a testamentary trust.

The extent of an LPR's tax obligation is determined by reference to both the components of the deceased's superannuation account and the relationship to the deceased of the ultimate beneficiary/beneficiaries (that is, as a tax dependant or non-dependant of the deceased).

Where lump sum payments are to flow to a testamentary trust, it is necessary for the LPR to look through those entities to determine whether the ultimate beneficiary is a dependant of the deceased.

If the death benefit is expected to benefit a dependant, the entire receipt will be tax-free in the hands of the LPR, whereas an amount that is expected to benefit a non-dependant will be taxed as shown in Table 1.[5]

The maximum tax rates (15% or 30%) operate by way of a tax offset and the tax that would otherwise be payable on the taxable component of the benefit. The tax residency of

Table 1. Death benefit tax rates

Component	Dependant	Non-dependant
Taxable (taxed)	Tax-free	Lower of tax rate or 15%
Taxable (untaxed)	Tax-free	Lower of tax rate or 30%
Tax-free	Tax-free	Tax-free

either the LPR or the beneficiary does not alter the maximum tax rates.

Further, the fact that a non-dependant beneficiary is a charity does not mean that there is no tax payable by the LPR on the share that the charity is expected to benefit from.

Who is a dependant?

Table 2 summarises who is a death benefit dependant for tax purposes.[6] While this seems relatively straightforward, private rulings published on the ATO legal database highlight that identifying a death benefit dependant can be a complex process, particularly when reliance is placed on the interdependency relationship or financial dependence tests.

Interdependency relationship

Two people have an interdependency relationship[7] if:

- they have a close personal relationship;
- they live together;
- one or each of them provides the other with financial support; and
- one or each of them provides the other with domestic support and personal care.

Further, regulations may specify matters that are, or are not, to be taken into account when determining whether two persons have an interdependency relationship. Regulation 302-200.01 of the *Income Tax Assessment Regulation 1997* (Cth) provides that the following matters must be taken into account:

> "(a) all of the circumstances of the relationship between the persons, including (where relevant):
>
> (i) the duration of the relationship; and
>
> (ii) whether or not a sexual relationship exists; and
>
> (iii) the ownership, use and acquisition of property; and
>
> (iv) the degree of mutual commitment to a shared life; and
>
> (v) the care and support of children; and
>
> (vi) the reputation and public aspects of the relationship; and
>
> (vii) the degree of emotional support; and
>
> (viii) the extent to which the relationship is one of mere convenience; and
>
> (ix) any evidence suggesting that the parties intend the relationship to be permanent; and
>
> (b) the existence of a statutory declaration signed by one of the persons to the effect that the person is, or (in the case of a statutory declaration made after the end of the relationship) was, in an interdependency relationship with the other person."

Table 2. Death benefit dependants for tax purposes

Relationship to the deceased	Tax dependant?
Spouse (including de facto and same sex)	Yes
Former spouse	Yes
Child under 18 (including ex-nuptial adopted and stepchild)	Yes
Child over 18 (financially independent)	No
In an interdependency relationship with deceased just before death	Yes
Financial dependant just before death	Yes

As explained in the explanatory statement[8] accompanying the regulation, it is not necessary for each of the listed circumstances to be satisfied in order for an interdependency relationship to exist. Each of the matters is to be given the appropriate weighting in the circumstances. There are also circumstances in which it would be inappropriate to consider certain matters.

Regulation 302-200.02 specifies when certain relationships will, or will not, be taken to be interdependency relationships, notwithstanding that certain of the usual requirements are not able to be satisfied because, for example, one of the parties is overseas or in gaol.

One issue that is problematic is the meaning of "close personal relationship" in the context of parent and child relationships. Generally speaking, it is not expected that children will be in an interdependency relationship with their parents because there is no mutual commitment to a shared life; the relationship between parents and their children would be expected to change significantly over time.

Financial dependant

Although s 302-195(1)(d) ITAA97 does not stipulate the nature or degree of dependency required, the test is one of financial dependence.

In *Malek and FCT*,[9] Senior Member Pascoe said:

> "In my view, the relevant financial support is that required to maintain the person's normal standard of living and the question of fact to be answered is whether the alleged dependant was reliant on the regular continuous contribution of the person to maintain that standard."

Timing issue: dependence

Although the law states explicitly that the time for testing interdependency and financial dependence is just before the death of the relevant person, the position in respect of spouses and children relies on the ATO's practice. The ATO has indicated[10] that it will apply a similar timing rule for these categories of dependants. This means, for example, that a child who was under 18 when the deceased died will be regarded as a dependant, notwithstanding that they are older than 18 when the death benefit is paid to the LPR. Similarly, the ATO accepts that the payment of a death benefit to the estate of a spouse who was alive when the first deceased died is a payment to a dependant spouse.[11]

Timing issue: expected to benefit

A death benefit paid to the trustee of a deceased estate is treated as if it had been paid to a death benefit dependant to the extent that is has benefitted or is expected to benefit a dependant.

The ITAA97 does not specify a time when the test about “dependants benefitting or expecting to benefit” must be satisfied. However, given the reference in s 302-10(2)(b) ITAA97 to present entitlement[12] and the link to s 101A(3) of the *Income Tax Assessment Act 1936* (Cth) (ITAA36), implicitly the test must be satisfied at the latest by 30 June in the year in which the superannuation proceeds are paid to the trustee of the estate. Informal discussions with the ATO confirm this view.

Accordingly, the timing of the payment of death benefits to the trustee of an estate could be crucial where there is some prospect of a family provision claim being made. Such a claim can be made by a person for whom the deceased had a responsibility to provide. A person wishing to make a claim for provision must do so within strict time limits that vary in different states and territories. For example, in Victoria, this is generally within six months from the date probate was granted; in Queensland, it is generally within nine months from death.

Example

The deceased, Bradley, died on 1 April 2019. He was survived by two adult children and his (second) wife Beverley. By his will, Bradley left his entire estate to Beverley if she survived him, but otherwise it was to be divided equally between the children.

A superannuation death benefit in the amount of $200,000 was paid to the LPR on 28 June 2019.

As at 30 June 2019, no amount had actually been paid to Beverley but it might be argued that as at that date she would be expected to benefit from all of it (as having survived Bradley, she was the sole beneficiary of his estate).

However, the answer may be different if the benefit was paid to the estate in the 2020 income year, by which time a claim has been made for family provision. If that claim is not settled before the end of the income year, it is difficult to predict who may benefit from the payment. In these circumstances, it might be safest to assume that the payment will benefit a non-dependant (or a private ruling sought from the ATO).

People will often enter into a deed to settle a family provision claim in a year after the death benefit has been paid, which purportedly makes a dependant entitled to the death benefit. This does not seem to be effective for tax purposes in the earlier year.

Example

The deceased, Bradley, died on 1 August 2019. He was survived by two adult children and his (second) wife Beverley. By his will, Bradley left his entire estate to

Example (cont)

Beverley if she survived him, but otherwise it was to be divided equally between the children.

The children made a claim for family provision on 1 March 2020. A superannuation death benefit in the amount of $200,000 was paid to the LPR on 28 June 2020. On 31 July 2020, the parties entered into a deed of arrangement by which the parties agreed that Beverley would receive the death benefit.

Again, it is unclear who will benefit as at 30 June 2020. The deed which was entered into after the end of the year does not appear to be effective to alter the tax consequences in the 2020 income year.

Determining whether someone benefits from a death benefit or some other amount

Another issue that arises when applying s 302-10 ITAA97 is determining whether a person benefits from a death benefit as opposed to some other amount. A similar issue arises in a different context when applying s 99B ITAA36 (which exempts certain distributions of trust corpus). The latter provision was considered by the AAT in *Campbell and FCT*.[13] The tribunal found that the trust records were unreliable as evidence and consequently the taxpayer could not show that the relevant distributions fell within the corpus exception.

Example

Using the previous facts in the above example, assume that Bradley’s daughter Bambi made a claim for family provision on 31 July 2019.

Assume also that the death benefit was paid to the LPR on 1 August and that the LPR was holding $200,000 from the sale of shares that Bradley had owned.

On 1 December 2019, all relevant parties entered into a deed, by which it was agreed that Bambi would receive $150,000. The LPR paid Bambi that amount on 10 December 2019.

The test time for s 302-10 purposes is 30 June 2020. It is important that the LPR be able to identify which money is used to satisfy Bambi’s entitlement. If the LPR cannot show that Bambi’s payment consists solely of the sale proceeds, some part of the payment made to her may be regarded as a payment of the death benefit. As Bambi is not a death benefit dependant, the LPR may well be subject to tax (depending on the components of the payment). If it can be shown that all of the death benefit was paid to Beverley, no tax would be payable (regardless of the components) as Beverley is a death benefit dependant.

For example, the LPR might consider keeping the death benefit payment in a separate bank account. Alternatively, if Bambi had been paid her entitlement before the death benefit was received by the trustee of the estate, it clearly could not have been a payment of that benefit.

What if death benefit is used to meet expenses?

In some cases, a death benefit is used to meet estate expenses. To the extent that an amount is paid to a creditor, is the death benefit regarded as benefitting a non-dependant?

Example

Poppy was killed in a workplace accident. She was 45 years old. Poppy left a will appointing her parents as her executors and her son Pablo as her sole beneficiary.

Poppy had substantial debts when she died. However, the trustee of her superannuation fund paid a death benefit of $400,000 to Poppy's executors. Some of this was used to pay Poppy's funeral and testamentary expenses and some was used to pay her debts. The balance ($200,000) was paid to Pablo. The executors obtained a ruling from the ATO that Pablo is a death benefit dependant of Poppy.

It was clear that the entire death benefit was never going to benefit Pablo. Does this mean that only part (50%) of it is tax-free on the basis that it is expected to benefit Pablo? And that the part (50%) that is used to pay creditors is to benefit a non-dependant?

When working out the tax payable by the trustee of deceased estate, s 302-10 draws a dichotomy between amounts that are expected to benefit "beneficiaries of the estate" who are dependants and those beneficiaries who are not.

For succession and, presumably, s 302-10 purposes, a creditor is not regarded as a beneficiary of an estate. This means in effect that s 302-10 can only ever apply by reference to the death benefit (net of expenses) that can benefit a beneficiary. It seems that the ATO agrees with this approach. In a private ruling,[14] the ATO indicated:

> "The fact that part of a superannuation death benefit may have been applied to pay outstanding liabilities of the deceased estate should not change the application of subsection 302-10(2) of the ITAA 1997."

This does not mean that, where a death benefit is expected to benefit a non-dependant, no tax is payable in respect of an amount used to pay creditors. Indeed, the ATO has taken the view in a private ruling that, even in an insolvent estate, tax is payable if the beneficiary who would have benefitted is a non-dependant.[15]

In specie asset transfer

Although death is considered a cashing event for a fund, the SISR94 contain no requirement that a death benefit lump sum must take the form of cash. This can be advantageous for SMSFs which hold real property.

There are, however, various matters that trustees and their advisers should consider before implementing an in specie transfer, including assuring themselves that the deed allows for such a transfer and whether there is enough cash in the fund to pay stamp duty and tax on any capital gain that might arise from the transfer.

Limitations of the SISR94

One issue that has not received much consideration in this regard is the operation of the SISR94. The regulations require that, in respect of each person to whom a benefit is cashed, it must be paid in either a single lump sum payment, or in the form of an interim lump sum payment and a final lump sum.[16] This means essentially that payments of lump sum death benefits are limited to two lump sum payments per recipient. This has been confirmed in informal discussions with the ATO.

This is problematic. Fund trustees following a member's direction to transfer particular assets or investments to a beneficiary (or their LPR) may be in breach of reg 6.21(2)(a) SISR94 (on the basis that each asset transfer amounts to a separate lump sum payment). On another view, it might be considered that a BDBN requiring that more than two assets be transferred to a person is invalid. This would mean that the transfer of those assets would have to be undertaken in accordance with the trust deed.

Again, while there does not appear to be any ATO activity in relation to this issue, trustees that undertake multiple transfers do so at the risk of receiving a qualified audit report for a breach of the SISR94 or making themselves potentially liable to a claim by those entitled under the deed in the absence of a valid BDBN.

A workaround that has been deployed in these situations is for a death benefit pension to be commenced before the assets are transferred. However, such a strategy is clearly limited to beneficiaries who are able to commence a pension as a result of the death of the deceased and by transfer balance caps.

Consideration might be given to amending the SISR94 to allow multiple lump sum payments where asset transfers are involved.

Conclusion

With superannuation balances in Australia now exceeding $2.9t, and the significantly escalating intergenerational wealth transfers occurring from Australia's ageing society, it is hardly surprising that superannuation is frequently one of the largest assets of many Australian deceased estates. This article has highlighted some of the timing and procedural issues that practitioners, when advising on estate planning and administration matters, need to be aware of in professional practice.

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6 The definition of "dependant" in s 302-195 ITAA97 differs slightly from the definition for superannuation purposes in that any child of the deceased is a superannuation dependant (the superannuation legislation essentially determines who can receive a benefit, while the tax legislation determines how that benefit will be taxed).

7 Defined in s 302-200 ITAA97.

8 Explanatory statement to the *Income Tax Amendment Regulations 2005 (No. 7)*.

9 [1999] AATA 678 at [10].

10 See TD 2013/12.

11 This was the position in TD 94/69 (now withdrawn) in respect of a predecessor provision and has been adopted in PBR 1051838730781.

12 Curiously, this provision appears to be incorrectly drafted. The current wording assumes that the payment is income (which it will not always be) and, even where it is, the provision will affect the way other amounts of net income are taxed. If the desired outcome is to tax the trustee, it may have been better for the provision to refer to the net income (rather than focus on entitlement to income). That is, the provision might have said that this part of the trust net income is assessable to the trustee, or following the introduction of the specific entitlement concept, say that the trustee is specifically entitled to the amount.

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Sancho Panza to the Commissioner's Don Quixote

by Jessica Rogers, Senior Associate (Tax Controversy), MinterEllison

In the recent decision of *La Mancha Africa SARL v FCT*, the Federal Court held that the implied undertaking yielded to the Commissioner's statutory powers and functions. The decision can be seen as further extending the Commissioner's ability to use information obtained in a variety of circumstances, but how much of an extension will it actually turn out to be? This article explores what the decision means in practical terms, its potential scope, and the potential limits of its reach.

Introduction

In December 2021, the Federal Court in *La Mancha Africa SARL v FCT*[1] (*La Mancha*) held that the implied undertaking does not prevent the Commissioner from using documents produced by a third party under subpoena for a purpose outside the proceedings in which the documents were produced.

Background to the implied undertaking

The implied undertaking (also known as the Harman undertaking, named after the case *Harman v Secretary of State for the Home Department*,[2] or the *Hearne v Street*[3] obligation) is a common law rule that documents produced pursuant to a compulsory process in proceedings (such as a subpoena or discovery, or filed as evidence) are not to be used for any purpose other than those proceedings without leave of the court, or unless the documents are tendered as evidence or read in open court.

Prior to *La Mancha*, the scope and content of the implied undertaking was fairly well established, as was the principle that the implied undertaking "must yield to inconsistent statutory provisions and to the requirements of curial process in other litigation",[4] such as a subpoena or discovery. It was also fairly well established that the Commissioner could use his information-gathering powers (such as his power under s 353-10 of Sch 1 to the *Taxation Administration Act 1953* (Cth) to issue a s 353-10 notice) to obtain a "non-Harman" copy of a document he had become aware of because it had been produced in legal proceedings. This particular fact pattern was the subject of the 2018 Full Court decision in *DCT v Rennie Produce (Aust) Pty Ltd (in liq)*[5] (*Rennie*). Consequently, the implied undertaking is no defence to non-compliance with a subpoena, discovery or s 353-10 notice.

Why is the decision important?

While much in this area was already quite established, what is novel about *La Mancha* is that it says the Commissioner need not undertake the step he took in *Rennie* in issuing a s 353-10 notice to obtain a "non-Harman" copy of a document. He can simply use the copy of the document he obtained in the proceedings. That is not the end of the story, however. To understand the scope and limits of when the Commissioner can simply use a "Harman" copy of a document, one needs to look a little deeper.

Scope of the decision

In *La Mancha*, the court was asked "to determine the legal question as to whether the Harman undertaking would restrict [the Commissioner's] use of the subpoenaed documents to use in this proceeding only". The question was framed in very general terms, with no articulation or specification of the many varied and possible uses of the subpoenaed documents beyond the proceedings. The court found that the answer to that question was "no".

In answering the question "no", Davies J had regard to the Commissioner's duty under s 166 of the *Income Tax Assessment Act 1936* (Cth) (ITAA36) to assess "[f]rom the returns, and from any other information in the Commissioner's possession". Her Honour also had regard to cases such as *Donoghue*[6] and *Denlay*[7] which have considered the Commissioner's duty under s 166 and found that the use of information by the Commissioner in fulfilling that duty overrides a number of other common law rights and protections, such as breach of confidence and legal professional privilege,[8] even where the information may have come to be in the Commissioner's possession in somewhat "murky" circumstances.

Davies J seems to have held that the Commissioner's general statutory powers and functions import similar rights and legal obligations to those under s 166 in going on to say that "[t]hese cases are binding authority on the *Commissioner's duty to apply the law* on the facts as he understands them to be on the basis of the information which he has in his possession" (emphasis added), and that this duty to "apply the law" is not "dispensed with by the *Harman* undertaking".[8] On a plain reading of the decision, the scope of the Commissioner's ability to use documents subject to the implied undertaking encompasses any of the Commissioner's duties or obligations "conferred for the purpose of facilitating the proper discharge of his duty to administer the tax laws", such as his information-gathering powers and collection powers, and not just his assessing power under s 166.[9]

In addition to the fact that the implied undertaking will yield to an inconsistent legal obligation, this result is also consistent with another principle which underpins the implied undertaking. One function of the implied undertaking is to prevent an inequitable circumstance where a party is forced to make a private document public because they have been compelled to provide it to the court and have not done so of their own volition. The implied undertaking seeks to limit the circumstances in which a document compulsorily provided will then be in the public domain.[4] As the Commissioner is bound by a range of secrecy and confidentiality obligations, any "Harman" documents he uses during the pre-litigation stage are also subject to those same obligations and will be kept confidential and not placed in the public domain by virtue of his use.

Limits of the decision

As to the limits of Davies J's decision in *La Mancha,* while not express in the decision, it seems that the Commissioner will still be unable to use documents obtained by compulsory process in one court proceeding (and thus subject to the implied undertaking) in another court proceeding. Her Honour had regard to a number of cases such as *Shi* and *Karas*[10] which both concerned a situation where documents obtained from one proceeding were sought to be used in another proceeding. Although both *Shi* and *Karas* were decided on other grounds, Davies J held that these cases were either distinguishable or "said nothing about the present issue".[11] This suggests that the implied undertaking will still prevent the Commissioner from using a document obtained in one proceeding in another proceeding, as both cases dealt with that precise issue where use was allowed for other reasons, not because the implied undertaking had no application.

Accordingly, the Commissioner would be unable to issue a subpoena in proceeding A, take the document in proceeding A, and tender it as evidence in proceeding B. It is suggested that this is a logical result, as any contrary result would render the implied undertaking otiose for the Commissioner or for other regulatory bodies with similar statutory powers or obligations to those of the Commissioner. Further, once the Commissioner is acting as a litigant in proceedings, he is then subject to the judicial process and it is arguable that, in his capacity as a litigant, he is no longer exercising those same powers and functions in administering the tax laws that he is prior to proceedings commencing, so there would be no inconsistent legal obligation for the implied undertaking to yield to in that situation. In any event, even if, when as acting as a litigant, the Commissioner is exercising his powers and functions in administering the tax laws, he is nevertheless bound by the rules of court in the same way as other litigants, including in relation to the implied undertaking. There are several cases which establish that the Commissioner is required to seek leave of the court for a release from the implied undertaking should he wish to use documents subject to the implied undertaking in other proceedings.[12]

Davies J also referred to comments in *Shi* that leave of the court would be required before documents obtained in a civil proceeding can be given to another investigative agency or to further a criminal investigation where those documents are subject to the implied undertaking.[13] These comments suggest that, unless provision of those documents to another agency formed part of the Commissioner's duty to apply the law or administer the tax laws (such that it placed the Commissioner under a legal obligation inconsistent with the implied undertaking), the Commissioner would not be able to use the documents, thus placing another limitation on what he can do with documents which are subject to the implied undertaking.

An elephant in the room remains. Can the Commissioner, having used subpoena documents subject to the implied undertaking in an audit and at objection (which, following *La Mancha*, he is perfectly entitled to do), then tender those documents in evidence in a proceeding if the dispute eventually proceeds to court? That question is not answered in *La Mancha.* The question about whether the Commissioner could use a "non-Harman" copy of a "Harman" document obtained under s 353-10 notice in subsequent court proceedings was also not answered in *Rennie*.

In the former *La Mancha*-type case (where a "Harman" document has been obtained by the Commissioner directly from proceedings), like in the subpoena example above, on one view there would be no inconsistent legal obligation for the implied undertaking to yield to once the Commissioner is in court, so the implied undertaking would likely apply to prevent the Commissioner from using the document in other proceedings. At the very least, as a model litigant, the Commissioner should draw the matter to the court's attention so that a process for resolving the matter could be put in place, particularly where it is a third party's document.[14]

As to the latter *Rennie*-type case (where the Commissioner has used his information-gathering powers to obtain a "non-Harman" copy of a document he came to know about from proceedings), similar considerations should apply. In addition, for the implied undertaking not to apply, the question is whether or not a document or the contents of a document, once subject to the implied undertaking, has been made public.[15] The implied undertaking applies equally to information or the contents of documents as it does to the documents themselves.[15] In the case of documents being produced in response to a s 353-10 notice, those documents would not be in the public domain as they would only be in the possession of the Commissioner and subject to the Commissioner's confidentiality obligations. The information contained in the documents and its existence would be within the Commissioner's knowledge as a result of other proceedings, so there is limited basis to see how the implied undertaking would not apply to these documents as well.

In *Rennie*, the Full Court in obiter made the comment that it was possible for a s 353-10 notice to amount to a contempt of court but that the question did not arise in that case which was about taxation officers receiving and using documents in response to a s 353-10 notice in the "lawful exercise of the powers and functions vested in the Commissioner".[16] When it had no application to that particular case, it is an interesting comment to make. Perhaps the comment was directed towards a situation where the documents seek to be tendered in court? Or perhaps not. The answer to this question is currently unknown and we will have to wait until the next case for a definitive answer.

Decision consistent with Commissioner's obligations and duties

Another question one could ask is whether or not this is a practice that the Commissioner should be seeking to employ. The Commissioner, as a model litigant, has a range of obligations,[17] including to "act honestly and fairly in handling claims and litigation".[18] In light of the decision in *La Mancha*, it would not be dishonest or unfair for the Commissioner to use subpoena documents where they are required for him to properly perform his statutory functions. In fact, in putting the question before the court for judicial consideration and having it resolved in the way he did in *La Mancha*, the Commissioner can be seen as taking steps to ensure that he did act in accordance with his model litigant obligations. When considering this question, it is also important to keep in mind that the Commissioner's obligations as a model litigant do not prevent him "from acting firmly and properly to protect [his] interests".[19] It is in the Commissioner's interests and, as Davies J noted in *La Mancha*, it is his duty under s 166 ITAA36 to assess taxpayers correctly and on the basis of the information in his possession. If, at the pre-litigation stage, the Commissioner is privy to such information from proceedings, then so be it. He is required to use it if it is necessary to perform his statutory duties. As to whether this practice could be seen as the Commissioner using his statutory powers to obtain information that an ordinary litigant may not be able to, there is little difference to the pre-litigation position generally where the Commissioner has access to a full suite of statutory information-gathering powers, which are not available to a taxpayer.

Conclusion

In light of some the apparent limitations or, at least, unanswered questions in *La Mancha*, the main and possibly sole implication of the decision is that it means the Commissioner no longer needs to take the administrative step of issuing a s 353-10 notice to obtain a "non-Harman" copy of a "Harman" document where the document is being used in the exercise of the Commissioner's lawful powers and functions of administering the tax laws.

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13 *La Mancha* at [4].
14 See *City of Swan v McGraw-Hill Co Inc* [2014] FCA 1271 at [17] to [18], where such a procedure was put in place in a similar situation.
15 *Treasury Wine Estates Ltd v Maurice Blackburn Pty Ltd* [2020] FCAFC 226 at [83].
16 *Rennie* at [56].
17 See Appendix B to the *Legal Services Directions 2017* (Cth).
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A Matter of Trusts

by Edward Hennebry, FTI, Sladen Legal

Section 100A: "oh no not you again"

Does context and purpose narrow the reach of s 100A of the *Income Tax Assessment Act 1936*?

Many tax professionals have observed a trend by the ATO to apply s 100A of the *Income Tax Assessment Act 1936* (Cth) (ITAA36) more enthusiastically than in the past, bringing into focus whether even basic transactions involving trusts are now open to indefinite scrutiny (as s 100A has an unlimited period of review).

In light of anticipated ATO guidance, it might be questioned whether a wide application of s 100A may be contrary to judicial pronouncements which emphasise the significance of *context and purpose* when interpreting and applying statutory provisions.

Statutory interpretation 101

Since *Project Blue Sky Inc v Australian Broadcasting Authority*,[1] "text", "context" and "purpose" are generally recognised as the core criteria when interpreting statutory provisions. Of these three criteria, *Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue*[2] and *FCT v Consolidated Media Holdings Ltd*[3] are generally cited as confirming that "text" is the surest guide to legislative meaning. However, does this mean that context and purpose should be disregarded in the statutory interpretation process?

1. Section 15AA of the *Acts Interpretation Act 1901* (Cth) prescribes that, when interpreting an Act:

> "… the interpretation that would best achieve the purpose or object of [an] Act (whether or not that purpose or object is expressly stated …) is to be preferred to each other interpretation."

2. The High Court in *Consolidated Media Holdings*, while observing that the task of statutory interpretation must begin and end with a consideration of the statutory text, also stated:[4]

> "The statutory text must be considered in its *context*. That context includes legislative history and extrinsic materials. Understanding context has utility if, and in so far as, it assists in fixing the meaning of the statutory text." (emphasis added)

3. The High Court in *Thiess v Collector of Customs*[5] emphasised that:

> "… it is one of the surest indexes of a mature and developed jurisprudence not to make a fortress out of the dictionary; but to remember that statutes always have some purpose or object to accomplish, whose sympathetic and imaginative discovery is the surest guide to their meaning."

4. The High Court in *K & S Lake City Freighters Pty Ltd v Gordon & Gotch Ltd*[6] stated:

> "[T]o read the section in isolation from the enactment of which it forms a part is to offend against the cardinal rule of statutory interpretation that requires the words of a statute to be read in their context."

It is acknowledged that judges have cautioned against making assumptions about a statute's purpose and construing the statute to coincide with the assumption. Indeed, this was emphasised by Thawley J in the Federal Court in *Peter Greensill Family Co Pty Ltd (trustee) v FCT*[7] to discount the taxpayer's contention that there existed a policy objective of not taxing foreign beneficiaries of resident trusts in respect of CGT events concerning non-taxable Australian property.

But purpose and context still arguably have an important part to play in the statutory interpretation exercise. The Full Federal Court in *Eichmann v FCT*,[8] having regard to the relevant explanatory memorandum, held that the small business CGT concessions should be construed beneficially rather than restrictively in order to *promote the purpose* of the concessions. It was also held that a narrow interpretation of the concessions "are not supported by the language of the provision and are inconsistent with the need to construe that language beneficially".

Can these principles be applied when interpreting s 100A?

Section 100A: context and purpose

As identified in the explanatory memorandum to the Income Tax Assessment Bill (No. 5) 1978, s 100A was inserted as a specific anti-avoidance provision to counter trust stripping arrangements designed to enable trading profits and other income derived by trusts to escape tax completely. It was not designed to apply to arrangements that are entered into in the course of ordinary family or commercial dealings.

Despite being an anti-avoidance provision, the courts held in *FCT v Prestige Motors Pty Ltd*[9] and *Idlecroft Pty Ltd v FCT*[10] that a "reimbursement agreement" should not be interpreted narrowly and that the extrinsic materials are consistent with the legislation having been framed broadly enough to catch not only trust stripping arrangements, but also other arrangements that have similar characteristics.

However, *Prestige Motors* and *Idlecroft* should arguably not be regarded as authority to discount context and purpose when determining the application of s 100A to a particular fact pattern. While the definition of a "reimbursement agreement" may be interpreted broadly, context dictates that its meaning is also informed by the exceptions under s 100A(8) and (13), highlighting the need for a tax avoidance purpose and the exception for ordinary family or commercial dealings.

In particular, and perhaps with the exception of a recent Federal Court decision (discussed below), the cases that have considered s 100A exemplify egregious instances of tax evasion behaviour that fall within its ambit:

– in *East Finchley Pty Ltd v FCT,*[11] a family trust resolved to distribute $585 to 126 non-resident beneficiaries, where the expectation was that those beneficiaries would lend the relevant amounts back to the trustee;
– in *Prestige Motors, a* complicated transaction involving the sale of the business to a unit trust was undertaken so that the profits from the business would be distributed to a unit holder with losses;
– in *Idlecroft,* two entities, one of which had substantial losses, entered into a joint venture agreement with the intention that any profits should be absorbed by the loss trust; and
– in *Raftland Pty Ltd v FCT,*[12] a substantial distribution was made to a "loss trust" where a fee was paid to the previous controllers of that trust.

The context and purpose of s 100A is also arguably informed by the fact that it has an unlimited period of review. Very few provisions in the Tax Acts have an unlimited period of review, and even those with a tax avoidance *purpose* (such as Pt IVA ITAA36) are subject to limited amendment periods.

When changes to self-assessment were legislated in 2005,[13] the unlimited amendment period ascribed to s 100A remained. The 2005 changes arose from a 2004 Board of Taxation report which highlighted that, regardless as to whether or not a taxpayer has paid the correct amount, eventually their tax affairs for a particular year should become final, unless they have deliberately sought to evade their responsibilities.

Accordingly, despite s 100A being a tax avoidance provision with similarities to Pt IVA, parliament evidently decided that s 100A falls within a similar category to fraud or evasion, so as to ensure that people who engage in calculated behaviour to evade tax should remain permanently at risk.

Recent case

The recent Federal Court case of *Guardian AIT Pty Ltd ATF Australian Investment Trust v FCT*[14] (*Guardian AIT*) held that, despite the presence of unpaid present entitlements from a trust to a specifically introduced corporate beneficiary and the declaring of dividends from the corporate beneficiary to the trust,[15] s 100A did not apply.

Crucial to the court's decision was the emphasis on the reimbursement agreement needing to precede the present entitlement (as noted in *East Finchley*), and that the retirement planning aspects underpinning the transactions (as substantiated by the evidence) meant that they were ordinary family or commercial dealings which lacked a tax-avoidance purpose.

Logan J, while acknowledging that he is bound by the decisions in *Prestige Motors* and *Idlecroft*, also noted that those cases concerned egregious facts that did not enliven a consideration of the term "ordinary family or commercial dealing". Accordingly, in reaching his conclusion as to the meaning of an ordinary family or commercial dealing, Logan J had regard to the *context* of "ordinary" and that it related to dealings which contained no element of artificiality.

While the precedential value of *Guardian AIT* may be limited (particularly as it is now on appeal), Logan J's decision provides much needed guidance on the interpretation of s 100A. It also serves as a reminder for taxpayers to maintain contemporaneous records to substantiate the incentives underpinning a transaction (in this instance, retirement planning).

Conclusion

Despite judicial pronouncements suggesting a wide interpretation of a "reimbursement agreement", the case law also indicates that context and purpose have an important role to play when interpreting statutory provisions.

The context and purpose of s 100A (as informed by its unlimited amendment period and the exclusion of ordinary family/commercial dealings) arguably suggests that s 100A should be confined to blatant and contrived arrangements involving fraud, evasion or shams.

It is hoped that the outcome of the *Guardian AIT* litigation will provide clarity (to both tax advisers and the ATO) on the types of ordinary family and commercial dealings to which s 100A seeks to exempt.

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Acknowledgment

The author would like to acknowledge the assistance of Daniel Smedley and Neil Brydges in writing this article. In particular, for their assistance in crafting the article's title. Iconic Australian band Australian Crawl had a hit in 1981 with the song "Oh no not you again". While that song is a feature of "classic rock" playlists, the title is an apt descriptor of another article on s 100A.

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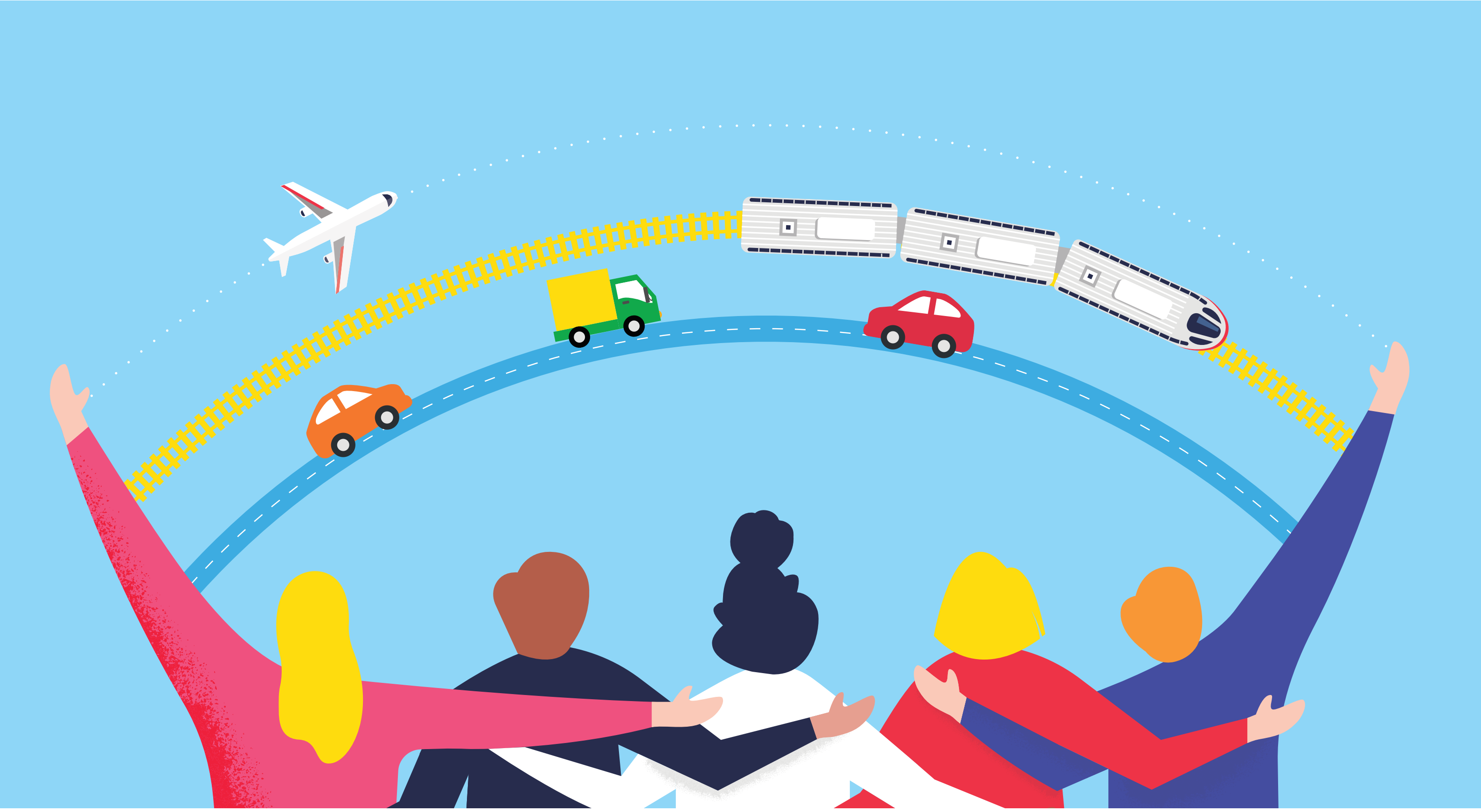

Superannuation

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

Are SMSF wills really "safer" than BDBNs?

This article concludes that an SMSF will is not necessarily safer than a BDBN. In fact, an SMSF will can be just as risky, if not more risky, than a BDBN.

The High Court will soon hand down its judgment on the appeal from *Hill v Zuda Pty Ltd*.[1] This will be a critical judgment. It will definitively answer (among other things) whether an SMSF binding death benefit nomination (BDBN) can last either indefinitely or for a maximum of only three years.

Some in the SMSF industry have suggested that *Hill v Zuda* proves that BDBNs are too risky and that an SMSF will is the way to obtain certainty and avoid the pitfalls of a BDBN. This article considers that issue: namely, is an SMSF will "safer" than a BDBN? This article concludes that no, an SMSF will is not necessarily safer than a BDBN. In fact, in many circumstances, an SMSF will can be just as risky, if not more risky, than a BDBN.

What exactly is an SMSF will?

The first question to ask is: what exactly is an SMSF will?

Even well-accepted terms do not have fixed, constant, normative meanings. For example, common terms like "unit trust" and "discretionary trust" do not have constant, fixed normative meanings.[2] Accordingly, if terms like "unit trust" and "discretionary trust" do not have fixed, constant, normative meanings, a far more novel term such as "SMSF will" does not have a fixed, constant, normative meaning.

Instead, as the High Court tells us, to obtain the meaning of a term, one must read the specific legislative regime. The SIS legislation does not use the term "SMSF will", so the concept is only whatever the current governing rules of the SMSF define the term to be.

Accordingly, different SMSF governing rules might have different definitions of "SMSF will". However, generally speaking, we would expect "SMSF will" to be defined as something along the lines of a document from an SMSF member, accepted by the SMSF trustee, that binds the trustee as to, among a range of other things, how to pay that member's superannuation death benefits.

What is the actual difference between an SMSF will and a BDBN?

Assume that an SMSF's governing rules do define an "SMSF will" as a document from an SMSF member, accepted by the SMSF trustee, that binds the trustee as to how to pay that member's superannuation death benefits. How does that differ from a BDBN? The short answer is that an SMSF will might not necessarily differ at all from a BDBN. Consider the following.

The *Superannuation Industry (Supervision) Act 1993* (Cth) (SISA93) does not use the term BDBN. Instead, it uses the term "notice given to a trustee of the entity in accordance with the regulations, to require a trustee of the entity to provide any benefits in respect of the member on or after the member's death to a person … mentioned in the notice" (s 59(1A) SISA93).

The *Superannuation Industry (Supervision) Regulations 1994* (Cth) (SISR94) are drafted in similar terms (reg 6.17A SISR94).

Accordingly, several significant risks with SMSF wills are presenting themselves. We now focus on two of them.

SMSF will risk 1: a court might hold that an SMSF will is a BDBN

If the High Court in *Hill v Zuda* decides that the BDBN rules in the SISA93 and the SISR94 apply to SMSFs, a court might decide that these rules apply to an SMSF will. Interestingly, the BDBN in *Hill v Zuda* formed part of the wording in the SMSF deed (ie hard-wired), rather than being a separate form of BDBN that relied on a power in the deed.

Naturally, the drafters of SMSF will provisions might try to draw some sort of technical distinction between a BDBN and an SMSF will. However, ask yourself: is the substance of an SMSF will a "notice given to a trustee of the entity in accordance with the regulations, to require a trustee of the entity to provide any benefits in respect of the member on or after the member's death to a person … mentioned in the notice"? Presumably, you have answered this question with a "yes". It is possible that a court would answer this question with a "yes" too. Afterall, courts tend to prefer to look to the substance of an issue, rather than form. Accordingly, an SMSF BDBN currently has uncertainty as to whether it can last three years or indefinitely. However, an SMSF will also has this uncertainty.

SMSF will risk 2: the SMSF will documents are just as liable to uncertainty as BDBN documents

SMSF wills are whatever the current set of governing rules defines them to be. This means that, if the current set of governing rules is invalid, presumably so is the SMSF will.

The case of *Re Narumon Pty Ltd*[3] is instructive in this regard. It considers many issues. One issue was the validity of a 2007 document purporting to be a deed implementing a new set of governing rules. That document was signed by Mr John Giles. He was both the trustee company's sole director and secretary. However, the document stated that he was signing on behalf of the company as its "authorised representative". The document did not state that he was signing in his capacity as director and secretary of the company. The document therefore failed and thus the set of governing rules that it was trying to implement failed.

A BDBN suffers from this weakness (ie the validity of the governing rules under which a BDBN is made might be attacked). However, the same is true of SMSF wills.

Further, it is not just the set of the governing rules under which the SMSF will is made that might be attacked. It is every aspect. For example, in *Munro v Munro*,[4] a BDBN failed because it nominated the "trustee of my estate", instead of the "executor of my will". Accordingly, an SMSF will might similarly be attacked for some seemingly trivial failure. As a further example, an SMSF will might require that a trustee "accept" the SMSF will in order for it to be valid. In *Cantor Management Services Pty Ltd v Booth*,[5] the Full Court considered whether a BDBN had been "given" to an SMSF trustee. The document had been left at the accountant's office, but the director of the trustee did not have actual knowledge of the document. One can easily imagine an SMSF will being challenged by a disappointed potential recipient asserting something along the lines of "the trustee did not properly accept the SMSF will", "the member did not properly give the SMSF will" etc.

Naturally, we have been referring to BDBN cases in this article as there are not any SMSF will cases. We don't believe that this is because BDBNs are inherently weaker than SMSF wills. Instead, we believe it is simply because:

– an SMSF will is, in substance, just a type of BDBN (ie "notice given to a trustee of the entity in accordance with the regulations, to require a trustee of the entity to provide any benefits in respect of the member on or after the member's death to a person … mentioned in the notice"); and
– SMSF wills are novel and less frequently used than BDBNs and thus SMSF wills have had less chance to be litigated.

Practical solutions

There are many practical solutions. One obvious solution is to take great care to ensure that all formalities etc are satisfied and that the BDBN rules in the SISA93, the SISR94 and the governing rules are all satisfied. (This, of course, is often easier said than done.)

There are other solutions too, which we won't detail in this article. However, we struggle to see an SMSF will being much of a practical solution. In fact, SMSF wills now suffer from two significant downsides that BDBNs don't.

First, there is now a growing body of jurisprudence regarding BDBNs allowing practitioners some degree of certainty as to where things stand. (Naturally, soon this body will be significantly larger when the High Court hands down its decision.)

Second, SMSF wills might lull people into a false sense of security. Hopefully, this article proves that SMSF wills are risky and there is danger in thinking otherwise. If you are relying on an SMSF will, we strongly recommend that you have an experienced SMSF lawyer review it, together with the SMSF deed document trail, to ensure that it is valid.

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Alternative Assets Insights

by Nick Houseman, CTA, Caleb Khoo and Edin Mahir, PwC

Glencore decision impact statement

The *Glencore* decision impact statement provides valuable insight into the Commissioner's views on a number of important transfer pricing issues.

Introduction

On 28 September 2021, the ATO released its decision impact statement in relation to the transfer pricing decision in the *Glencore* case,[1] affirming that the decision outcome was "mostly unfavourable to the Commissioner". The decision impact statement follows the High Court's refusal in May 2021 for the Commissioner to apply for special leave to appeal the decision of the Full Federal Court of Australia.

The ATO's decision impact statement sets out the Commissioner's views regarding a number of important transfer pricing issues, including the appropriate degree of depersonalisation, evidence, reconstruction and contrasts between Subdiv 815-A of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) (which was relevant for the *Glencore* case) and Subdiv 815-B ITAA97 (which is more commonly encountered in practice today and, while similar to Subdiv 815-A, contains some textual differences).

Issues decided by the courts

The decision impact statement highlights the following issues as decided by the courts:

- **restructuring:** the Full Federal Court did not follow the conclusion of the primary judge (Davies J) that the Commissioner was "impermissibly restructuring the contract" and instead held that, under both the predecessor Div 13 of the *Income Tax Assessment Act 1936* (Cth) (ITAA36) and Subdiv 815-A ITAA97, the Commissioner could substitute terms that resulted in a different formula or a different methodology to be utilised in order to ascertain the arm's length consideration. The court's comments on this issue focused on the pricing mechanism in the particular circumstances and did not endorse a broader substitution of terms to the agreement;
- **pricing:** the Full Federal Court held that Glencore Investment Pty Ltd (GIPL) had discharged its onus of proof by establishing that the actual pricing terms that applied between Cobar Management Pty Ltd (CMPL) and Glencore International AG (GIAG) in the 2007 to 2009 years (other than in respect of the freight terms in 2009, which were decided in the Commissioner's favour) were ones that might reasonably have been expected between independent parties, with some of the same relevant objective characteristics as CMPL and GIAG, dealing at arm's length.

  The courts accepted the taxpayer's expert evidence that the relevant disputed terms were commercially prudent for the parties to adopt, existed in the relevant industry between independent parties with some of the same relevant objective characteristics as CMPL and GIAG, and ultimately were a matter of commercial judgment having regard to the particular risk appetite of a particular mine (although there was apparently no evidence led about CMPL's particular risk appetite); and
- **High Court's reasons for not granting special leave:** the Commissioner applied for special leave to appeal from the High Court on the basis that the Full Federal Court misconstrued the "arm's length principle" applicable under Div 13 ITAA36 and Subdiv 815-A ITAA97, and that the taxpayer did not discharge its onus of proof because it failed to lead evidence of the dealing that was likely to have been entered into between CMPL and GIAG if they had dealt with each other at arm's length. The Commissioner's application was refused on the basis that the Commissioner was seeking to overturn findings of fact upheld by the Full Federal Court and that there was no question of principle sufficient to warrant a grant of special leave.

ATO's view of the decision

Appropriate degree of depersonalisation

The Full Federal Court set out at paras 177 to 186 of the judgment seven propositions to be addressed in appropriately depersonalising the hypothetical independent parties that need to be established to enable the transfer pricing exercise to be undertaken. One of the arguments that the Commissioner proposed centered on the postulated need to consider the risk appetites of the relevant parties and/or the Glencore group in "personalising" the relevant hypothetical independent parties to the arrangement. No such evidence regarding the risk appetites of the parties or the Glencore group was presented before the courts and was ultimately found not to be necessary. Rather, perspectives around risk appetites were considered as a matter of commercial judgment and were established by reference to evidence from industry experts as to what might reasonably be expected from independent parties acting at arm's length. This specific point was also addressed throughout the seven propositions established by the Full Federal Court.

The Full Federal Court also noted that choices which are open to be made about risk may affect the determination of the arm's length consideration, and it follows that there is likely to be more than one price which is an arm's length price. In that respect, the court noted that a taxpayer is under no obligation to choose a pricing methodology which pursues profitability in Australia at the expense of prudence.

The Commissioner does not accept that the *Glencore* case narrows the extent by which a comparable hypothesis is to be personalised, nor that it sets a standard for "depersonalisation". Rather, the ATO cites passages in the earlier *Chevron* case[2] (which dealt with the application of Australia's transfer pricing rules to a related party loan) and takes the view that there is neither inconsistency in the application of the arm's length principle, nor the tests to be applied in respect of Div 13 ITAA36 and Subdiv 815-A ITAA97 between *Chevron* and *Glencore*. The ATO's view is that the outcomes in the two cases were reached after a consideration of all of the evidence before the courts in each case.

Insight: The seven propositions for depersonalisation will need to be carefully considered by taxpayers when undertaking the required transfer pricing analysis. This includes considering which factors are a feature of commercial judgment (and therefore to be answered from the perspective of "what might reasonably be expected from independent parties acting at arm's length"), and which factors reflect objective attributes in which to clothe (or "personalise") the hypothetical parties in attempting to answer that question from their perspective.

As discussed below, evidence around the risk appetites of the parties or relevant group policies was not presented to the court and this appears to be a key theme in the decision impact statement, with an implicit view from the Commissioner that had such evidence been before the courts, it may have impacted outcomes. However, transfer pricing is a hypothetical exercise based on an objective test. It is therefore unremarkable that the Full Court found that it is necessary to exclude from that hypothesis any considerations that are a product of a non-arm's length relationship with the related party and the broader group.

Evidence

The decision impact statement reinforces the Commissioner's views around the need to undertake a careful examination of the totality of evidence available to best establish the arm's length conditions that might reasonably have been expected to operate in any given case. The following example of the types of evidence to be examined are provided by the Commissioner:

- evidence about all of the relevant objective circumstances of the actual parties in the actual market at the relevant time;
- relevant group policies;
- how the taxpayer and its group might have contemporaneously dealt with third parties for the same or a similar transaction;
- the prevailing contemporaneous practices in the relevant industry; and
- what other independent entities in the same or similar contemporaneous circumstances as the taxpayer and the counterparty might reasonably have been expected to have done.

The Commissioner outlines that where a taxpayer relies solely on the opinion of an expert as to what independent parties in the industry might reasonably have been expected to have done, that may not be considered to be sufficient by the Commissioner to discharge their onus of proof depending on the totality of evidence available. In attempting to address the aforementioned theme regarding "depersonalisation" and evidence (not) presented before the courts, the Commissioner outlines that, although expert evidence was ultimately accepted by the Full Federal Court, evidence about the Glencore group's policies or its risk appetite might also have been relevant had it been before the court.

The decision impact statement also looks to address the implications for leading evidence regarding comparability and benchmarking analyses. In this regard, the Commissioner notes that, if a taxpayer seeks to rely on agreements that exist in the industry between independent parties that are not truly comparable but may establish general "reference points", it will not be accepted that such agreements alone are sufficient to establish arm's length conditions. The Commissioner reinforces that the totality of evidence available, including any "truly comparable" agreements, will need to be considered when establishing relevant arm's length conditions.

Insight: Evidence will always be the crucial aspect to any transfer pricing dispute, and it is not surprising to see the Commissioner reiterate the importance of examining the totality of evidence available when establishing arm's length conditions. Taxpayers should ensure that they have identified, compiled and examined the available evidence in connection with their transfer pricing arrangements, particularly in relation to assertions on which the transfer pricing position is likely to turn.

With respect to the Commissioner's views in relation to reliance on expert opinions, taxpayers will need to ensure that this is considered in the context of the totality of evidence available and evaluated by reference to the *Glencore* decision, including the seven propositions regarding "depersonalisation" established by the court.

With respect to the Commissioner's comments regarding comparability analysis, taxpayers should ensure that appropriate transfer pricing comparability analysis is undertaken in accordance with Australia's transfer pricing rules. However, where information is available regarding supplementary reference points or other arrangements providing probative value for the transfer pricing analysis, this should also be considered to help corroborate the taxpayer's position. In practice, the Commissioner often focuses on the pursuit of that "truly comparable" agreement. If the reference points demonstrate a clear pattern of pricing, it would be disingenuous to exclude specific agreements in an effort to find that "truly comparable" agreement instead of accepting that the agreements produce a relevant arm's length range (as repeatedly expressed by the courts in other transfer pricing decisions such as *SNF*[3] and *Chevron*).

Reconstruction

The Commissioner agrees with the Full Federal Court's conclusion that he was not impermissibly restructuring or reconstructing the relevant arrangement in this case ("restructuring" appears to be used synonymously with "reconstruction" by the Commissioner in the decision impact statement).

The Commissioner also cited Thawley J's observations in the Full Federal Court, in agreeing that there is no justification in the statutory language to limit the terms and conditions that can be substituted under the relevant provisions to only those that "define the price".

Insight: The Full Federal Court overturned a conclusion of the Federal Court and instead found that *Glencore* was a "repricing" case, not a "reconstruction" case. Given that disputes centred on reconstruction require a higher bar to be met in terms of onus of proof, this conclusion may be seen as a silver lining for the Commissioner as it confirms that the "reconstruction" hurdle is somewhat further than originally drawn by Davies J at first instance.

The Commissioner's views regarding the transfer pricing provisions not being limited to terms and conditions that "define the price" are unsurprising and consistent with what is observed in practice. This is inconsistent with the conclusion of the majority in the Full Federal Court, which confirmed that there is no power or authority to substitute different terms of a contract where those terms are not seen as defining the consideration received. The same conclusion was said to apply to Subdiv 815-A but the scope of that limitation was left as "a question for another day". Given these findings and the Commissioner's views, taxpayers should prudently ensure that they consider the totality of the commercial and financial relations being analysed from a transfer pricing perspective, including having regard to the commercial rationale underpinning the arrangements and the alternative options realistically available to the parties.

Subdivision 815-B

The Commissioner notes that there are textual differences between the statutory tests in Subdiv 815-A and Subdiv 815-B ITAA97, which may have a bearing on how relevant the decisions in the *Glencore* case and the *Chevron* case are to how Subdiv 815-B is ultimately applied by a court. In particular, the Commissioner cites that:

- s 815-125 of Subdiv 815-B defines "arm's length conditions" with specific reference to independent parties dealing wholly independently with one another in "comparable circumstances", and a non-exhaustive list of relevant factors to which regard must be had when identifying those comparable circumstances is provided; and
- s 815-130 of Subdiv 815-B sets out a "basic rule" and an "exceptions" framework for how the arm's length conditions are to be identified and in what circumstances the identification of the arm's length conditions is to be based on the "actual commercial or financial relations".

Insight: Taxpayers should be mindful of the differences between Subdiv 815-A and Subdiv 815-B ITAA97 when considering the relevance of the *Chevron* and *Glencore* decisions for transfer pricing matters involving the application of Subdiv 815-B. In particular, the scope of reconstruction is more prescriptive and limited under Subdiv 815-B. The "basic rule" is that the identification of the arm's length conditions must "be based on the commercial or financial relations in connection with which the actual conditions operate" and "have regard to both the form and substance of those relations". Departure from this basic rule can only occur in limited prescribed circumstances.

Implications for impacted advice or guidance and comments

The ATO is of the view that the *Glencore* decision has no implication on any related advice or guidance.

The takeaway

Taxpayers are free to draw their own conclusions and interpretations from the *Glencore* case. However, the decision impact statement provides valuable insight into the Commissioner's views. Taxpayers will need to take note of the Commissioner's views (including around depersonalisation, evidence, comparables and reconstruction) and prepare accordingly, as it is those views that they will encounter at first instance in ATO engagement processes, including risk reviews, audits and advance pricing arrangements.

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References

1 *FCT v Glencore Investment Pty Ltd* [2020] FCAFC 187.

2 *Chevron Australia Holdings Pty Ltd v FCT* [2017] FCAFC 62.

3 *FCT v SNF (Australia) Pty Ltd* [2011] FCAFC 74.

Events Calendar

March/April 2022

STATE/EVENT	DATE	CPD
Online		
Financial Services Taxation Conference	10/3/22	11
Tax Disputes Masterclass	16/3/22	7
SA Tax Forum	23/3/22	11
Superannuation Intensive	30/3/22	8
WA Tax Forum	6/4/22	12
National Infrastructure Conference	28/4/22	12
Agribusiness Intensive	28/4/22	12
New South Wales		
Financial Services Taxation Conference	10/3/22	11
Tax Disputes Masterclass	16/3/22	7
Women in Tax - Purposeful Pursuits	27/4/22	1
National Infrastructure Conference	28/4/22	12
Queensland		
Women in Tax - Purposeful Pursuits	21/4/22	1
Agribusiness Intensive	28/4/22	12
South Australia		
SA Tax Forum	23/3/22	11
Women in Tax – Purposeful Pursuits	7/4/22	1
Western Australia		
WA Tax Forum	6/4/22	12

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The Tax Institute would like to thank the following presenters from our December, January and February 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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