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The Tax Institute

Taxation in Australia

Australian expatriates: casualties of law
Matthew Marcarian, CTA

Section 100A and trust reimbursement agreements
Mark West, CTA

The impact of NDAs on state and federal taxes
Michael Bearman, CTA, and Piotr Klank, CTA

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

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Tax News – at a glance

by TaxCounsel Pty Ltd

May – what happened in tax?

The following points highlight important federal tax developments that occurred during May 2023. A selection of the developments is considered in more detail in the "Tax News – the details" column on page 646 (at the item number indicated).

2023–24 Federal Budget

The Federal Budget was handed down by the Treasurer on the evening of 9 May 2023. The more significant tax-related measures contained in the Budget are noted. **See item 1.**

Car expenses: cents per kilometre rate

The Commissioner has released a draft legislative instrument that sets the rate at which work-related car expense deductions may be claimed in the 2023–24 income year when using the cents per kilometre method (LI 2023/D12). **See item 2.**

The Commissioner's remission powers

The Commissioner has released a draft legislative instrument which would modify the operation of particular provisions in the *Taxation Administration Act 1953* (Cth) which permit the remission of the general interest charge, shortfall interest charge, and administrative penalties including the failure to lodge penalty (LI 2023/D10). **See item 3.**

Status of deregistered company

The Federal Court (Feutrill J) has held that an appeal to the court purportedly brought by a company that had become deregistered was not competent and should be dismissed (*RFZD v FCT* [2023] FCA 324). **See item 4.**

Freezing order issues

In a recent decision, the Federal Court (Wigney J) rejected contentions of the taxpayers that there were grounds for ordering that moneys paid by them into court following the making of freezing orders should be repaid to them (*DCT v Widdup (No. 2)* [2023] FCA 377). **See item 5.**

Guardian decision impact statement

The Commissioner has released a decision impact statement in relation to the decision of the Full Federal Court in the *Guardian AIT* case in which the Full Court unanimously dismissed the Commissioner's appeal from a decision of Logan J on the application of the trust reimbursement provisions (s 100A of the *Income Tax Assessment Act 1936* (Cth) (ITAA36)) but allowed the Commissioner's appeal on the application of the general anti-avoidance provisions in Pt IVA ITAA36 in relation to one of the two income years in issue. The decision impact statement indicates that no application has been made by either party to the High Court seeking special leave to appeal.

It should be noted that an appeal to the Full Federal Court from the recent decision of Thawley J in *BBlood Enterprises Pty Ltd v FCT* [2022] FCA 1112, in which his Honour considered the operation of s 100A ITAA36, has been heard.

ATO 2023 targets

The ATO has announced that its three key focus areas for 2023 tax returns are:

1. rental property deductions, particularly interest expenses and ensuring that rental property owners correctly apportion loan interest expenses where part of the loan was used for private purposes (or the loan was refinanced with some private purpose);
2. work-related expenses, particularly the changes to the working from home methods and whether claims are able to be supported; and
3. capital gains tax, particularly the CGT main residence exemption where there has been a period of income-producing use.

President's Report

by Marg Marshall, CTA

Develop your career and community

President Marg Marshall encourages members to be actively involved in The Tax Institute community.

The Federal Budget is now behind us and EOFY is quickly approaching. I know this is a busy time for many of our members, but I hope you are able to find pockets of rest and reflection amid the business. Please remember that our team is here to support you. Whether that support comes in the form of resources and analysis, formal education and development, or a friendly face in the profession, we are dedicated to providing it.

Membership of a professional association like the Institute is what you make it. Generally, the more effort and engagement you put forward, the more value you receive in terms of your career opportunities, satisfaction and growth. That's why, this month, as you renew your membership, I'd encourage you to also consider the ways in which you can be actively involved in our community and how it can help to build your career in the way you desire.

In the early days of your career, volunteering is a wonderful way to build experience and connections. With the shift to remote working, many young professionals are at risk of missing out on important opportunities for on-the-job learning and mentoring. Volunteering can be one way to bridge that gap, not only in technical skills, but also in soft skills such as collaboration, presentation and communication.

For those more developed in their career, volunteering allows you to be involved in work that you may not otherwise have the chance to explore. You can branch out into different specialities or gain skills in areas outside of the tax technical which will serve you well as you shape a leading career for years to come.

Opportunities such as writing for our journals or other publications is also useful in building your professional profile and reputation – an important consideration before you make the move for a promotion, a new role or onboarding a new client.

And for those among us who are already experts in their chosen specialty, volunteering is an opportunity to give back to the profession and contribute expertise. Mentoring young tax professionals can be an incredibly rewarding experience, as can providing technical expertise that has been built over the span of a career.

Our work in the policy and advocacy space has really picked up steam in recent years, thanks in no small part to our wonderful volunteers. We are working on issues that are important for the tax community and its clients, including those arising from the recent Federal Budget.

The work we do in this space helps shape the future of our economy. If you want to make a difference with your professional skills, the Institute is here to help facilitate that. Whether that is through sitting on a state council or an engagement committee, or by authoring expert resources, volunteering with us benefits you and our community alike. So I encourage you to consider how you might like to be more involved this year and set a personal goal for yourself to put your hand up at the next opportunity. I am sure it will be a rewarding experience.

CEO's Report

by Chair and
Acting CEO,
Clare Mazzetti

A strategic way forward

Chair and Acting CEO, Clare Mazzetti, on the recent changes at the Institute and its strategic future.

As you know from various communications and from Marg's President's Report last month, there has been much change within The Tax Institute recently. I'd like to take this opportunity to reassure you that these changes are in line with our long-term vision for the organisation.

In August 2022, I was appointed Chair of The Tax Institute, with a responsibility to oversee strategic governance. This was part of a long-term plan to invest in the future growth and stability of our organisation.

As we now work to fill the position of CEO at the Institute, my role as Acting CEO is to work with our Board to orient our organisation on a strong path for the future. It is important that we are all clear on our goals and values. With this clarity, we can move forward.

The key focus of our activity is to reinvigorate our engagement committees, and to co-design the mix and optimal balance of activity led by the national and state offices. We want to increase and expand the number of learners engaged across our education offers. And we will focus on broadening the membership base of the Institute.

In the meantime, my priority is ensuring that the changes we are undergoing are for the better of all of our members, volunteers and staff. I have spent my career in various advisory, management consulting and transformation roles. People are at the centre of my approach to defining, strategising and achieving goals for a business. The future direction of The Tax Institute will continue to centre around members and the tax community.

It is clear that our community is an integral part of the Institute. From contributing to our Tax Knowledge Exchange database, to speaking at our events, to volunteering on committees and councils, members are generous with their time and knowledge. This wonderful attitude of sharing is something I have seen among many tax professionals, and particularly among members of the Institute.

The importance of a network of peers who share their insights freely cannot be overstated. When it comes to professional development and achievement, the people you surround yourself with make a difference. This network is also a rich and vital part of the advocacy work that we do on behalf of the profession. I am delighted to be part of it.

Over the past month, I have attended a number of our events in Sydney, including sitting on the panel for our Federal Budget webinar and attending the Women in Tax lunch. It has been a privilege to meet and chat with our members. I hope that you come and say hello when you see me out and about at our events. I am always happy to chat.

As the Institute moves forward with a strategic and considered growth plan, we value your input. Please don't hesitate to reach out to your local Institute representatives with questions or feedback.

Senior Tax Counsel's Report

by Julie Abdalla, FTI

Federal Budget 2023–24

The Federal Budget 2023–24 prioritised the current cost-of-living pressures. However, there are many aspects of our tax and superannuation systems that are in need of attention.

Australians and businesses of all sizes are currently struggling with continuing cost-of-living pressures. Sustained levels of high inflation, combined with low unemployment rates, increasing household spending have created a challenging economic environment within which the government needs to operate. Although the government has forecast a one-off Budget surplus of $4.2b for the 2022–23 year that can assist Australians with the cost of living, any new measures risk inadvertently adding to inflationary pressures and entrenching some of the current conditions.

It was in this context that the Treasurer, the Hon. Dr Jim Chalmers MP, delivered the Federal Budget 2023–24 (the Budget). The Budget attempted to address these issues by primarily focusing on supporting small businesses and vulnerable Australians most in need of assistance.

From a tax perspective, the Budget delivered a large number of measures compared to those in recent times. Many of the measures were seen as somewhat underwhelming, a product of the broader macroeconomic circumstances described above. For detailed information about the Budget, refer to The Tax Institute's Budget Report and two-part webinar series.

Despite the limitations imposed on government, we had hoped to see a commitment to more meaningful tax reform. Below we consider structural change and system maintenance that could have been taken into account in the Budget.

Clarifying announced but unenacted measures

The government addressed a handful of the announced but unenacted measures (ABUMs). The government delayed the start date of some measures, confirmed that the patent box measures are not proceeding, and amended the operation of the proposed changes to the non-arm's length expense rules for superannuation funds.

However, there are many ABUMs that remain outstanding. At the outset, we need certainty as to whether the government will take action on them. A strategic approach to the progression of ABUMs can remove existing irritants or sources of excessive compliance burdens for taxpayers. This can also ensure that the list becomes manageable and does not remain unwieldy. Key ABUMs that the government should consider progressing include:

- implementing the proposed changes to corporate tax residency, including further consultation on the extension of the proposed rules to trusts and corporate limited partnerships;
- consulting on the proposed changes to the individual tax residency rules;
- relaxing the residency rules for self-managed superannuation funds;
- introducing the proposed changes to legacy product conversions; and
- consulting on the raft of proposed changes to Div 7A of Pt III of the *Income Tax Assessment Act 1936* (Cth).

Addressing existing shortcomings

Australia's tax and superannuation systems have many shortcomings that impose unreasonable requirements on taxpayers and would benefit from reform. Addressing these issues could be done within the current economic restrictions and would allow taxpayers to more efficiently use their limited resources. Key examples include:

- replacing the draconian approach to non-compliance with the superannuation guarantee with a more proportionate approach that better balances employees' rights with penalties, and encourages employers to rectify non-compliance;
- reviewing all thresholds, rates and limits across our tax and superannuation system and ensuring that they are indexed or regularly reviewed, better aligning taxpayer obligations with economic realities; and
- abolishing and replacing the current FBT regime with a principle-based approach that better aligns with its original policy objective (it may be possible to stagger the approach to reform, starting with the expansion of the scope of the proposed change to FBT on car parking to review the fringe benefit as a whole).

The need for reform

As always, the need for holistic tax reform remains. Australia's future economic challenges need to be planned for today. The Tax Institute is continuing to advocate for reform. This includes educating the public on why reform is needed, having open discussions and debates to set the scope of the reform, deciding on appropriate start dates for new rules, and establishing a pathway for successful implementation. Without reform, Australia will not be able to support the needs of an ageing population or ensure that our tax system supports growth and does not hinder productivity.

Tax News – the details

by TaxCounsel Pty Ltd

May – what happened in tax?

The following points highlight important federal tax developments that occurred during May 2023.

Government initiatives

1. 2023–24 Federal Budget

The Federal Budget was handed down by the Treasurer on the evening of 9 May 2023. The more significant tax-related measures contained in the Budget are noted below.

Business concessions

Clean building MIT withholding tax concession. The clean building managed investment trust (MIT) withholding tax concession is to be extended to data centres and warehouses that meet the relevant energy efficiency standard where construction commences after 7:30 pm (AEST) on 9 May 2023. This measure is to apply from 1 July 2025.

The minimum energy efficiency requirements for existing and new clean buildings are to be raised to a 6-star rating from the Green Building Council Australia or a 6-star rating under the National Australian Built Environment Rating System. There is to be consultation on transitional arrangements for existing buildings.

Housing: build-to-rent developments. For eligible new build-to-rent projects where construction commences after 7:30 pm (AEST) on 9 May 2023:

- the rate for the capital works tax deduction (depreciation) is to be increased to 4% per year; and
- the final withholding tax rate on eligible fund payments from MIT investments is to be reduced from 30% to 15%.

This measure is to apply to build-to-rent projects consisting of 50 or more apartments or dwellings made available for rent to the general public. The dwellings must be retained under single ownership for at least 10 years before being able to be sold, and landlords must offer a lease term of at least three years for each dwelling.

The reduced MIT withholding tax rate for residential build-to-rent projects is to apply from 1 July 2024.

GDP adjustment factor. The GDP adjustment factor for pay as you go (PAYG) and GST instalments is to be set at 6% for the 2023–24 income year, a reduction from 12% under the statutory formula.

The 6% GDP adjustment rate will apply to small businesses and individuals which are eligible to use the relevant instalment methods (up to $10m aggregated annual turnover for GST instalments and up to $50m aggregated annual turnover for PAYG instalments) in respect of instalments that relate to the 2023–24 income year and fall due after the enabling legislation becomes law.

Small business: instant asset write-off. The instant asset write-off threshold will be temporarily increased to $20,000 from 1 July 2023 until 30 June 2024.

Small businesses, with an aggregated annual turnover of less than $10m, will be able to immediately deduct the full cost of eligible assets costing less than $20,000 that are first used or installed ready for use between 1 July 2023 and 30 June 2024. The $20,000 threshold will apply on a per asset basis, so small businesses can instantly write off multiple assets.

Assets valued at $20,000 or more (which cannot be immediately deducted) can continue to be placed into the small business simplified depreciation pool and depreciated at 15% in the first income year and 30% each income year thereafter.

The provisions that prevent small businesses from re-entering the simplified depreciation regime for five years if they opt out will continue to be suspended until 30 June 2024.

Small and medium business: energy incentive. Small and medium businesses, with an aggregated annual turnover of less than $50m, will be able to deduct an additional 20% of the cost of eligible depreciating assets that support electrification and more efficient use of energy. Up to $100,000 of total expenditure will be eligible for this small business energy incentive, with the maximum bonus deduction being $20,000.

A range of depreciating assets, as well as upgrades to existing assets, will be eligible for the business energy incentive. These will include assets that upgrade to more efficient electrical goods such as energy efficient fridges, assets that support electrification such as heat pumps and electric heating or cooling systems, and demand management assets such as batteries or thermal energy storage.

Eligible assets will need to be first used or installed ready for use between 1 July 2023 and 30 June 2024. Eligible upgrades will also need to be made in this period.

Certain exclusions will apply, such as electric vehicles, renewable electricity generation assets, capital works, and assets that are not connected to the electricity grid and use fossil fuels.

Electric cars: FBT. The FBT exemption for eligible plug-in hybrid electric cars is to be withdrawn from 1 April 2025. Arrangements involving plug-in hybrid electric cars entered into between 1 July 2022 and 31 March 2025 will remain eligible for the exemption.

Personal tax

Medicare levy: lump sum payments in arrears. Eligible lump sum payments in arrears will be exempt from the Medicare levy from 1 July 2024. This measure will ensure that low income taxpayers do not pay higher amounts of Medicare levy as a result of receiving an eligible lump sum payment, for example, as compensation for underpaid wages.

Eligibility requirements will ensure that relief is targeted to taxpayers who are genuinely low income and should be eligible for a reduced Medicare levy. To qualify, taxpayers must be eligible for a reduction in the Medicare levy in the two most recent years to which the lump sum accrues. Additionally, taxpayers will need to satisfy the existing eligibility requirements of the existing lump sum payment in arrears tax offset, including that a lump sum accounts for at least 10% of the taxpayer's income in the year of receipt.

Medicare levy: low-income thresholds. The Medicare levy low-income thresholds are to be increased for singles, families, and seniors and pensioners from 1 July 2022.

The threshold for singles will be increased from $23,365 to $24,276. The family threshold will be increased from $39,402 to $40,939. For single seniors and pensioners, the threshold will be increased from $36,925 to $38,365. The family threshold for seniors and pensioners will be increased from $51,401 to $53,406. For each dependent child or student, the family income thresholds will increase by a further $3,760 instead of the previous amount of $3,619.

Superannuation guarantee. From 1 July 2026, employers will be required to pay their employees' superannuation guarantee (SG) entitlements on the same day that they pay salary and wages.

Currently, employers are only required to pay their employees' SG on a quarterly basis. By increasing the payment frequency of superannuation to align with the payment of salary and wages, this measure will ensure that employees have greater visibility over whether their entitlements have been paid and better enable the ATO to recover unpaid superannuation.

Funding of $40.2m is to be provided to the ATO in 2023–24, which includes $27m for the ATO to improve data-matching capabilities to identify and act on cases of SG underpayment by employers and $13.2m for consultation and co-design.

Superannuation balances of $3m or more. As was previously announced, the tax concessions available to individuals with a total superannuation balance exceeding $3m are to be reduced from 1 July 2025.

This change will bring the headline tax rate to 30%, up from 15%, for earnings corresponding to the proportion of an individual's total superannuation balance that is greater than $3m. Earnings relating to assets below the $3m threshold will continue to be taxed at 15% or 0% if held in a retirement pension account.

Interests in defined benefit schemes will be appropriately valued and will have earnings taxed under this measure in a similar way to other interests.

The measure will not place a limit on the amount of money that an individual can hold in superannuation, and the current contribution rules will continue to apply.

Compliance

GST compliance program. There is to be funding of $588.8m to the ATO over four years from 1 July 2023 to continue a range of activities that promote GST compliance.

These activities will ensure that businesses meet their tax obligations, including accurately accounting for and remitting GST, and correctly claiming GST refunds. It is envisaged that this funding will also help the ATO to develop more sophisticated analytical tools to combat emerging risks to the GST system.

Global minimum tax and domestic minimum tax. Key aspects of pillar two of the OECD/G20 Two-Pillar Solution are to be implemented to address the tax challenges arising from digitalisation of the economy:

- a 15% global minimum tax for large multinational enterprises, with the income inclusion rule applying to income years starting on or after 1 January 2024 and the undertaxed profits rule applying to income years starting on or after 1 January 2025; and
- a 15% domestic minimum tax applying to income years starting on or after 1 January 2024.

The global minimum tax and domestic minimum tax will be based on the OECD global anti-base erosion model rules, which are designed to ensure that large multinationals pay an effective minimum level of tax on the income arising in each jurisdiction where they operate.

A global minimum corporate tax rate of 15% prevents a "race to the bottom" on corporate tax rates and protects the corporate tax base. The global minimum tax rules would allow Australia to apply a top-up tax on a resident multinational parent or subsidiary company where the group's income is taxed below 15% overseas.

A domestic minimum tax would give Australia first claim on top-up tax for any low-taxed domestic income. In a small number of instances, a large multinational company's effective Australian tax rate may fall below 15%. In these instances, the domestic minimum tax applies so that Australia collects the revenue that would otherwise have been collected by another country's global minimum tax.

The global minimum tax and domestic minimum tax will apply to large multinationals with an annual global revenue of EUR750m (approximately $1.2b) or more.

General anti avoidance provisions. The scope of the general anti-avoidance rule that applies for the purposes of income tax (Pt IVA ITAA36) is to be expanded so that it can apply to schemes that:

- reduce tax paid in Australia by accessing a lower withholding tax rate on income paid to foreign residents; or
- achieve an Australian income tax benefit, even where the dominant purpose was to reduce foreign income tax.

This measure is to apply to income years commencing on or after 1 July 2024, regardless of whether the scheme was entered into before that date.

Tax compliance: funding and amnesty. Funding over four years from 1 July 2023 is to be provided to enable the ATO to engage more effectively with businesses to address the growth of tax and superannuation liabilities.

The additional funding is intended to facilitate ATO engagement with taxpayers who have high-value debts of over $100,000 and aged debts that are older than two years where those taxpayers are either public and multinational groups with an aggregated turnover of greater than $10m, or privately owned groups or individuals controlling over $5m of net wealth.

Further, a lodgment penalty amnesty program is to be provided for small businesses with an aggregated turnover of less than $10m to encourage them to re-engage with the tax system. The amnesty will remit failure to lodge penalties for outstanding tax statements lodged in the period from 1 June 2023 to 31 December 2023 that were originally due during the period from 1 December 2019 to 29 February 2022.

Personal Income Tax Compliance Program. The Personal Income Tax Compliance Program is to be extended for two years from 1 July 2025 and its scope extended from 1 July 2023.

This extension will enable the ATO to continue to deliver a combination of proactive, preventative and corrective activities in key areas of non-compliance, and to expand the scope of the program to address emerging areas of risk, such as deductions relating to short-term rental properties to ensure that they are genuinely available to rent.

Changes to former government measures

Changes are to be made to a number of measures announced by the former government. These changes include:

- deferring the start date of the 2016–17 mid-year economic and fiscal outlook measure "Tax integrity – franked distributions funded by capital raisings" from 19 December 2016 to 15 September 2022;
- amending the non-arm's length income (NALI) provisions which apply to expenditure incurred by superannuation funds by:
  - limiting income of self-managed superannuation funds and small Australian Prudential Regulation Authority (APRA) regulated funds that are taxable as NALI to twice the level of a general expense. Additionally, fund income taxable as NALI will exclude contributions;
  - exempting large APRA regulated funds from the NALI provisions for both general and specific expenses of the fund; and
  - exempting expenditure that occurred before the 2018–19 income year.

The three separate patent box measures announced by the former government in the 2021–22 and 2022–23 Budgets are not to proceed.

The Commissioner's perspective

2. Car expenses: cents per kilometre rate

The Commissioner has released a draft legislative instrument that sets the rate at which work-related car expense deductions may be claimed in the 2023–24 income year when using the cents per kilometre method (LI 2023/D12).

The Commissioner has determined the rate to be 85 cents per kilometre for that income year and subsequent income years until such time as the instrument is repealed or varied. The previous rate was 78 cents per kilometre.

LI 2023/D12 was developed to ensure that the rate for claiming work-related car expense deductions using the cents per kilometre method is updated to reflect recent average operating costs for cars. The update of the rate reflects the annual movement of the private motoring subgroup of the consumer price index, rounded to the nearest whole cent, within the year.

3. The Commissioner's remission powers

The Commissioner has released a draft legislative instrument which would modify the operation of particular provisions in the *Taxation Administration Act 1953* (Cth) which permit the remission of the general interest charge, shortfall interest charge, and administrative penalties including the failure to lodge penalty (LI 2023/D10).

The modifications will ensure that the Commissioner can continue his longstanding practice of providing:

- remissions as an administrative response to a natural disaster or other serious and external adverse events impacting the community;
- low-value or low-risk remissions; and
- agreement-based remissions where a remission is agreed to prior to the relevant liability arising.

LI 2023/D10 will remove any doubt about the Commissioner's power to make remission decisions in relation to classes of entities, as well as in circumstances where a charge or penalty has not yet become due and payable (but may become due and payable in the future).

The modifications will support the use of automated processes that remit interest or penalties as soon as those liabilities arise, without requiring a separate request from a taxpayer and a decision from the ATO every time a liability arises.

Recent case decisions

4. Status of deregistered company

The Federal Court (Feutrill J) has held that an appeal to the court purportedly brought by a company that had become deregistered was not competent and should be dismissed (*RFZD v FCT*[1]).

The company (referred to as the nominal applicant) was deregistered on 30 January 2022 under s 601AD of the *Corporations Act 2001* (Cth). Before it was deregistered, the nominal applicant had applied to the AAT for review of a decision of the Commissioner to allow, in part, its objection to amended assessments of superannuation guarantee charge penalties and administrative penalties applied in relation to pay as you go withholding. After the nominal applicant was deregistered, the AAT made a decision to affirm the Commissioner's decision and published reasons for that decision.

On 11 May 2022, the nominal applicant filed a notice of appeal from the AAT in the Federal Court, the Commissioner being the named respondent in the appeal. On 25 May 2022, the Commissioner filed a notice of objection to competency of the appeal, one ground of the notice being that the nominal applicant had no capacity to bring the appeal as it was deregistered on 30 January 2022. No steps were taken or proposed to have the company's registration reinstated.

Feutrill J said that, in his view, neither the nominal applicant nor the solicitors purporting to act for the applicant had discharged the burden of establishing the competency of the appeal. The appeal was manifestly not competent because the nominal applicant had been deregistered, did not exist, and was not a legal person. The appeal was an abuse of process. If, and to the extent that, the former company had a right of appeal from the decision of the AAT, that chose in action would form part of the former company's property that was vested in ASIC by operation of s 601AD(2) of the *Corporations Act 2001*. As the appeal was not competent, his Honour said that it should be dismissed in accordance with r 33.30(5) of the *Federal Court Rules 2011* (Cth).

As to the question of costs, his Honour said that costs should follow the event and should be paid by the solicitors as the real party to the proceedings or as solicitors who have commenced the appeal without authority. Further, the circumstances warranted the exercise of the discretion to award costs on an indemnity basis for the period from which it ought to have been evident to the solicitors who purportedly acted for the nominal applicant that the contentions that they advanced were hopeless.

5. Freezing order issues

In a recent decision, the Federal Court (Wigney J) rejected contentions of the taxpayers that there were grounds for ordering that moneys paid by them into court following the making of freezing orders should be repaid to them (*DCT v Widdup (No. 2)*[2]).

On 21 June 2022, the Deputy Commissioner issued Mr Julian Widdup and Mrs Cecilia Widdup with a number of notices under various provisions in the ITAA36. Those notices included: (1) notices of liability under s 271-90 of Sch 2F ITAA36 to pay family trust distribution tax of $3,599,409 for which Mr and Mrs Widdup were said to have been liable since 20 July 2018 (the FTDT notices); (2) notices of liability to a general interest charge of $1,210,907 (accrued as at 21 June 2022) in respect of the family trust distribution tax liability; (3) notices of amended assessment to income tax under s 170(1) ITAA36 which assessed Mr and Mrs Widdup to each be liable for income tax of $1,785,073 for the income year ended 30 June 2018; and (4) notices of assessment of shortfall interest of $249,943 in respect of the assessed income tax shortfall.

Later on the same day (21 June 2022), the Deputy Commissioner applied to the Federal Court ex parte for freezing orders to be made against Mr Widdup, Mrs Widdup and two companies associated with them (the Widdup respondents), as well as two offshore companies with which the Widdup respondents had relevant dealings. The duty judge who heard the interlocutory application (Nicholas J) on an urgent basis made the freezing orders against all respondents. The freezing orders were to have effect up to and including 29 June 2022. The proceeding was listed for "further hearing" of the interlocutory application before the duty judge on 29 June 2022.

There was, however, no further hearing of the Deputy Commissioner's interlocutory application. On 29 June 2022, the freezing orders were, with the consent of the Widdup respondents, extended until further order. On 1 August 2022, the orders ceased to have effect, by operation of their terms, because $4,810,316 was paid into court by and on behalf of the Widdup respondents. On 5 August 2022, the freezing orders, along with some ancillary orders, were discharged by consent.

The basic issue in the present proceedings was whether the money paid into court on 1 August 2022 should be repaid. It was argued by the Widdup respondents that there had been conscious maladministration or jurisdictional error on the part of the Deputy Commissioner when issuing the notices of liability for family trust distribution tax on which the prospective judgment was said to be partly based.

Wigney J was not satisfied on the current state of the evidence that the Widdup respondents had established jurisdictional error or conscious maladministration on the part of the Deputy Commissioner when issuing the FTDT notices. Nor was his Honour persuaded that the Widdup respondents had established that they had a good arguable case in that regard, or at least an arguable case that was strong enough to warrant the repayment of the money paid into court. That was essentially because, in his Honour's view, it was at least open to the Deputy Commissioner to issue the FTDT notices on the basis of the information available to the Deputy Commissioner at the time.

Wigney J was not persuaded that it was in any way inappropriate or erroneous for the Deputy Commissioner to apply ex parte for freezing orders, or that it was in any way inappropriate or erroneous for Nicholas J to have made the freezing orders. His Honour was not satisfied that there was any material non-disclosure, or lack of bona fides, on the part of the Deputy Commissioner when applying for the ex parte relief.

His Honour was satisfied that the three criteria or requirements for the making of freezing orders were satisfied in all of the circumstances. The Deputy Commissioner established that: (1) she had good arguable causes of action, or prospective causes of action, in respect of the income tax and family trust distribution tax liabilities of Mr Widdup and Mrs Widdup; (2) there was a real and not fanciful risk that Mr Widdup and Mrs Widdup may encumber or dissipate their assets if not restrained from doing so, with the result being that the prospective judgment may be defeated; and (3) the balance of convenience favoured the making of the freezing orders.

Wigney J went on:

> "164. I am not persuaded that the evidence adduced by the Widdup respondents in support of the present application casts doubt upon any of the bases upon which the freezing orders were made. The Widdup respondents' evidence and submissions focussed primarily on the Deputy Commissioner's cause of action in respect of the family trust distribution tax liability. I am not persuaded by the evidence in its present state that the Widdup respondents have made out a good arguable case that the FTDT notices were the product of conscious maladministration or jurisdictional error. Nor have the Widdup respondents established any reason why the Court is not, at this point, bound by the terms of s 350-10 of sch 1 to the TA Act to regard the FTDT notices and amended assessments as conclusive evidence that the notices and assessments were properly given or made and that the amounts and particulars in the notices and assessments are correct. That is particularly the case in respect of the amended assessments."

His Honour also said that he was not persuaded that the evidence relied on by the Deputy Commissioner supported a finding that there remained a real and not fanciful risk that a prospective judgment in the Deputy Commissioner's favour may be defeated if the money that had been paid into court was repaid to the Widdup respondents. The Widdup respondents did not adduce any evidence relevant to the risk of the encumbrance or dissipation of assets. Nor did they adduce any other evidence, or advance any other submissions, as to why the money paid into court should be repaid. Their case rested almost entirely on the proposition that it was wrong, or inappropriate, for the freezing orders to have been made in the first place and, on that basis alone, the funds paid into court following the making of the freezing orders should be repaid. For the reasons he had already given, Wigney J was not persuaded that it was wrong or inappropriate for the freezing orders to have been made.

It should be noted that a crucial underlying issue raised in relation to the FTDT assessments (which Wigney J was not called on to determine in the proceedings before him) was whether (as contended by the Widdup respondents) a family trust election had not been made. If the parties do not resolve this question, it is likely that it will be the subject of further litigation in relation to the objections that have been made against the FTDT assessments. While not called on to make a decision on the issue, Wigney J did in fact canvas some aspects of it. The issue potentially extends to the making of other elections or choices under the income tax law more generally where the legislation requires the use of an approved form.

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References

1 [2023] FCA 324.

2 [2023] FCA 377.

Tax Tips

by TaxCounsel Pty Ltd

Information-gathering power

A decision of the Federal Court has considered the exercise by the Commissioner of the power to require information and evidence to be given.

Background

The decisions of Wigney J in two interlocutory matters has signalled an emerging substantive dispute in relation to a liability to family trust distribution tax.

The most recent of these decisions is *DCT v Widdup (No. 2)*[1] in which his Honour considered some issues relating to whether a family trust election had or, according to the taxpayers, had not been made in relation to a discretionary trust. That decision is noted in the Tax News column at p 646 of this issue of the journal.

The other decision is *DCT v Widdup*[2] in which Wigney J dismissed a challenge to the validity of notices issued by the Commissioner which required attendance of the recipients of the notices to give evidence and a notice requiring the furnishing of information. This decision is considered in this column.

The legislation

The Commissioner's general power[3] to require a person to give information, attend and give evidence, or to produce documents for the purpose of the administration or operation of a taxation law, is conferred by s 353-10 of Sch 1 to the *Taxation Administration Act 1953* (Cth) (TAA53). In the case of income tax, that section replaced the former s 264 of the *Income Tax Assessment Act 1936* (Cth) (ITAA36).

Section 353-10 Sch 1 TAA53 provides as follows:

> "**353-10 Commissioner's power**
>
> (1) The Commissioner may by notice in writing require you to do all or any of the following:
>
> (a) to give the Commissioner any information that the Commissioner requires for the purpose of the administration or operation of a taxation law;
>
> (b) to attend and give evidence before the Commissioner, or an individual authorised by the Commissioner, for the purpose of the administration or operation of a taxation law;
>
> (c) to produce to the Commissioner any documents in your custody or under your control for the purpose of the administration or operation of a taxation law.
>
> Note: Failing to comply with a requirement can be an offence under section 8C or 8D.
>
> (2) The Commissioner may require the information or evidence:
>
> (a) to be given on oath or affirmation; and
>
> (b) to be given orally or in writing.
>
> For that purpose, the Commissioner or the officer may administer an oath or affirmation.
>
> (3) The regulations may prescribe scales of expenses to be allowed to entities required to attend before the Commissioner or the officer."

It is clear that decisions given in relation to the former s 264 ITAA36 are relevant to the construction and application of s 353-10 Sch 1 TAA53.[4]

For convenience, s 353-10 Sch 1 TAA53 is referred to as s 353-10 in this article.

The facts

Mr Julian Widdup and Mrs Cecilia Widdup were embroiled in a dispute with the Deputy Commissioner of Taxation in respect of their liability for family trust distribution tax and income tax for the income year ended 30 June 2018.

The Deputy Commissioner commenced proceedings in June 2022 to recover the tax liability of Mr and Mrs Widdup and they filed a cross-claim in July 2022 in which they claimed that the notices issued by the Deputy Commissioner in respect of their liability for family trust distribution tax were invalid.

As indicated, the controversy the subject of the decision of Wigney J in the *Widdup (No. 1)* case did not directly concern or rise out of the principal proceeding. Rather, it concerned the validity of three notices that the Deputy Commissioner issued to Mr and Mrs Widdup pursuant to s 353-10. Two of the notices, both dated 17 October 2022, required Mr and Mrs Widdup to attend and give evidence before officers of the ATO on 25 and 24 November 2022, respectively. The third notice, dated 21 October 2022, required Mr Widdup to provide specified information and documents to the ATO by 18 November 2022.

Mr and Mrs Widdup claimed that the notices were invalid. On 8 November 2022, they and two companies filed a cross-claim against the Deputy Commissioner in which they claimed, among other things, that the notices that had been served on them were invalid and should be quashed. Of more immediate relevance was that, on 14 November 2022, Mr and Mrs Widdup filed an interlocutory application in which they claimed that the notices should be stayed and that the Deputy Commissioner be restrained from taking any action to enforce them. The decision in *Widdup (No. 1)* addressed and determined that interlocutory application.

The notices to Mr and Mrs Widdup requiring them to give evidence were in effectively identical terms. The body of the notice addressed to Mr Widdup dated 17 October 2022 read as follows:

> "16. …
>
> Under section 353-10 of Schedule 1 to the *Taxation Administration Act 1953*, I require you to attend and give evidence:
>
> 1. for the purpose of the administration or operation of a taxation law,
> 2. before any or all of the following officers,
>
> … ,
>
> 3. at 21 Genge Street Canberra ACT 2601,
> 4. on **25 November 2022** at 9.30 am and until you are excused from further attending.
>
> You may be required to give evidence on oath or affirmation. The officer who administers the oath or affirmation is authorised by me to do so.
>
> The powers of the Commissioner of Taxation under section 353-10 of Schedule 1 to the *Taxation Administration Act 1953* have been delegated to me as Deputy Commissioner of Taxation under section 8 of the *Taxation Administration Act 1953*."

The letter under cover of which the notices were sent included the following statement:

> "18. …
>
> You may choose to have an advisor with you at the interview. However, Dr Terrence Dwyer and any past or present employees of his practice are specifically excluded from attending the interview as an adviser."

The notice addressed to Mr Widdup dated 21 October 2022 required him to give the information specified in Sch A and to produce the documents specified in Sch B no later than 18 November 2022.

Mr and Mrs Widdup requested that the Deputy Commissioner give reasons for the decision to issue the notices pursuant to s 13 of the *Administrative Decisions (Judicial Review) Act 1977* (Cth). Reasons were in due course provided.

General principles

Wigney J set out the principles that are relevant to the operation of s 353-10 which were derived from the decisions which have considered that section and the former s 264 ITAA36.[5] These principles are as follows:

1. the power to issue a notice under s 353-10 is largely unconstrained. The only express requirement or constraint in subs (1) is that the power must be exercised for the "purpose of the administration or operation of a taxation law";
2. like all such statutory powers, the power to issue a notice must be exercised in good faith;
3. proof of bad faith generally requires proof of extreme circumstances, such as "dishonesty", "improper or ulterior motive" or "deliberate impropriety", and will generally only be made out in rare and extreme cases;
4. the Commissioner is entitled to "make a 'roving inquiry' into the income or assessment of a particular taxpayer". The Commissioner "may 'fish' in a 'pool' that contains (or might contain) persons who are subject to an Australian tax liability";
5. a notice under s 353-10 need not identify the person or persons in connection with whose income or assessment the request for information, evidence or documents has been made;
6. it is not necessary that the Commissioner know in advance whether the information or documents actually exist, or that the recipient of the notice is actually able to provide the information or produce the documents;
7. the time allowed to comply with a notice must be reasonable. An unreasonable time period is one which "looked at objectively" is "so devoid of any plausible justification, that no reasonable body of persons could have reached [it]";
8. a notice which requires the provision of information must contain enough detail to allow a reasonable person to identify and furnish the information in question; and
9. likewise, a notice requiring the production of documents must state with reasonable clarity the documents that must be produced. That said, notices should not be read "carpingly", hypercritically or with a determination to detect possible error.

The decision

Wigney J said that Mr and Mrs Widdup had not made out a prima facie case that the notices were invalid.

There was no evidence capable of supporting any inference or finding that the notices were issued for an improper purpose. Each notice stated, on its face, that the information, documents or evidence, as the case may be, was sought for the purpose of the administration or operation of a taxation law. There was no evidence to suggest that the notices were issued, or the information was required, for any other purpose. There was no evidence capable of supporting any inference or finding that the notices were not issued in good faith.

Wigney J said that Mr and Mrs Widdup's main complaints appeared to revolve around the timing of the notices. In particular, the timing was said to be unreasonable because there was no urgency, and compliance with the notice was required contemporaneously with compliance with the court-ordered timetable in the principal proceeding. His Honour, however, said that there was no merit in the contention that the times for compliance with the notices were unreasonable in any respect.

Exclusion of the solicitor

Wigney J said that the final issue that needed to be addressed was the Deputy Commissioner's apparent intention to prevent Mr and Mrs Widdup's solicitor, Dr Dwyer, from attending the interviews to be conducted with them. Mr and Mrs Widdup contended that the Deputy Commissioner did not have the power to exclude Dr Dwyer from their interviews, and that it was, in any event, unreasonable for him to be so excluded. When considering this contention, Wigney J said:

> "43. It may be accepted that s 353-10 does not expressly empower the Deputy Commissioner to exclude someone from accompanying a person who is required by notice to attend and give evidence. That said, it must equally be accepted that the Deputy Commissioner has an implied power under s 353-10 to determine who can and who cannot be permitted to attend when a person is giving evidence pursuant to a notice. It could not, for example, be doubted that the Deputy Commissioner can determine that the evidence be given in private and that members of the general public be excluded. Counsel for Mr and Mrs Widdup ultimately accepted the existence of such an implied power.
>
> 44. It is now well established that statutory powers are almost invariably conferred subject to the implied limitation that they be exercised reasonably … A statutory power cannot be exercised arbitrarily, capriciously, in bad faith or for an improper purpose. The question then is whether, in this case, the Deputy Commissioner's decision to not permit Dr Dwyer to accompany Mr and Mrs Widdup when they give evidence was or is arbitrary, capricious or manifests bad faith or an improper purpose."

Wigney J said that the reason given for the exclusion of Dr Dwyer contained in the letters which enclosed the statement of reasons under s 13 of the *Administrative Decisions (Judicial Review) Act 1977* in relation to the two notices to attend to give evidence was that the Deputy Commissioner had "formed the view that [Dr Dwyer's] attendance at the proposed interviews could prejudice the Commissioner's investigation because he appears to have participated in the design and/or structuring of the tax affairs of you and/or your associated entities". His Honour went on:

> "46. A further hint as to why it was decided to exclude Dr Dwyer is given in paragraphs 9 to 11 and 23(i) or 22(i) of the statement of reasons (in the two notices to attend and give evidence). Those paragraphs explain why the review of the tax affairs of the Fidelity Holdings Trust was conducted on a covert basis after Dr Dwyer provided certain information on behalf of Mr Widdup in response to an information request by the Commissioner. Senior counsel for the Deputy Commissioner submitted that it is readily apparent from the relevant letters and statements of reasons that the main reason for excluding Dr Dwyer from the interviews is that Dr Dwyer had been involved in the design and structure of Mr and Mrs Widdup's tax affairs. He may therefore at some point in the future be required to give evidence in relation to those affairs. It was submitted that, in those circumstances, it was reasonable to exclude Dr Dwyer from attending Mr and Mrs Widdup's interviews so as to avoid any potential conflict that may arise.
>
> 47. While the reasons given by or on behalf of the Deputy Commissioner for excluding Dr Dwyer from attending the interviews may not be particularly compelling, I am nonetheless not persuaded that the decision to exclude Dr Dwyer was legally unreasonable. That is because I am not persuaded that the decision to exclude Dr Dwyer was arbitrary, capricious, lacking bona fides, illogical or made for an improper purpose."

Wigney J noted that the decision to exclude Dr Dwyer from the interviews was not, strictly speaking, a condition or requirement specified in the relevant notices. It was referred to only in the covering letters. It was therefore somewhat doubtful that the decision to exclude Dr Dwyer, even if found to be legally unreasonable, would necessarily lead to the invalidity of the notices themselves. The interlocutory relief sought by Mr and Mrs Widdup related only to the notices. His Honour said that it was, however, unnecessary to reach a concluded view in respect of this issue, given the finding that the decision was not legally unreasonable in any event.

Balance of convenience

Finally, given that Mr and Mrs Widdup had failed to establish that they had a prima facie case that the notices were invalid, it was strictly unnecessary to address whether the balance of convenience favoured the grant of interlocutory relief. Wigney J nevertheless noted that the balance of convenience did not necessarily weigh in favour of granting the interlocutory relief sought by Mr and Mrs Widdup.

Observations

The exercise by the Commissioner of the power to require a person to attend and give evidence has arisen for judicial decision in a number of decisions over the years.

However, it does not appear that the question of whether the Commissioner can exclude a particular adviser to a taxpayer from being present at a compulsory interview has been the subject of a published decision and, accordingly, the decision of Wigney J is of considerable interest.

The dates on which the compulsory interviews were to take place in the *Widdup* case have passed so if the interviews took place on those dates there will likely be no more litigation on this particular point in the case.

TaxCounsel Pty Ltd

References

1 [2023] FCA 377.

2 [2022] FCA 1403. For convenience, this decision is referred to in this article as *Widdup (No. 1)*.

3 There are other information-gathering powers conferred on the Commissioner, for example, in relation to obtaining information about rights or interests in property. See Div 354 Sch 1 TAA53.

4 *Widdup (No. 1)* [2022] FCA 1403 at [6] and [10].

5 *Widdup (No. 1)* [2022] FCA 1403 at [6]–[15].

Mid Market Focus

by Nilan Gandhi, HLB Mann Judd

Save emissions, save tax

With the FBT season in full swing, businesses and employers should understand the FBT ramifications if they go green and go electric on motor vehicles for their employees.

Introduction

The Treasury Laws Amendment (Electric Car Discount) Bill 2022 (the Bill) was introduced into parliament in July 2022 and enacted as law on 12 December 2022.

The Bill amends the *Fringe Benefits Tax Assessment Act 1986* (Cth) (FBTAA86) to exempt from FBT the use, or availability for use, of cars that are zero or low-emissions vehicles made available by employers to current employees. Additionally, to be eligible for the exemption, the value of the car at the first retail sale must be below the luxury car tax threshold for fuel-efficient cars.[1]

The government is supporting the take-up of electric vehicles by increasing the affordability of these vehicles by removing the FBT on them. By removing the FBT, these vehicles are competitive in the market and attractive for employers and businesses wanting to provide a motor vehicle to their employees.

What vehicles are electric vehicles?

According to the explanatory memorandum to the Bill, electric vehicles must be zero or low-emissions vehicles. An electric vehicle must satisfy one of the following conditions to be eligible to be considered as an electric vehicle:[1]

- it must be a battery electric vehicle;
- it must be a hydrogen fuel cell electric vehicle; or
- it must be a plug-in hybrid electric vehicle.

Additionally, the electric vehicle must:

- use one or more electric motors for propulsion; and
- be fuelled by either an off-vehicle electrical power source, a battery, an electric generator, a hydrogen fuel cell, or a combination of these.

Cars that do not fit within the meaning of a zero or low-emissions vehicle will not be affected.

Employers and FBT exemption

For employers looking to obtain an FBT exemption on the electric vehicle, they must ensure that the following conditions are satisfied under s 8A FBTAA86:

- the vehicle is a zero or low-emissions vehicle;
- the first time that the vehicle is both held and used is on or after 1 July 2022;
- the vehicle is used by a current employee or their associate; and
- the vehicle is not subject to the luxury car tax.

If these conditions are satisfied, the employer will have no FBT consequences when providing an electric vehicle to employees or associates. Therefore, it is vital that employers ensure that these conditions are satisfied prior to arranging electric vehicles for their employees.

Benefits for employers

Employers providing electric vehicles to their employees (as opposed to non-electric vehicles) can expect to reap the following benefits:

- there will be no exposure to FBT as the vehicles will be treated as exempt;
- less rigorous FBT compliance burdens and record-keeping requirements; and
- the retention of staff by offering electric car fringe benefits as part of effective remuneration packages.

Benefits for employees

Electric vehicles also provide a number of benefits for employees, including:

- the opportunity to make contributions in a novated lease arrangement from pre-tax dollars, allowing employees to have more cash in their pocket; and
- electric cars that are salary packaged will be exempt from FBT, which means that employees will continue to receive the full tax benefit from the deductions without the FBT obligations.[2]

Upcoming potential changes

It is worth noting that, in the recent 2023–24 Federal Budget released on 9 May 2023, Treasurer Jim Chalmers announced changes to the FBT exemption for hybrid electric cars,[3] namely, that purchases of hybrid electric cars from 1 April 2025 will no longer be exempt from FBT.

It is worth noting that purchases of hybrid electric vehicles between 1 July 2022 and 31 March 2025 will continue to receive the FBT exemption status.

Other considerations

While the FBT exemption on electric cars may seem attractive for both employers and employees, there are several considerations that will need to considered if an electric car is provided.

Charging station

The ATO has released guidance stating that a home charging station is not treated as a car expense with the car fringe benefit provided. It is treated as a property fringe benefit or as an expense payment fringe benefit.[4]

Electricity costs

The ATO has released PCG 2023/D1 on the electric vehicle home charging rate. PCG 2023/D1 outlines the ATO's methodology in calculating the cost of electricity when an electric vehicle is charged at an employee's or individual's home. The employee has the choice to either use the methodology in PCG 2023/D1 or to determine the cost of the electricity by determining its actual cost. The choice by the employee is applicable to each vehicle and applies for the whole FBT year.[5]

Reportable fringe benefit

While electric cars are exempt from FBT, employers will still need to report the value of the fringe benefit provided as this will need to be calculated to determine whether an employee has a reportable fringe benefit.

Although no tax is payable by the employee on this reportable fringe benefit, it will need to be reported on the employee's tax return and may affect their entitlement for other government support payments.

It should be noted that the employer may incur compliance costs when calculating this reportable fringe benefit and thus incur administrative and payroll support costs.

In summary

While the provision of electric cars to employees provides an FBT exemption for employers and employees, both parties will need to act fast to reap these benefits before the FBT exemption is abolished. In addition, employers and employees need to carefully consider their electric vehicle arrangements to ensure that they are eligible for exemption.

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1 Explanatory memorandum to the Treasury Laws Amendment (Electric Car Discount) Bill 2022.

2 D Thai, *Electric car FBT exemption explained (2023)*, 6 May 2023. Available at https://zecar.com/reviews/electric-car-discount-fbt-exemption-everything-you-need-to-know.

3 Australian Government, *Budget 2023–24, Budget measures: Budget paper no. 2*, 9 May 2023, p 25.

4 Australian Taxation Office, *Electric cars exemption*, 28 February 2023. Available at www.ato.gov.au/Business/Fringe-benefits-tax/Types-of-fringe-benefits/FBT-on-cars,-other-vehicles,-parking-and-tolls/Electric-cars-exemption/?=Redirected_URL.

5 Para 3 of PCG 2023/D1.

Higher Education

From Royal Artillery to accounting professional

The dux of CommLaw1 Australian Legal Systems for Study Period 2 2022 shares her passion for learning and how she made the leap into accounting.

Robyn Anderson
Accountant
Coho Resources, Queensland

Please provide a brief background of your career in tax.

I started my career in the British Army in the Royal Artillery in 2011 and studied accounting and finance in 2015. I have proudly completed an honours degree in accounting at Oxford Brooks University by distance learning, and my chartered accountant qualification with ACCA in the UK. I moved to Australia in 2017 and worked as an accounts officer for a family-run business in Queensland. From there, I worked through positions as an assistant accountant and company accountant in various industries, including logistics, franchising, oil and gas. I have also worked for a small tax accounting practice preparing returns for individuals and small businesses based on the Gold Coast.

Why did you choose The Tax Institute Higher Education?

I wanted to complete postgraduate studies in Australian tax to develop my knowledge of tax laws and be able to apply this knowledge for the benefit of my employers. I liked that the learning was delivered online and specific to tax.

Why did you choose to study CommLaw1 Australian Legal Systems?

CommLaw1 was the third subject that I studied with The Tax Institute Higher Education and is part of the Graduate Diploma of Applied Tax Law, which I have since completed.

What skill or knowledge areas have you gained by undertaking the Graduate Diploma of Applied Tax Law?

The qualification built my confidence from a corporate perspective. I became more efficient; I knew where to source information and could do my own calculations.

What part of CommLaw1 did you find most interesting?

I found the law of torts the most interesting part of the CommLaw1 subject. However, the contracts module provided the most benefit to me professionally.

Do you have any tips for others on managing the workload?

It can be difficult at times to juggle the study workload with full-time work commitments. I have been actively studying while working for almost a decade, so I feel familiarity and routine helped me the most. I have created a reference index to use and have all the module notes saved for easy access during the exam. I find that repeating practice exams is the best way to feel prepared for the real thing.

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

Now that I have completed the Graduate Diploma of Applied Tax Law, my focus is on the final exam in the CPA Program. The qualification I did with ACCA in the UK is not well known in Australia. I am also considering completing a board-approved course to register as a tax agent with the TPB, which I believe may only be one subject away based on my prior learning.

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

Do it! The program is informative, comprehensive and well-delivered. Whether you are a professional in business or practice, the Graduate Diploma is an advantageous qualification that is well-regarded by employers and will instil a strong knowledge of the taxation laws governing Australia.

Australian expatriates: casualties of law

by Matthew Marcarian, CTA,
Principal, CST Tax Advisors

Over the last 20 years, Australia's international tax settings have changed in a way which has increased the tax burden on Australian expatriates. Too often they become "casualties of law", their interests overlooked by poorly conceived, and sometimes politicised, tax policy and design. This article examines these changes and analyses major tax issues facing Australian expatriates at different stages of their expatriate journey. The article demonstrates how Australian expatriates can face higher taxes and significantly more complexity than fellow Australians. The tax issues examined include the ongoing legislative uncertainty relating to individual and corporate tax residency, the removal of both the 50% CGT discount and the main residence CGT exemption for non-residents, the forex rules, the treatment of foreign structures, and overseas retirements plans. This article also notes that an opportunity exists for the new Albanese government to address many issues to make them less burdensome and fairer for the Australian "diaspora".

Introduction

In post-lockdown Australia, our citizens are once again on the move, in search of new opportunities in "Expatland".[1] This continues a healthy trend which has been described as a significant phenomenon for our country[2] – an Australian "diaspora" which can offer many benefits to the nation if properly engaged.

In 2005, the report of the Senate inquiry *They still call Australia home* observed that:[3]

> "… expatriate Australians represent an underutilised resource: not only are they an asset in terms of promoting Australia and its social, economic and cultural interests; they are also ambassadors for our nation, which is otherwise disadvantaged by our geographic remoteness and small population."

In 2003, a landmark study published by the Committee for Economic Development of Australia[4] (the Hugo report) found that the main reasons Australians moved overseas included better employment opportunities, professional development, higher income, promotion/career advancement and lifestyle.[5] Australia's lock-down policy has not changed these motivations.

Since Australia's borders were opened on 1 November 2021,[6] more than 250,000 "residents of Australia" have departed on a long-term basis.[7] According to the "population clock" of the Australian Bureau of Statistics, one Australian resident leaves Australia every two minutes to live overseas.[8]

Most departing Australians become a non-resident of Australia under tax law and the majority of those will one day return.[9] These Australians will have to navigate increasing complexity in their tax affairs. They may become casualties of law and find themselves worse off than their resident compatriots as a result.

More should be done to reduce the complexity of Australia's international tax laws, a burden which affects a broad cross-section of taxpayers but falls disproportionately on Australian expatriates. From their perspective, various inequities have crept into our tax system, without appropriate explanation or policy rationale. Some tax changes have been highly politicised.

The introduction of Div 775 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97),[10] and the amendments to s 23AG of the *Income Tax Assessment Act 1936* (Cth) (ITAA36),[11] have increased the uncertainties facing Australian expatriates.

Tax residency has become a more critical matter than ever before. Dramatic changes to our capital gains rules have been ushered in and the concepts of simplicity and equity have been abandoned.[12]

This article examines some of the key tax issues for Australians at various stages of their expatriate journey, whether they are departing, returning or living abroad:

- departing Australians must now consider whether a proposed move abroad may be financially detrimental, relative to staying in Australia;
- returning Australians face a tax system full of traps for the unwary, which sometimes results in punishing fiscal outcomes; and
- Australians still living abroad must monitor proposed Australian tax changes to avoid the pitfalls which may come with the lack of any consistent political representation at home.[13]

Definitions

Before moving on, it is useful to define the terms "Australian expatriates", "departing Australian" and "returning Australian".

For the purposes of this article, an "Australian expatriate" means an Australian citizen who lives overseas[14] and who is also a non-resident of Australia.

A "departing Australian" is an Australian resident citizen[15] who will cease Australian tax residency when they leave Australia.

A "returning Australian" is an Australian citizen who has returned to Australia and who will become a resident.[16]

We will also resist using the expression "foreign resident" in favour of the much clearer and less emotive term "non-resident".

Departure issues

Residency and salary income

For most departing Australians, the taxation of their salary income will be top of mind as they plan their move overseas.

In the author's experience over two decades of practice, many have asked whether Australia will be able to tax their overseas salary when they move. Some realise that the more precise question is whether they will become a non-resident. Fewer still understand that a tax treaty might shelter their overseas employment income from Australian tax even if they remain resident.

Before 1 July 2009, most departing Australians would have had certainty about the taxation of their salary income, including those individuals whose actual residency status may have been unclear. This was because there was an exemption from Australian tax for the foreign earnings of an Australian resident engaged in "continuous foreign service" for at least 91 days, provided the income was subject to tax in the foreign country (s 23AG ITAA36).

While the administration of s 23AG was not always straightforward,[17] the exemption had appeal. Its purpose was to relieve many small taxpayers of the burden of having to declare their income and claim a foreign tax credit, where in many cases the tax differences were minor.[18]

In 1986, the original objective of s 23AG was:[19]

> "to provide an exemption from Australian tax for salary or wages earned overseas by an Australian resident during a continuous period of at least 12 months … provided … that the income is not exempt from tax in the country in which it is derived."

The government was not concerned with what tax rate applied to the income. There was an artful simplicity to that approach.[20] The section provided a full exemption from Australian tax if there was continuous foreign service for at least 365 days and there was a proportional exemption for service between 91 days and 364 days.[21]

In 1991, in a bid to simplify tax laws, amendments were passed[22] to introduce a full exemption for taxpayers provided they had continuous foreign service of at least 91 days.

The explanatory memorandum (EM)[23] explained that the proportional exemption provision involved "significant compliance and administrative costs" and required "individual taxpayers to perform a number of complex calculations to determine their period of foreign service, the proportion of that income subject to exemption and the taxation liability of any non-exempt portion of that income".

The changes were introduced to "substantially simplify the law and hence reduce compliance and administrative costs" removing "unwarranted complexities in calculating tax liabilities".

By 2009 however, the philosophy of government had changed.

In a surprise move, the 2009–10 Budget measures[24] indicated that the government would change its policy towards "Australians working overseas". It was a clumsy statement that should have more accurately referred to "Australian tax residents" working overseas.[25]

The Budget measures noted that the original intent of s 23AG was "to relieve double taxation" but its view was that "in practice little foreign tax may actually be paid on the foreign income concerned".[26] It decided to amend s 23AG to limit its application for most taxpayers.

The Budget measures also noted that taxpayers would instead have to rely on the general foreign income tax offset system to obtain relief from double taxation. The government did not mention, but should have, that double tax treaties may have also provided exemptions for many taxpayers.[27]

When the amending Bill was introduced,[28] the EM noted that the existing exemption could produce:[29]

> "non-neutral tax outcomes between individuals working in different countries, with different tax rates and between individuals working overseas and individuals working in Australia."

The new approach was said to be consistent with the "general principle that individuals who are Australian residents for tax purposes should pay tax on their worldwide income".[30]

The government also wished to lower "administrative costs for the Australian Taxation Office"[31] which it said devoted "significant resources to providing interpretive advice on the operation of section 23AG".[32]

Limiting the scope of the exemption would "help maintain the integrity of the tax system by ensuring that most Australian resident individuals face the same tax burden in relation to their worldwide income".[33]

In Bills Digest no. 158 of 2008-09, the government put it slightly differently:

> "The Treasurer stated in a media release on 12 May 2009 that the new measure is designed to ensure that workers who earn income overseas do not have an unfair advantage over workers who earn income and pay tax in Australia. The Government wishes to make the exemption fairer by ensuring that Australian resident taxpayers who work in low-tax jurisdictions pay the same rate of Australian tax as those taxpayers who work in Australia."

The true motivation was likely to have been revealed in the Bills Digest. Australians living and working in low-tax jurisdictions seemed to be the cohort that the amendments were most concerned with. However, no statistics were released to explain the number of Australians living in the relevant "low-tax jurisdictions", nor how many of them should still be considered Australian residents.

For Australians who had not quite departed in the traditional sense, the removal of the 90-day exemption was a major issue. The repeal of that exemption meant that the "safety net" for many simple taxpayers was removed, resulting in increased complexity for those moving overseas on relatively short-term assignments.

Inevitably, the correctness of the "residency assertion" for those Australians was brought sharply into focus. It resulted in an apparent explosion of cases on residency in the courts.[34]

Timing became a significant issue. It became critical to determine whether a departing Australian was a non-resident from the actual day of departure or some later day.

Interestingly, the Board of Taxation has noted that the previous exemption in s 23AG provided practical certainty and significant administrative and compliance relief for employees and employers, at the limited notional cost to the government.[35]

> "… right the wrong perpetrated on the Australian diaspora by reinstating the main residence exemption …"

For non-resident Australians, the amendment to s 23AG did not have any direct consequences. However, it increased the risk of error. Previously, if they had erred with the position taken in relation to personal tax residency, the consequences would have been mostly limited to liability on foreign investment income and capital gains.

With the changes to s 23AG, there could be significant additional tax due on foreign salary income, unless that income was protected by a treaty.

The changes also had an impact on the taxation of some returning Australians, which is discussed later in this article.

Residency rules: changing or not?

For most departing Australians, the question of whether they will become a non-resident when they leave Australia can be relatively easily answered under our current rules. Most will have straightforward personal circumstances and will establish homes in a new country of residence. A small percentage could be described as itinerant and would still be a resident here.

Our existing residency rules are mostly well understood, and following *Harding's* case,[36] we now have greater clarity about the expression "permanent place of abode".

Inevitably, there are complicated cases where it can be unclear whether a departing Australian has ceased residing in Australia or alternatively whether they have established a "permanent place of abode" overseas. Sometimes returning Australians find it difficult to determine when they have commenced tax residency.

While uncertainties remain, a far bigger issue is that we have significant uncertainty about what our residency laws will be.

Legislative uncertainty

Moving overseas is almost always a major undertaking and certainty about the tax consequences should be fundamental. Unfortunately, there is now considerable uncertainty about what will happen to our residency rules, making it difficult to advise taxpayers even about relatively short time periods.

In the 2021–22 Federal Budget, the Coalition announced that a new "modernised framework" for Australia's residency laws would be introduced. It was to be based on a report by the Board of Taxation[37] completed in March 2019.

The key reform was to be the introduction of a "bright line" 183-day test, and "other secondary tests" which would depend on a combination of physical presence and other "objective criteria".[38] For such a major measure, insufficient detail was provided in the Budget and it has provoked significant concerns. The reference to the 183-day bright line test was clear enough. But it was the imprecise reference to "other secondary tests" that caused consternation in expatriate circles.

A review of the Board's report indicates that the "other secondary tests" included a "ceasing residency test" and a "commencing residency test". If the government had accepted the Board's entire framework, it should have mentioned those tests explicitly, without leaving it to the public to read between the lines.

There is justified concern that aspects of these tests are unworkable and that the attempt to codify common law principles into these secondary tests is not appropriate.[39] Specifically, the notion that an Australian could be considered a resident if they spend more than 45 days in Australia in a tax year is anathema to many. With memories of 14-day quarantine periods still fresh, a "45-day rule" could effectively limit time in Australia to 30 days if quarantine rules were to be re-imposed.

Horizontal equity issues contained in the proposals need to be dealt with also,[40] and one can anticipate a range of interpretational problems arising with several elements of the secondary tests.

Unfortunately, it has been almost two years since the announcement and Australian expatriates have been left hanging.[41] If the new government wishes to continue with the changes, it should make an announcement soon and ensure genuine and extensive consultation on any draft legislation.

There is an opportunity now to engage with Australia's expatriate community in a transparent way, to show that the new government is more willing than its predecessors to consider their views. The aim should be to avoid imposing harsh approaches to a segment of the Australian population that has been unfairly treated in recent times.

CGT event I1

CGT event I1 occurs when an individual "stops being a resident". At the cessation of residency, a gain or loss arises on all CGT assets, excepting taxable Australian property.[42] As this can create funding problems, the law permits individuals to make a choice to disregard CGT event I1.[43] That "choice" is a good thing. However, it must be recognised that the removal of the CGT discount for non-residents has increased the complexity relating to that choice.

If the choice is made, the relevant assets become taxable Australian property. The assets remain in the Australian CGT net, and a gain or loss will arise on the happening of a later CGT event.

Where a gain is made, the benefit of the 50% CGT discount is reduced in the proportion that the non-resident ownership period bears to the total ownership period. This can result in much higher effective tax rates, depending on the individual situation.[44]

Some departing Australians may be able to avoid higher effective rates if they end up selling the relevant asset while they are resident in certain treaty countries, to whom Australian has allocated taxing rights. Take, for example, Australia's treaty with the United States which contains this concession at art 13(6):

> "An individual who elects, under the taxation law of a Contracting State, to defer taxation on income or gains relating to property which would otherwise be taxed in that State upon the individual ceasing to be a resident of that State for the purposes of its tax, shall, if the individual is a resident of the other State, be taxable on income or gains from the subsequent alienation of that property only in that other State."

However, if the departing Australian moves back to Australia and then sells the particular asset, they would be assessable in Australia again at higher effective rates compared to other fellow Australians.

There is also the possibility of the Australian expatriate moving to a third country (either to a non-treaty country or to a treaty country to which Australia has not allocated taxing rights) and the departing Australian would again be assessable, at likely higher effective rates. Hence, the ongoing compliance difficulties of making the election to disregard CGT event I1 should not be overlooked. Doing so will require the departing Australian's journey through "Expatland" to be tracked before an accurate tax return can be prepared.

Self-managed superannuation funds

Given the prevalence of self-managed superannuation funds (SMSFs), it would be remiss not to mention that departing Australians with SMSFs have some work to do to ensure that their funds remain "complying". That can be done by ensuring that central management and control of the fund remains in Australia[45] and ceasing contributions. This is another point of complexity and cost for a departing Australian which could be addressed by simple amendment.

Issues while away

Removal of 50% CGT concession for foreign residents

On 8 May 2012, the Labor Government announced that it would legislate to prevent "foreign residents" from accessing the 50% CGT concession. The changes were introduced as part of the Tax Laws Amendment (2013 Measures No. 2) Bill 2013.

The EM to the Bill gives few clues as to the policy behind the changes. The EM indicated that:[46]

> "the reduction in effective tax rate (by way of the CGT discount) is not necessary to attract foreign investment in these assets. Removing the CGT discount for foreign and temporary residents increases the return to Australia from gains made through foreign investment in Australian land."

This explanation was unsatisfactory in two respects.

First, the implication that the CGT discount was introduced to attract foreign investment was not correct.[47] Second, the explanation failed to consider the tens of thousands of Australian expatriates with ownership of Australian land.

It is fallacious to suggest that ownership by Australian citizens living abroad should constitute "foreign investment". Unfortunately, the result has been that Australians living overseas have borne higher tax rates on capital gains from real estate than their fellow resident Australians. If the aim was to make the foreigners pay more, it is doubtful whether that objective has been achieved.

Relatively few "foreigners" would have paid top marginal rates on large capital gains. Those who had held Australian real property on the date of the announcement would have been entitled to some CGT discount, given the transitional rules.

Those purchasing new properties after the change would most likely have purchased using a company, with the result that capital gains would attract only the company tax rate.[48] Transfer pricing techniques could have reduced the effective tax rate further.

Therefore, the notion that eliminating the 50% CGT discount for *foreigners* would have raised significant additional revenue should be questioned.

It is also hard to justify the horizontal inequity of the situation for Australian citizens when one considers that real estate is also a major asset class for Australian expatriates. Their ties with Australia make them less likely than actual foreigners to change their purchasing behaviours and therefore the burden of higher tax rates falls disproportionately on them. For example, Australians living overseas are far less likely to take the approach of utilising a company to acquire real property in Australia.

Usually, Australian expatriates acquire properties which they hope to hold for the long term, after they return to Australia, either because they consider that the property will become their main residence or because it will be a long-term investment property.

With these objectives in mind, the use of a company would prohibit access to any CGT concession that would otherwise be available following their return to Australia.

How the 50% CGT discount is reduced for non-residents

The policy which grandfathered existing assets from the change was poorly conceived. Rather than grandfathering existing assets owned on 8 May 2012, it was the "value increase" up to 8 May 2012 that was grandfathered. That approach has introduced unnecessary complexity into the administration of the CGT system for all stakeholders because of the need to apply the convoluted formulas set down in s 115-115 ITAA97. To obtain the benefit of the grandfathering, the non-resident must ascertain the market value of the property on 8 May 2012 as the example below illustrates.

Example

Assume that an Australian non-resident had acquired an investment property on 1 July 2008 for $750,000, had returned to Australia on 1 July 2018, and had sold that property on 30 June 2020 for $1,750,000. Assume that the market value of the property on 8 May 2012 was $1,100,000.

Section 115-115 essentially gives the taxpayer access to the 50% CGT discount only if they choose to calculate the discount percentage using the "market value" method contained in s 115-115(4).

In this example, and assuming that a satisfactory assessment of market value is obtained, the formula in s 115-115(4) produces a discount of 26.7%.

Otherwise, s 115-115(5) requires taxpayers to calculate the applicable CGT discount by reference to the number of days they were a resident over the total ownership period.

Essentially, the formula has the effect that the 50% CGT discount is reduced by the proportion of days the person is resident during the holding period.

In this example, the person is resident for 1/6 of the period and so the CGT discount is not 50% but 8.33%.

The cost of compliance to secure the discount is not insignificant. An assessment of market value by a valuer, along with cost of advice from a tax professional, can be expensive.

Taxes have also become a disincentive to sale. In the author's experience, many Australian expatriates have opted not to sell Australian properties, precisely because the removal of the CGT discount provides such a bad tax outcome.

The prospect of high effective tax rates for Australian non-residents may well have contributed to a "lock-in effect" for Australian real property over the past decade. That would surely not have assisted with housing affordability, an issue which the Coalition politicised in 2018 when it legislated to remove the main residence exemption for non-residents.

Removal of the main residence CGT exemption

In the 2017–18 Federal Budget, the Coalition announced that it would legislate to remove the main residence exemption for "foreign investors". In the Budget speech delivered on 9 May 2017, the Treasurer explained the government's measures to address housing affordability. The following extract from the Treasurer's speech reminds us of the political context at the time:

> "And on demand management, we will continue to prefer the scalpel to the chainsaw, to avoid a housing shock.
>
> Mum and dad investors will continue to be able to use negative gearing, supporting the supply of rental housing and placing downward pressure on rents.
>
> Our regulatory agencies will continue to use the flexible and calibrated controls they have available.
>
> And we will legislate to extend APRA's ability to apply controls to the non-ADI sector and explicitly allow them to differentiate the application of loan controls by location.
>
> Even tougher rules on foreign investment in residential real estate will be introduced, removing the main residence capital gains tax exemption, and tightening compliance.
>
> We will also apply an annual foreign investment levy of at least $5,000 on all future foreign investors who fail to either occupy or lease their property for at least six months each year.
>
> And we will restore the requirement that prevents developers from selling more than 50 per cent of new developments to foreign investors."

Preserving benefits to "Mum and Dad investors" while "getting tough" on foreigners was clearly the mantra. The Treasurer did not explain that getting tough on foreigners would also mean getting tough on tens of thousands of Australians living overseas, many of whom were also "Mums and Dads".

Indeed, in the Budget papers, the proposal was explained in quite different terms as follows:

> "The Government will extend Australia's foreign resident capital gains tax (CGT) regime by … denying foreign and temporary tax residents access to the CGT main residence exemption from 7:30PM (AEST) on 9 May 2017 …"

The truth was laid bare. The proposal would potentially affect thousands, if not tens of thousands, of Australian expatriates, impacted by dint of being non-residents for tax purposes, but not because they were part of some undesirable cohort.

It was never explained how the removal of the main residence CGT concession for "foreigners" would address housing affordability.

It took two months before the Treasurer acknowledged that the proposal would affect non-residents generally and not simply foreigners or "foreign investment".

On 21 July 2017, in a boldly titled media release, "Helping Australians realise their dream of home ownership",[49] the Treasurer and Assistant Minister noted:

> "The Turnbull Government is also today releasing draft legislation to stop foreign residents investing in residential real estate claiming the main residence exemption.
>
> The Government will stop foreign tax residents from claiming the main residence capital gains (CGT) exemption when they sell property in Australia from Budget night 2017."

When describing the revenue impact of the change in the media release, the Treasurer and Minister explained that the target was "the foreign investor". They noted that: "These changes to foreign investors buying residential real estate are part of a package estimated to add $600 million in revenue over the forward estimates."

The whole tone of the media release was confused. Was the removal of the main residence exemption aimed at foreign investors, foreign residents, or foreign tax residents?

Whatever the truth, the suggestion was that foreign residents in their droves had been buying up Australian real estate and claiming the main residence exemption unfairly. Not a skerrick of evidence was advanced to support that contention.

On the same day as the media release, Treasury opened its consultation on the measure. It was entitled "Housing tax integrity – Capital gains tax changes for foreign residents".[50] It contained not a single reference to "foreign investors".

The Tax Institute, in its submission[51] to Treasury, noted that the policy behind the measure appeared "somewhat confused". It requested the government explain the abuse that it was trying to prevent. It also noted that it could find "no legitimate policy reason for denying Australian citizens the CGT main residence exemption" simply because they were foreign residents at the time of sale, flagging the potential for the changes to produce unfair and arbitrary results. None of The Tax Institute's equity concerns were addressed.

Instead, on 8 February 2018, the Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No. 2) Bill 2018 (the 2018 Bill) was introduced into the House.

The Treasurer, in his second reading speech,[52] continued his trademark approach to all things "foreign", stating that:

> "No longer allowing foreign residents to claim this exemption will send a clear message that foreign residents will have to comply with our stringent capital gains tax rules."

A week later, Michael Pascoe, writing in the *Sydney Morning Herald*,[53] hit the nail on the head when he said:

> "Ordinary expats have become collateral damage in the government's 'Australia First' chest-beating as it cracked down on foreigners buying residential real estate."

On 1 March 2018, the Assistant Minister to the Treasurer found yet another way to describe the proposed change. He explained that the Bill:[54]

> "delivered on the government's commitment to implement tighter rules for foreign residents owning Australian property."

Labor's interest in the Bill at that time was to ensure that New Zealand citizens were not adversely impacted and that Australian tax residents could still access the CGT exemption. It called for a Senate inquiry.[55]

The Senate inquiry was handled by the Senate Economics Legislation Committee[56] (the Committee) which sought public submissions. The submission from CPA Australia concluded that:[57]

> "It is unreasonable to effectively penalise Australians for departing Australia for work or personal reasons by revoking their right to a CGT exemption on their family home."

Many other submissions expressed similar views.[58] Some echoed The Tax Institute's recommendation from its 2017 submission to Treasury[59] that a partial main residence exemption should be allowed relating to the period of residency.[60]

The Committee even noted a submission from the Affordable Housing Consortium which expressed the view that the proposed changes could work to suppress the supply of housing stock by discouraging the sale of properties.

Given those concerns, one would have expected the Committee to have sought some economic modelling from the government to ascertain how the measure would reduce pressure on housing affordability. No such modelling appears to have been requested. It is doubtful that any existed.

Notwithstanding the apparent lack of substance, the Committee's concluding view was that:

> "the measures contained in the Bill will form an essential part of the government's comprehensive and targeted plan to improve outcomes for Australians across the housing spectrum."

None of the concerns swayed the Committee. It recommended that the government proceed with the legislation, noting it had a "responsibility to ensure that Australian citizens working overseas were made aware of the changes", essentially washing its hands of the matter.

The EM that introduced the 2018 Bill also provided no details about the policy behind the measure. There was no reference to economic analysis about how the measure would reduce pressure on housing affordability.

Fortunately, there were continuing objections to the unfairness of the proposals[61] which gathered steam.[62]

The late Mr Paul Drum, head of CPA Australia at the time, said:[63]

> "The government has not put forward reasons as to how it is good public policy that the CGT laws be changed retrospectively and to the detriment of taxpayers … it's draconian to change the tax treatment of the family home post the acquisition of that home – and for some citizens that are now non-residents, it may have been their family home for more than 30 years."

It was called "unjustifiably bad policy".[64] Under sustained pressure from many quarters as to the fairness of the measures, including from Labor,[65] the Coalition appeared to drop the measure in March 2019[66] in the run up to the 2019 federal election. But Australian expatriates had only a short reprieve. Not long after the Coalition's re-election in May 2019, it announced its intention to revive the measure.[67]

Significant objections to the policy continued. *The Australian Financial Review* labelled it a "zombie tax measure".[68] Professor Robert Deutsch called the proposal "outrageous"[69] and "draconian".[70]

As for the passage of the revived Bill,[71] there was no discussion in either House about the well-documented equity concerns.

Labor appeared exhausted by the process and the shadow Treasurer noted his party's efforts to make "what was a bad Bill in 2017, a better Bill".[72] By this, he referred to much-needed amendments to allow foreign residents to access the main residence exemption if certain "life events"[73] occur – those being death, divorce or terminal illness. Those concessions did not go far enough.[74] The effective date was extended to 1 July 2020 and the Bill was passed.

Where are we at now?

Section 118-110 ITAA97 now prevents an "excluded foreign resident"[75] from benefiting from the main residence exemption. No regard is had to the amount of time the excluded foreign resident lived in the home while they were a resident of Australia.

Unquestionably, the door has been left open for those taxpayers who can afford to hold the property until they become a resident in Australia again. If an excluded foreign resident retains their property, selling it after they return to Australia, they will be able to access a full or partial main residence exemption. In that case, the CGT exemption is not curtailed by the period of non-residency. That is cold comfort for those who were pressured to sell their homes prior to 1 July 2020, during the height of lockdown.[76]

In the end, one is left with the sinking feeling that, all along, the policy was aimed at foreign nationals – but that Australian expatriates had become casualties of law.

Those expatriates caught unaware of the change will suffer a potentially life-changing tax event, relative to other fellow Australians. Those who are aware have nonetheless had an unfair and unjustified economic constraint foisted on them.

There is no evidence that the government ever took seriously the Committee's reminder of its "responsibility" to ensure that Australian citizens abroad were made aware of the changes. This raises significant questions about due process.

Was this revenue raising under the guise of housing affordability?

In the author's view, the Albanese Government should reinstate the main residence exemption so that Australian citizens abroad are not discriminated against. If that means allowing foreign nationals access to the exemption, that is only fair. After all, under the old law, a foreign national could only have claimed the main residence CGT exemption if they had permission to acquire the property, and if they had lived in the property and used it as their main residence. That is all our law required of them.

The ATO will also have ample opportunity to review main residence claims, given that the foreign resident CGT withholding regime is now in place.

In the author's experience, most departing Australians are now electing to retain their former main residence for fear that selling their Australian property will only make it harder to buy back into the market once they return to Australia.

Returning issues

They still call Australia home,[77] but the returning Australian can face a myriad of complexity. Having had a life outside Australia, they are likely to have their finances structured in a way which does not necessarily provide for a happy tax homecoming.

Few of Australia's international tax rules contain de minimis exemptions or time periods which could permit the returning Australian an exemption on the grounds of simplicity. Where there are exemptions or concessions, they have serious shortcomings and amendments should be made to address these. Some of these problems are elaborated on in the next section of this article.

Employment income: tax derivation time

Since the amendments to s 23AG, returning Australians now face a tax liability on income received after they become a resident, which may relate to services rendered before returning to Australia. This is because of the common law principle that employment income is assessable on receipt.

When one realises that "temporary residents" who come to Australia are treated quite differently with respect to their employment income (they are not taxed unless the work relates to services performed after they become a "temporary resident"[78]), the outcome for the returning Australian seems inappropriate.

Foreign termination payment exemption

One exception to the treatment of employment income for a returning Australian is the exemption for "foreign termination payments" in s 83-230 ITAA97. That section permits an Australian resident to treat a termination payment as non-assessable, non-exempt income if certain conditions are satisfied. Essentially, the payment must be received "in consequence of" the termination of employment and it must relate wholly to foreign service.

The main problem is that no apportionment is possible between Australian and overseas service periods. A returning Australian will be assessable on the whole termination payment even though the period of Australian employment may comprise only a small part of the service period. That is strongly at odds with many other approaches to taxation in Australia where apportionment is the norm. This issue could easily be fixed by simple amendment.

Australians returning with foreign entities

Many returning Australians will come home either owning or controlling foreign companies or trusts. More often than not, such structures are established without the intention of obtaining a future Australian tax advantage. But our tax system inherently treats foreign structures in a harsh manner as if the only reason for their establishment was Australian tax avoidance.

Returning Australians will need to consider:

- whether foreign companies or trusts are residents of Australia;
- whether and to what extent the controlled foreign company (CFC) rules apply;
- whether and to what extent Div 6AAA ITAA36 applies; and
- whether their personal presence in Australia constitutes a permanent establishment of a foreign company

These areas of law are more complex than most returning Australians imagine. Many months of planning may well be required ahead of a return to Australia.

While a detailed discussion of these laws is beyond the scope of this article, there are certain stand out issues which are discussed below.

Corporate residency rules

As with our individual tax residency rules, there is disappointing lack of certainty about what our company residency rules will be.

On 6 October 2020, the government announced that it would make technical amendments to the corporate residency test. It would essentially introduce a new "significant economic connection" test, adopting a proposal by the Board of Taxation.[79] This new test will be satisfied where a company's "core commercial activities" are undertaken in Australia and where its central management and control is also in Australia.

While the concept of central management and control is well understood, having been clarified most recently in *Bywater*,[80] the new proposed "core commercial activities" test is not well understood. In the absence of legislation, reference must be made to the Board's report to understand what is meant.

The main trouble with these reforms is that they have stalled, compounding uncertainty for returning Australians who might have ownership of private companies incorporated overseas.

Trust residency

A longstanding issue is that a non-resident trust will become a resident trust for Australian tax purposes if any of its trustees become residents of Australia. That outcome is sudden and unforgiving. Even if there are several trustees in office, merely one trustee becoming an Australian resident is enough to create unwarranted complexity and cost.

If a foreign trust accidentally becomes a resident of Australia (because an individual trustee may have simply moved to Australia), Australia can levy taxation on capital gains in a situation where an overseas trust holds only foreign assets, even if there are no Australian resident beneficiaries or transferors. That outcome is difficult to accept but no attempts have been made to address this problem.

CFC rules

The CFC rules[81] are a famously complicated. They are concerned with preventing the deferral or avoidance of Australian tax on tainted income.

The rules are fraught with interpretational challenges and can produce results which are hard to reconcile with anti-avoidance goals. They often apply to normal commercial structures where there is no avoidance purpose.

The main issue for returning Australians is the lack of any de minimis exemptions.

The owner of a small overseas business must contend with the same CFC rules as a large multinational when determining whether there is any "attributable income" that must be included in assessable income.

The active income test[82] permits a CFC to have less than 5% of its turnover comprised of tainted income, without attribution. However, working through the concepts just to get to a 5% exemption is no mean feat. It would be far better to have an exemption by value, or even a wholesale exemption from the CFC rules for small companies or small businesses.

A simplifying policy, such as not applying the CFC rules at all unless certain profit/turnover tests are met would be welcome.

Australians returning with foreign currency

The forex realisation events in Div 775 ITAA97 require the recognition of forex gains and losses arising from specified "forex events". These provisions have always been an unwieldy and confusing set of rules to apply. Even the most sophisticated clients find the rules incomprehensible.

In 2006, The Tax Institute wrote to the Board of Taxation in blunt terms as follows:[83]

> "The rules in Division 775 are of such complexity and incomprehensibility that they are at risk of being ignored in practice. This does not mean that foreign exchange gains and losses are not being brought to account but rather, people are favouring common sense accounting-type approaches, rather than trying to divine which particular forex realisation event (FRE) applies to each step of the transaction."

Problems with Div 775 were identified early, and in 2004, the government announced that it would:[84]

> "amend the foreign currency provisions of the income tax law to extend the scope of a number of compliance cost saving measures in the law, and to make technical amendments to ensure that the provisions operate as intended."

Unfortunately, the announcements died a natural death. Writing for *The Tax Specialist* in 2008, Fiona Dillon noted that the failure to persevere with much needed improvements to Div 775 had:[85]

> "left both practitioners and administrators in the awkward position of knowing the forex law applicable to relevant transactions is subject to be retrospectively amended, and yet not knowing with any real certainty what that law as amended may say."

While the forex rules apply to all resident taxpayers with foreign currency accounts, returning Australians run into these excruciating rules more often than most.

Returning Australians usually come home with foreign bank accounts of some description. Some Australians will have active foreign accounts, whereas others may just keep an account open with a small balance.

Policymakers should realise that Australians living abroad have no reason to seek Australian tax advice at the time they open these accounts. Therefore, many are not expecting to deal with the tax complexity that awaits them in Australia. Indeed, there is no separately identified disclosure required in relation to foreign exchange gains or losses in an individual income tax return.[86] Unless the right questions are asked, the issue will often be missed and the returning Australian will be none the wiser.

Even if the returning Australian becomes aware of the issue, there is no grace period, such as a "six-month-rule" for foreign bank accounts, which might permit a returning Australian to repatriate funds without tax consequences after arriving home.[87]

Tax professionals can help clients to identify whether exemptions or simplifying approaches can be utilised. If clients cannot be exempted from the provisions, the next task is to identify whether any of the forex events have occurred and to quantify the relevant assessable income or allowable deductions.

Specific forex problems

For the majority of returning Australians, the main forex realisation event of relevance is forex realisation event 2, which arises simply where funds in a foreign bank account are "used".[88] That is an absurd outcome but it is what the law presently requires.

Although there are many difficulties with Div 775, two common scenarios are raised below which illustrate problems and uncertainties commonly faced by returning Australians.

Example 1 analyses the "private and domestic exemption" which is often thought to be useful to avoid unintended results. By its very length, it demonstrates the need for reform.

Example 2 illustrates a problem that is often caused by forex gains and losses being on revenue account.

Example 1. Private and domestic exemption

In practice, taxpayers assume that they should be exempt from the forex rules if they have used their foreign bank account only for private or domestic use. This example deals with that assumption.

William is an Australian citizen who has recently returned to live in Australia after spending four years working in San Francisco.

On moving home William, decided to keep his Wells Fargo bank account open. He retained a relatively small balance of USD $12,500 in the account. The account was a transactional account. On the day William returned, US$1 bought A$1.33.

Six months later, William's favourite team the Golden State Warriors wins the NBA Championship. William uses his Wells Fargo account to purchase a Warriors Championship cap for US$30. On that day, US$1 bought A$1.42.

At tax time, William is puzzled to hear from his tax agent that, because he has a foreign bank account, he will need to consider the application of Australia's forex rules.

William has assumed that, because he only used the account for private transactions, he should not have any tax issues with it.

Division 775 contains an important exemption for private or domestic transactions — if it can be made to work. Under s 775-15, a taxpayer's assessable income does not include a forex realisation gain ("the realisation gain") to the extent that it is a gain of a private or domestic nature. However, the gain must also be one which is "not covered" by one of the items in the table in s 775-15(2)(b).

The expression "not covered" presumably means that no item in the specified table applies to the realisation gain. Consequently, if any of the items in the table apply to the realisation gain, the gain would be assessable irrespective of whether it is private or domestic.

Essentially, one is asked to examine the table to see whether any of the items apply to the realisation gain. The table is reproduced below.

“Forex realisation gains to which this subsection does not apply			
Item	**You make the forex realisation gain as a result of this event ...**	**happening to ...**	**and the following condition is satisfied ...**
1	forex realisation event 1 or 2	foreign currency or a right, or a part of a right, to receive foreign currency	a gain that would result from the occurrence of a realisation event in relation to the foreign currency, or to the right, or the part of the right, would, apart from this Division, be taken into account under Part 3-1 or 3-3
2	forex realisation event 2	a right, or a part of a right, created or acquired in return for the occurrence of a realisation event in relation to a CGT asset you own, where subparagraph 775-45(1)(b)(iv) applies	a gain or loss that would result from the occurrence of the realisation event in relation to the CGT asset would be taken into account for the purposes of Part 3-1 or 3-3
3	forex realisation event 4	an obligation, or a part of an obligation, you incurred in return for the acquisition of a CGT asset	a gain or loss that would result from the occurrence of a realisation event in relation to the CGT asset would be taken into account for the purposes of Part 3-1 or 3-3”

Item 1 of the table applies if it can be said that a realisation gain arises because forex event 1 or 2 happens to foreign currency and if the realisation gain would be “taken into account” for the purposes of Pt 3-1 or Pt 3-3 ITAA97 (“the CGT provisions”).

In plain language, something is “taken into account” if it is considered. The question is whether the “gain” is considered for the purposes of the CGT provisions.

For a guide to the correct interpretation of this strangely worded table, we look to the relevant EM to the Bill[89] which introduced Div 775. The EM explains how private and domestic gains are treated, in the following terms:[90]

> “2.26 First, a gain may not be assessable because it is of a private or domestic nature. In those cases, the forex component of the gain is not assessable income either *[Schedule 4, item 58, subsection 775-15(2)]*. Even so, the income tax system does tax some private or domestic gains. In particular, private gains arising under the CGT provisions that do not qualify for the private use asset exclusions are taxable.
>
> 2.27 Accordingly, the forex component of the following private or domestic gains is taxable under the forex rules if a gain upon a realisation event happening to the CGT asset mentioned *would be taxable* under the CGT provisions ...” (emphasis added)

The Act asks whether the forex gain would be “taken into account” by the CGT provisions, whereas the EM poses a different question, namely, whether the realisation gain *would be taxable* under the CGT provisions. We proceed with the question proposed by the EM: whether the forex component of a private or domestic gain *would be taxable* under the CGT provisions.

Foundationally, it is important to discuss the nature of a bank account. In TD 2006/16, the Commissioner states that:

> “a bank account with a credit balance is a single chose in action representing the account holder’s right to be repaid the balance standing to the credit of their account. The net amount standing to the credit of such a bank account from time to time reflects all of the amounts deposited into and withdrawn from the account, including any exempt income deposited. However, the actual funds represented by that amount are beneficially owned by the bank and not the account holder. All the account holder has is a chose in action, being the right to receive the balance standing to the credit of their account, generally payable on demand.”

In ATO ID 2003/551, the ATO’s analysis is that, because a bank account is “one asset”:

> “each deposit adds to the cost base and reduced cost base whilst each withdrawal constitutes a part ending or part satisfaction of the debt asset. Each withdrawal will constitute a CGT Event C2 happening to the relevant part of the asset (the amount withdrawn).”

If that analysis is correct, when William transfers US$30 from his Wells Fargo account, he withdraws money triggering CGT event C2.

William’s capital proceeds in Australian dollar terms amount to $42 (US$30 x 1.42) compared with his cost base of $39 (US$30 x 1.33). William has a $3 capital gain.

One must then consider the possibility that William has an exempt capital gain because of the personal use asset exemption in s 118-10(3) ITAA97. Under that section, the capital gain William makes from a personal use asset, or part of the asset, is disregarded if the first element of the asset’s cost base is $10,000 or less.

William’s bank account (being a chose in action) should be a “personal use asset” if it is used or kept mainly for his personal use or enjoyment.[91]

The Commissioner may well accept that proposition based on the following analysis provided in a recent private ruling:[92]

> “The ordinary meaning of private is ‘belonging to or for the use of one particular person or group of people only’ and that of domestic, ‘relating to the running of the house or to family relations’. It is our view that whether a forex gain or loss from a bank is private or domestic is ultimately determined by the dominant purpose for

which the bank account is held. Other factors may be of assistance (but not determinative) include:

- The character of the right held by the taxpayer;
- The source of the funds used to open the account;
- The nature of the deposits and withdrawals from the account;
- The intention to earn interest from the account."

Because William has used his Wells Fargo bank account primarily for private or domestic purposes, the gain arising on CGT event C2 should be exempt if the first element of the asset's cost base is $10,000 or less.

The "asset" should be the bank account itself, being the single chose in action. The first element of the cost base of the chose in action should be the amount of money William deposited to open the bank account,[93] which is the view that the ATO takes on the matter.[94]

This appears to be good news for William because he recalls making an opening deposit of a few hundred dollars when he first arrived in San Francisco. However, because William became a resident of Australia after he opened his Wells Fargo account, he must apply the market value acquisition rule in s 855-45(2) ITAA97.

The first element of the cost base is the market value of the chose in action on the day William became resident (US$12,500). Consequently, he cannot treat the account as being an exempt personal use asset since the balance in the account on his residency day was more than A$10,000.

Finally, after a truly tortuous journey through Div 775 ITAA97, Div 855 ITAA97 and the CGT provisions, we find that William has a $3 assessable foreign exchange gain.

Example 1 (cont). Limited balance exemption

The need for a limited balance exemption was recognised when Div 775 was introduced. However, the requirement to make a prospective election to take advantage of the exemption creates obvious problems if a taxpayer cannot reasonably be aware of the option to make the election. Many returning Australians would not be.

Continuing the current analysis of example 1 above, William has the possibility of applying the limited balance test.[95] It would permit him to disregard forex gains and losses that arise on his account.

He can make an election if the account is a "qualifying forex account" and if that account and any other qualifying forex account covered by the election would have a combined balance of less than A$250,000.[96]

A "qualifying forex account" is any account which has the primary purpose of facilitating transactions,[97] precisely the purpose of William's Wells Fargo account. However, the election seems only capable of applying prospectively,[98] despite a previous attempt at reform which did not proceed.[99]

In this case, William did not know that he could have made the election.

It is disappointing to see that such issues have still not been addressed in almost 20 years. This is particularly so because, when Div 775 was introduced, the government noted that "compliance costs may be disproportionately high compared with the amount of taxation revenue concerned".[100]

Small bank accounts ought to be automatically exempted. The government should also recognise that the $250,000 limit was introduced 20 years ago.

Until Div 775 is completely rewritten, amendments should be made to significantly increase the limited balance threshold and apply the limited balance exemption automatically, unless the taxpayer elects otherwise.

Example 2. Revenue treatment of forex gains and losses

Another common problem is the inequity of treating foreign exchange gains and losses on revenue account when most returning Australians are not in business. Because of this treatment, mismatches arise, even for taxpayers of modest means.

A returning Australian may make a capital loss on foreign real estate but may also make a forex realisation gain on the repayment of a related bank loan. The forex realisation gain is ordinary income, but the capital loss on the sale of the real estate must be carried forward and quarantined.

Consider the example of Elena who moves to Australia from London.

At the time she returns to Australia, Elena has an apartment in London worth £400,000 (A$720,000) and has a UK bank loan of £200,000 (A$360,000).

A year later, she decides to sell the apartment, but the British pound has deteriorated against the Aussie dollar. Elena sells her London apartment for £400,000 but she receives only A$640,000, making an A$80,000 capital loss in Australia.

However, when she repays the UK bank loan, she makes a forex realisation gain of A$40,000 under forex realisation event 4.

This is clearly inequitable. Elena cannot offset the capital loss she makes on the property against the forex gain on the repayment of the loan.

Had exchange rates moved the other way, Elena could potentially have made a gain on the sale of the property and a deductible forex loss on the repayment of the bank loan.

That result would be overly favourable to Elena since she would receive the benefit of the 50% CGT discount on the capital gain, and the forex loss (not being a capital loss) could then be utilised against the discounted gain.

The foreign superannuation fund puzzle

Many returning Australians come home with retirement savings in overseas funds, and limited superannuation in Australia. Usually, that is not because of any deliberate strategy, but often because their overseas employment arrangements will come with contributions to in-country retirement schemes.

If a returning Australian is not able to roll their retirement savings into a complying Australian superannuation fund, they are at a comparative disadvantage to fellow Australians. The inequity in this area should be addressed, though calls for reform are not new. The Hugo report noted that:[101]

> "There is a need to investigate in some detail the 'transaction costs' of a return to Australia, including how superannuation and accumulated wealth generated overseas would be treated for taxation purposes in Australia."

In spirit, these vehicles are foreign superannuation funds, but often they do not benefit from that status under Australian tax law.

Instead of benefiting from the concessions in Div 305 ITAA97, they are instead treated as foreign trusts.

The benefit provided under Div 305 for a foreign fund which can be treated as a superannuation fund is clear.

First, the returning Australian has six months to roll over their benefits into a complying Australian superannuation fund without tax consequences.[102] Second, even if the foreign fund remains on foot, it is only the earnings post-residency[103] that will eventually be taxed on withdrawal.

An Australian who is taxed instead under s 99B ITAA36 on a distribution from a foreign retirement trust ends up being taxed on income received by the retirement fund well before they returned to Australia.[104] On most occasions, there would be no tax avoidance purpose that would warrant the application of s 99B.[105]

There is also the risk that amounts which should be exempt under the corpus exception to s 99B[106] might be treated as being taxable if sufficient records are not available. There is also the question of whether *both* employer and employee contributions to such funds would be considered corpus.

A public ruling on these and related issues is badly overdue in order to give taxpayers certainty, at least as far as common arrangements are concerned.

These issues affect large numbers of Australians abroad. The tens of thousands of Australians living in the US would assume that their US retirement plans would be treated as superannuation funds under Australian law, but that is not the case.

Under the *Superannuation Industry (Supervision) Act 1993* (Cth), a superannuation fund is a fund which is indefinitely continuing and which is a provident, benefit, superannuation or retirement fund.[107] That seems like a broad class of funds, but the current interpretation reduces the number of funds that can qualify.

The Commissioner's approach, bound by judicial precedent,[108] is to ascertain whether a scheme provides benefits to members that might not be considered retirement benefits from an Australian perspective — and to use the Australian "sole purpose test" as an interpretative standard.

The Commissioner has ruled privately that many common vehicles used by expatriates abroad for retirement savings are not considered "superannuation funds". For example, the Commissioner does not consider that a US 401(k) plan[109] or a US individual retirement account[110] can be considered superannuation funds. Hong Kong exempt occupational retirement schemes also do not seem to qualify,[111] nor does the Central Provident Fund in Singapore appear to qualify for superannuation fund treatment.[112]

The laborious and complex requirement to analyse the underlying trust deed of a foreign fund to ascertain whether it contains provisions which are wholly consistent with Australian superannuation funds is a significant burden to place on returning Australians.

Even if the returning Australian does have a foreign retirement plan which qualifies as a "superannuation fund", problems arise because of the recent introduction of contribution caps. That makes roll-overs into Australian funds a much more difficult and expensive proposition, if even possible.

Australia's policymakers are well aware that the portability of foreign retirement savings into Australia is desirable. However, the last time the issue was publicly examined was well before contribution caps were introduced.

In 2004, the Senate Inquiry[113] noted that:

> "workers in Australia are inevitably able to contribute to complying funds. If they choose to contribute to a non-complying fund, they may make this choice with a full appreciation of the taxation consequences. An expatriate, in most cases, will *not* have the choice of making contributions to an Australian complying superannuation fund. It therefore seems anomalous to press a tax disadvantage upon them."

Here, one is reminded of the favourable treatment of foreign equity distributions under Div 768 ITAA97.

Australia's policy is to permit Australian companies to remit foreign equity distributions from their offshore subsidiaries back to Australia without any corporate tax.[114] By corollary, why should individuals, particularly returning Australians, not be allowed to easily remit their foreign retirement savings without tax into the Australian superannuation system?

Moving forward

Simplicity and equity in tax policy and administration must be kept top of mind.

This article has shown that when tax laws are modified, very little thought is given to the impact on Australian expatriates. Sometimes their interests appear to be deliberately overlooked.

The new government has an opportunity to grasp the Australian expatriate challenge and differentiate itself from the previous government.

The most urgent matter would be to right the wrong perpetrated on the Australian diaspora by reinstating the main residence exemption. That would restore the reputation of government in expatriate circles and would prevent further casualties of law.

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10 Effective from 1 July 2003.

11 Effective 1 July 2019. Section 23AG ITAA36 was amended to remove the exemption of foreign employment income derived from continuous foreign service of more than 90 days.

12 These CGT changes have been the removal of the 50% CGT discount for foreign residents which took effect on 8 May 2012 and the removal of the main residence CGT exemption from 1 July 2020.

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15 For simplicity here, we ignore "permanent residents" who could also depart Australia.

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31 Ibid para 1.47.

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34 The Tax Institute has noted that in the 79-year period from 1930 to 2009, there were only 25 individual tax residency cases decided by the Administrative Appeals Tribunal and the courts. In the 10-year period from 2010 to 2020, there have been 56 individual tax residency cases.

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36 *Harding v FCT* [2018] FCA 837.

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40 The proposals appear to grant concessions to those who move overseas for employment purposes compared to those who may move overseas for other reasons.

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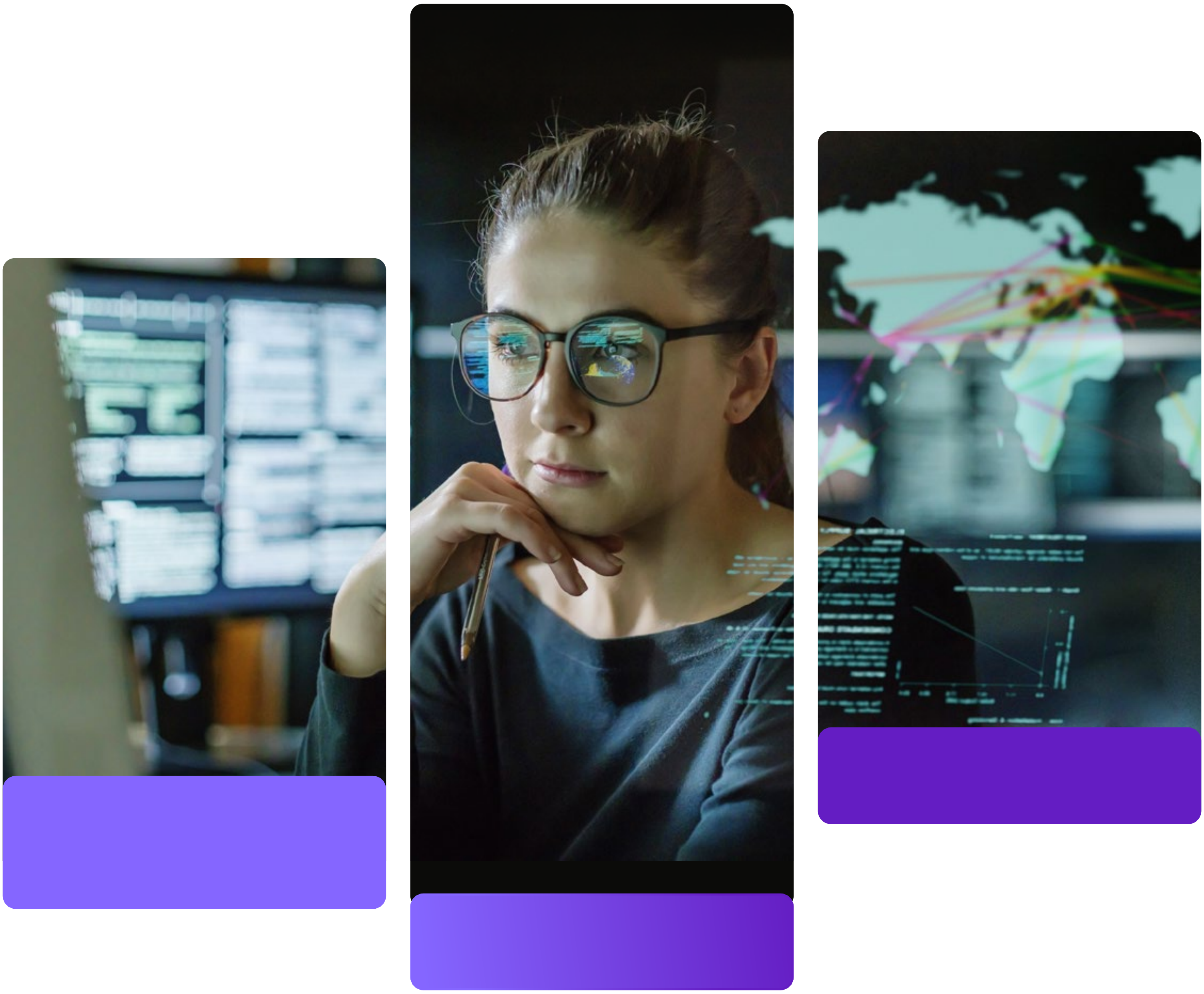


Section 100A and trust reimbursement agreements

by Mark West, CTA, Principal, West Garbutt

The provision of greater clarity and certainty around the operation of s 100A has not been progressed as far as may have been hoped by the issue of TR 2022/4. The opportunity has not been taken to correct positions reflected in TR 2022/D1 which are not grounded on the exact words of s 100A or the case law (old and new). These positions include how TR 2022/4 fails to recognise the *lack* of tax purpose as an *exclusion* from the structure of s 100A, rather than representing the *existence of* tax purpose being a *requirement*. Issues also remain around the meaning of "agreement". On the critical matter of what is "ordinary family dealing", TR 2022/4 has unhelpfully sought to "repackage", but still to maintain, the "predication test" reasoning from *Newton's* case (relating to tax purpose) by introducing the new concept of a "core test" with an excessive focus on tax objectives.

Overview

Section 100A of the *Income Tax Assessment Act 1936* (Cth) (ITAA36), a provision that has passed its 44th birthday (from its earliest effective date of 12 June 1978), has come into a new prominence in the last eight (plus) years. This has been since the release of certain examples by the ATO in 2014.

Over the years following those 2014 examples, there has been slow progress towards a public ATO ruling – recently issued in final in December 2022.

During those years, the ATO has been conducting audits, placing s 100A on centre stage for families that use trusts in their private and business/investment affairs.

This article seeks to provide an update of the current state of the ATO guidance and, most importantly, of the law on s 100A. It also seeks to provide some practical suggestions on how to manage risks surrounding s 100A, given the current state of the law.

As the author has advanced previously,[1] it is only by a disciplined analysis of the law relating to s 100A – of the exact words of the section – that taxpayers and the ATO will achieve greater certainty of the effect, and practical implications, of s 100A.

We have made progress, spurred on by recent case law, to a more disciplined adherence to the words of the section.

But we are not there yet.

Words and structure of s 100A

The key "operative" provision is s 100A(1) which deems a beneficiary to not be presently entitled to income of a trust estate where that entitlement arises out of a "reimbursement agreement":

> "(1) Where:
>
> (a) apart from this section, a beneficiary of a trust estate who is not under any legal disability is presently entitled to a share of the income of the trust estate; and
>
> (b) the present entitlement of the beneficiary to that share or to a part of that share of the income of the trust estate (which share or part, as the case may be, is in this subsection referred to as the ***relevant trust income***) *arose out of a reimbursement agreement or arose by reason of* any act, transaction or circumstance that occurred in connection with, or as a result of, a reimbursement agreement;
>
> the beneficiary shall, for the purposes of this Act, *be deemed not to be, and never to have been, presently entitled to the relevant trust income*." (emphasis added)

If s 100A applies, the amount of income to which the beneficiary is deemed not to be entitled to is taxed to the trustee at the trustee taxation rates. There is no amendment period restriction on s 100A.[2]

The nexus between the present entitlement subject to potential adjusted treatment (from taxation to the beneficiary to taxation of the trustee) and a "reimbursement agreement" is provided by way of the words "arose out of" or "arose by reason of".

From the start, it can therefore be noted, s 100A does not test the act of distributing to the beneficiary, including for some tax avoidance purpose. Section 100A asks:

- whether there is a "reimbursement agreement", as defined; and then
- whether the present entitlement "arose out of" or "arose by reason of" that agreement (or any act, transaction or circumstance that occurred in connection with, or as a result of, the agreement).

Section 100A(2) applies the same treatment as s 100A(1) to beneficiaries who have actually been paid amounts, or had amounts applied to their benefit from, the income of a trust estate. It is otherwise identical to s 100A(1) and it is not discussed separately in this article.

Sections 100A(3) to (6B) are specific mechanical provisions that are not directly relevant to the positions put forward in this article, but we will refer to them where relevant.

Section 100A(7) is the first of the key "interpretative" provision in s 100A:

> "(7) Subject to subsection (8), a reference in this section, in relation to a beneficiary of a trust estate, to a *reimbursement agreement* shall be read as a reference to an agreement, whether entered into before or after the commencement of this section, *that provides for* the payment of money or the transfer of property to, or the provision of services or other benefits for, a person or persons other than the beneficiary or the beneficiary and another person or other persons." (emphasis added)

A "reimbursement agreement" therefore is concerned with bringing about (providing for) a payment of money, transfer of property, provision of services or other benefit to a person other than the beneficiary that is presently entitled. (Case law discussed below[3] has indicated that there does not need to be an actual "reimbursement" *from* the beneficiary.)

This is a very wide potential scope.

Beneficiaries will always do things (referred to as "actions or outcomes" in this article) in the normal course of consuming or otherwise directing the use of their trust entitlement that involve giving money to, benefitting etc other persons. For example, even if a beneficiary receives their trust entitlement fully in cash, the beneficiary will make payments and transfers to other people as they spend that entitlement.

The key points from s 100A(1) and (7) are whether there is an "agreement", as defined:

- that provides for these things – the actions or outcomes; and
- out of which, or by reason of which, the subject trust entitlement arose.

Section 100A(8) modifies s 100A(7) to exclude agreements *without* a tax purpose:

> "(8) A reference in subsection (7) to an agreement shall be read as *not* including a reference to an agreement that was *not* entered into for the purpose, or for purposes that included the purpose, of securing that *a person who, if the agreement had not been entered into, would have been liable to pay income tax* in respect of a year of income would *not be liable to pay income tax* in respect of that year of income or would *be liable to pay less income tax* in respect of that year of income than that person would have been liable to pay if the agreement had not been entered into." (emphasis added)

That s 100A(8) must be read with s 100A(9):

> "(9) For the purposes of subsection (8), an agreement shall be taken to have been entered into for a particular purpose, or for purposes that included a particular purpose, *if any of the parties to the agreement* entered into the agreement for that purpose, or for purposes that included that purpose, as the case may be." (emphasis added)

Therefore, a "reimbursement agreement" will not exist where the agreement was not entered into for the purpose (either sole or with other purposes) of reducing the income tax payable of a person.

The "person" does not have to be the beneficiary presently entitled, the person receiving benefits under s 100A(7), or any other specific person.

The exclusion will *not* apply if *any* of the parties to the agreement had a tax avoidance purpose.

This is the sole mention of tax purpose in s 100A – as an *exclusion* based on *lack* of tax purpose. On the words of s 100A, tax purpose does *not cause inclusion* of any "agreements", as defined.

Sections 100A(10) to (12) are further interpretative provisions noting that loans and the releases of debts are benefits or payments, and that references to a person include references to the person as trustee.

Section 100A(13) is a further critical subsection to consider in detail, because it:

- sets out a very wide meaning of an "agreement" which, in turn, causes the concept of "reimbursement agreement" to be very wide; and then
- contains what are the substantive exclusions from that resulting wide scope of "reimbursement agreement".

Section 100A(13) defines agreement to be:

> "any *agreement, arrangement or understanding*, whether formal or informal, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings, but does *not* include an agreement, arrangement or understanding *entered into in the course of ordinary family or commercial dealing*." (emphasis added)

Section 100A(13) gives the basis of what is commonly referred to as the "ordinary family dealing" or "ordinary commercial dealing" exceptions to s 100A.

There is some case law about the ordinary commercial dealing exclusion but there is very limited case law about the ordinary family dealing exclusion.

There is fundamental disagreement between some taxpayers and the ATO about the interpretation of this ordinary family dealing exclusion, partly over how much of the meaning of the term "ordinary family dealing" in s 100A can properly be drawn from *Newton's* case[4] from which the wording appears to have been derived.[5] This is discussed below.

Suggested flow or step chart

Following the logic of the structure flowing from the words of s 100A, a flow or step chart for applying the section is represented in Table 1.

Table 1. Logical flowchart of s 100A

Step	Section reference	Description	If yes	If no
1	Section 100A(1)(a)	Is there a beneficiary of a trust estate, who is not under a legal disability, who is presently entitled to a share of the income of the trust estate?	Move to step 2	Section 100A does not apply
2	Section 100A(13): definition of "agreement"	Is there an "agreement, arrangement or understanding"?	Move to step 3	Section 100A does not apply
3	Section 100A(7): definition of "reimbursement agreement"	Did the agreement *provide for* a payment or transfer of property to another person other than the beneficiary?	Move to step 4	Section 100A does not apply
4	Section 100A(8): no tax purpose exclusion from the definition of "agreement"	Was the agreement *not* entered into for the purpose of reducing the income tax payable of "a person"?	The arrangement is not a "reimbursement agreement" and s 100A does not apply	Move to step 5
5	Section 100A(13): ordinary dealing exclusion from the definition of "agreement"	Was the agreement entered into in the course of ordinary family dealings or ordinary commercial dealings?	The arrangement is not an "agreement" and s 100A does not apply	Move to step 6
6	Section 100A(1)(b)	Did the beneficiary's entitlement *arise out of* the reimbursement agreement?	Section 100A applies	Section 100A does not apply

Put another way, the questions in respect of a trust entitlement (step 1 in Table 1) are:

- whether there is a "reimbursement agreement" (steps 2 and 3 in Table 1) – but *excluding*: (a) where there is no tax purpose (step 4 in Table 1), and (b) where there is an ordinary family or commercial dealing (step 5 in Table 1); and then
- whether the present entitlement "arose out of" or "arose by reason of" that agreement (or any act, transaction or circumstance that occurred in connection with, or as a result of, the agreement) (step 6 in Table 1).

Preview of ATO approach

It is useful to jump forward, briefly, to note that the current ATO approach, discussed below in more detail, as now reflected in TR 2022/4, roughly (but not exactly) corresponds with the steps outlined in Table 1 by stating the "requirements" and "exceptions" per para 5 of TR 2022/4 as:

> "• The following 3 requirements are satisfied:
>
> - 'Connection requirement' … [being steps 2 and 6 in Table 1];
> - 'Benefit to another requirement' … [being 3 in Table 1];
> - 'Tax reduction purpose requirement' … [being 4 in Table 1]; and
>
> • The 'ordinary dealing exception' is not satisfied … [being 5 in Table 1]."

It is explained below that the grouping of the steps this way, particularly the characterisation by the ATO of tax purpose matters as relating to a requirement rather than acknowledging the absence of tax purpose as an exception (just like the ordinary dealing exception), is significant.

The grouping in TR 2022/4 of the meaning "agreement" (step 2) with the "arose out of" requirement (step 6) also tends to distract from the primacy, and starting point, of the existence of a "reimbursement agreement" (the combination of steps 2 and 3) under the structure of s 100A – before any consideration of the exclusions in steps 4 (no tax purpose) and 5 (ordinary dealing). Such re-grouping by the ATO in TR 2022/4 appears to be an attempt to promote a focus on tax purpose.

The current ATO guidance

The current ATO guidance is TR 2022/4, together with PCG 2022/2.

History

The history of the current ATO guidance on s 100A starts with the administrative position published on the ATO website in July 2014, titled *Trust taxation – reimbursement agreement*[6] (which is still referred to at para 54 of PCG 2022/2 under "Date of effect"), on the basis that the ATO will "stand by" that 2014 administrative position if more favourable to a taxpayer's circumstances for entitlements arising before 1 July 2022.

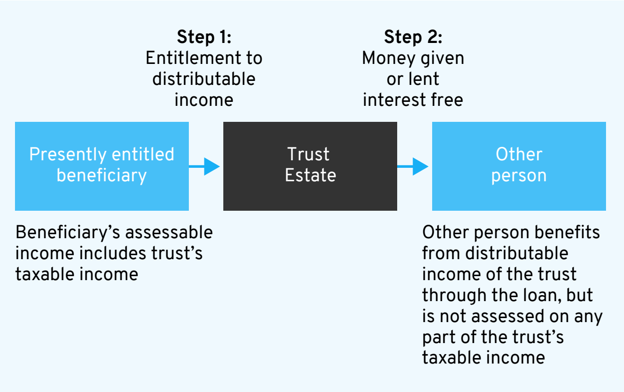
This a fairly meaningless concession. The July 2014 ATO guidance made general statements and did not state a reasoned legal basis for the ATO views. It was more in the nature of an "ambit claim".

Example 1 of that July 2014 guidance includes the following:

> **"Example 1 – trust estate**
>
> The trustee of a trust estate makes a beneficiary entitled to trust income.
>
> Instead of paying the amount of trust income to the beneficiary, the trustee gives, or lends on interest-free terms, the money to another person. The other person

benefits from the trust income but is not assessed on any part of it.

The arrangement does not constitute ordinary commercial or family dealing.



This arrangement would generally constitute a reimbursement agreement *if it was intended that the beneficiary who was made presently entitled to the trust income pays a lower amount of tax than would have been payable by the person who actually enjoyed the economic benefits of that income*." (emphasis added)

Consistent with the sense of this example, from 2014, the ATO's focus has been to seek to interpret s 100A by reference to tax purpose. (The other family dealing examples offered in 2014 were uncontroversial, being related to a trust established under will and to family lending at commercial terms.)

The ATO commenced audits on this basis, some of which are still ongoing or are at objection stage.

However, taxpayers had to wait until 23 February 2022 before the ATO was prepared to provide a public statement of the claimed *legal basis* for its views, by way of TR 2022/D1 and accompanying PCG 2022/D1. This is despite the ATO promising since October 2018 to provide such a draft ruling. The long history of the repeatedly deferred estimated dates for delivery of the draft ruling has since been (unhelpfully, for taxpayers) deleted from the ATO website.

During this time, taxpayers under audit also experienced delays with the issue of ATO position papers. When ultimately provided, such position papers were described as the "TCN approved view", in advance of the issue of TR 2022/D1.

The author is aware of such audit position papers being issued in December 2020, a very long time after the July 2014 ATO guidance and numerous earlier promised dates for the draft ruling.

The long delay in the public issue of TR 2022/D1 is difficult to understand, when audits had already been commenced.

When finally issued, TR 2022/D1 sought to accommodate the ATO's views to the decision of Logan J in *Guardian AIT Pty Ltd ATF Australian Investment Trust v FCT*,[7] but noted that the decision was on appeal and, in parts, maintained alternative views.

TR 2022/4 and PCG 2022/2, as issued on 8 December 2022, include material differences from TR 2022/D1 and PCG 2022/D1, largely due to the ATO seeking to accommodate the decision of Thawley J in *BBlood Enterprises Pty Ltd v FCT*.[8]

Not long after the issue of TR 2022/4, the Full Federal Court appeal in *FCT v Guardian AIT Pty Ltd ATF Australian Investment Trust*[9] was handed down.

The ATO issued a decision impact statement on the *Guardian* Full Court appeal decision (on 24 April 2023). In terms of s 100A, little change to TR 2022/4 is proposed, only clarifications:

- to take account of the Full Court's observations on the adoption of plans or recommendations from advisers; and
- that a beneficiary must be a party to the agreement where payment of money to the beneficiary is proposed so that the beneficiary must "do something", such as on-pay or direct payment to others.

All of this history has been difficult for taxpayers under audit.

Where exactly do the ATO views sit now, per TR 2022/4?

TR 2022/4: general approach

Paragraph 5 of TR 2022/4 sets out the ATO approach at the highest level. Fully extracted, that paragraph states:

"5. This Ruling provides the Commissioner's view about these arrangements and the 4 basic requirements for section 100A to apply, namely that:

- The following 3 requirements are satisfied:
  - '*Connection requirement*' – broadly stated, the present entitlement (or amount paid or applied for the benefit of the beneficiary) must have arisen out of, as a result of or in connection with a reimbursement agreement (being an *agreement, understanding or arrangement* that has the 3 qualities described in the following points in this paragraph).
  - '*Benefit to another requirement*' – the agreement must provide for the payment of money or transfer of property to, or provision of services or other benefits for, a person other than that beneficiary.
  - '*Tax reduction purpose requirement*' – a purpose of one or more of the parties to the agreement must be that a person would be liable to pay less income tax for a year of income.
- The '*ordinary dealing exception*' is not satisfied – the agreement must not be one that has been 'entered into in the course of ordinary family or commercial dealing'." (emphasis added)

More comment is made below (under "Issues with ATO guidance") but, at this point and as already foreshadowed above, it can be noted that stating the structure of s 100A this way – particularly the characterisation by the ATO of tax purpose matters as relating to a *requirement* rather than acknowledging the absence of tax purpose as an *exception* (just like the ordinary dealing exception) – does not accord with the words of s 100A.

The grouping in TR 2022/4 of the meaning of "agreement" with the "arose out of" requirement also tends to distract from the primacy, and starting point, of the existence of a "reimbursement agreement" under the structure of s 100A – *before* any consideration of the exceptions for no tax purpose and for ordinary dealing. It is reasonable to expect that adherence to the *exact structure* and the *exact words* of s 100A would provide the most reliable guidance.

As already noted, such departure from the *exact words* and *exact structure* of s 100A in TR 2022/4 appears to be an attempt to promote a focus on *tax purpose*.

Agreement

In paras 66 to 70 of Appendix 1 to TR 2022/4, the widest possible approach to the existence of an agreement is taken, relying sometimes on case law from former s 260 ITAA36 and other provisions. There appears to be an intention to regard repeated cooperation, such as occurs within families, as constituting an agreement.

This is particularly evident from comments in paras 69 and 70 about such matters as tacit adoption, concerted action, an understanding over a period of time:

> "69. Consistent with the approaches of the Courts where the meaning of the words agreement, arrangement or understanding have been otherwise considered:
>
> …
>
> - While an 'arrangement or understanding' must have been entered into consensually, the parties' acceptance or adoption may be tacit and it is not essential that they be committed or bound to support it. The arrangement may be both informal and unenforceable, and the parties may be free to withdraw from it or to act inconsistently with it, notwithstanding their adoption of it. An arrangement or understanding may lack formality and precision.
>
> 70. An agreement could be:
>
> - informal concerted action by which 2 or more parties may arrange their affairs towards a purpose; an example in the particular context of section 100A would be an 'arrangement or understanding' that the beneficiary would act in accordance with the wishes of another person or group, or
> - an understanding that the parties will implement a series of steps undertaken individually or collectively by those parties over a period of time, or
> - the actual implementation of such a series of steps." (footnotes omitted)

Further, at para 74, emphasis on conduct before and after the time an entitlement arises seeks to extend what will constitute an agreement:

> "74. Where a present entitlement arises from an agreement or a payment or application of trust income results from an agreement, naturally, the relevant agreement must be in existence at the time when the present entitlement arises or the payment is made or funds applied. However, the existence of that agreement might be established by evidence of the conduct of the parties before and after that time." (footnotes omitted)

As noted above from the decision impact statement since issued on the *Guardian* Full Court appeal decision, the ATO will need to modify some of its comments[10] to allow for the *Guardian* appeal decision in which it was held that a beneficiary ordinarily needs to be a part of the agreement where a payment to the beneficiary, and accordingly some payment *by* the beneficiary, is proposed as part of the agreement.[11]

Connection requirement

The breadth of the ATO's view about a present entitlement arising from a reimbursement agreement is probably best summarised in para 73 of TR 2022/4:

> "73. It is sufficient for there to be a connection between the reimbursement agreement and some other act, transaction or circumstance from which the entitlement has arisen. If the beneficiary's present entitlement or the payment or application of income to or for them was *one of the consequences of* any act, transaction or circumstance that occurred in 'connection with' or 'as a result of' the reimbursement agreement, this aspect of subsections 100A(1) or (2) would be satisfied. The existence of such a connection will depend on the facts of a particular case." (footnotes omitted and emphasis added)

Taxpayers should take care about the evidence that they should retain and be able to present, when addressing the onus the ATO will demand be satisfied in respect of claims about what would have been distributed to the beneficiary absent any reimbursement agreement:

> "76. The taxpayer has the onus of establishing a reasonable expectation that the beneficiary would have been presently entitled to the original amount if the reimbursement agreement had not been entered into. A 'reasonable expectation' requires more than a possibility. It involves a prediction as to events which would have taken place if the reimbursement agreement had not been entered into. The prediction must be sufficiently reliable for it to be regarded as 'reasonable'." (footnotes omitted)

Benefits to another

The wide scope of how a benefit may arise to someone other than the beneficiary is set out in paras 79 and 80 of TR 2022/4. This includes (consistent with the *BBlood* decision, commented on below) that a reimbursement agreement does not need to involve a payment *to*, and so a "reimbursement" back *from*, a beneficiary:

> "79. Subsection 100A(7) does not limit who can be the provider of the money, property, services or other benefits. It also does not require that a benefit be provided directly.

80. Similarly, it is not a requirement of subsection 100A(7) that the 'relevant trust income', to which the beneficiary is presently entitled or has paid or applied for their benefit, also be the precise form or amount of the benefits that are provided to another person under the agreement. It is sufficient that someone other than the beneficiary benefits, such as by the provision of money, property, services or other benefits, whether directly or indirectly procured by (or in connection to or as result of) the beneficiary's present entitlement (or the income paid or applied for the beneficiary)."

Tax reduction purpose

The ATO adopts from the words of s 100A(8) (and from the *BBlood* decision commented on below) a view that it is the tax "purpose of one or more parties to the agreement"[12] that is relevant, not the tax *purpose or effect* of the agreement.

Paragraphs 84 and 85 of TR 2022/4 summarise the narrowness of the bases on which a tax purpose may be taken *not* to exist:

"84. An agreement is entered into for a tax reduction purpose if any of the parties to the agreement entered into the agreement for that purpose. For there to be a tax reduction purpose, it is not necessary that an alternative postulate be established, so as to identify a specific amount of tax that would be avoided by an identified person, though such matters may be identifiable in many cases. In *BBlood*, Thawley J observed that:

In the context of a discretionary trust for example, where a trustee has very broad discretions, it would often be difficult, if not impossible, to say with certainty what would have occurred were it not for the relevant agreement.

85. To meet the tax reduction purpose requirement:

- the person whose tax liability is to be reduced or eliminated need not be a party to the reimbursement agreement
- the income tax liability to be reduced can be in relation to any year of income, meaning that a purpose of deferring tax to a later year would be sufficient to demonstrate the tax reduction purpose
- a person can have a purpose of securing a reduction in tax for subsection 100A(8) even where that purpose is not achieved or ceases to be held at some time following the entry into the agreement
- there is also no requirement that the tax reduction purpose be the sole or dominant purpose of the party or parties for entering into the agreement. It need only be one of the purposes of the relevant party or parties for entering into the agreement." (footnotes omitted)

Ordinary dealing

As for TR 2022/D1, the ATO's views on the ordinary dealing exception are likely to remain the most contested parts of TR 2022/4 – especially about what is in the course of ordinary *family* dealing.

The Appendix to this article extracts, for comparison, the ATO's "old" comments in TR 2022/D1 and its "new" comments in TR 2022/4 in response to the "alternative view" that tax avoidance (the way the ATO refers to tax purpose) is not relevant to the ordinary dealing exception. (The author found particularly surprising the prior ATO statement at para 163 of TR 2022/D1 presuming to identify the "contemporary meaning" adopted by parliament, without *any* reference to the principles of statutory interpretation. That statement has been removed in TR 2022/4 without explanation, or acknowledgment of its error.)

The ATO has had to adapt its views expressed in TR 2022/D1 as a consequence of the *BBlood* decision.

In TR 2022/D1, the ATO sought to directly apply the predication test from *Newton v FCT*[13] as the meaning of "entered into in the course of ordinary family or commercial dealing" in s 100A.[14]

Because Thawley J in *BBlood* did not mention *Newton* in his reasoning on the ordinary family or commercial dealing exclusion, the ATO has, in TR 2022/4, altered its reasoning to be about a supposed "core test" of family and commercial objectives:[15]

"98. The core test is that ordinary family or commercial dealing is explained by the family or commercial objectives that the dealing will achieve …"

The ATO still seeks, albeit less directly, to rely on the *Newton* reasoning by making those objectives primarily about tax purpose, as illustrated by paras 99 and 100:

"99. The method for applying the core test is to ask whether a dealing can be explained by, or is founded in, the achievement of family or commercial objectives. *In one sense, this closely parallels the predication test* in former section 260, first expressed in *Newton* and applied in later High Court authorities on that section. Under the predication test, as originally formulated by Lord Denning on behalf of the Judicial Committee of the Privy Council, for the Commissioner to establish that an arrangement had the purpose or effect of avoiding tax, that purpose had to appear on the face of the arrangement. If having regard to the overt acts by which an arrangement was implemented, it was 'capable of explanation by reference to ordinary business of family dealing, without necessarily being labelled as a means to avoid tax', section 260 would not apply.

100. The Courts that have considered section 100A and observed that the wording of the ordinary family or commercial dealing test derives from the decision in *Newton* have also cautioned that there are differences in the statutory tests as between sections 100A and 260. *Notwithstanding these differences, the principles drawn from the authorities on former section 260 can be helpful in demonstrating whether family or commercial objectives explain, found or (to adapt the language of the section 260 cases) are the predicate of the dealing to which the core test is being applied.*" (footnotes omitted and emphasis added)

In expounding these (new) views about family or commercial *objectives*:

- the core test is stated to involve "an inquiry into what the objectives of the dealing are, whether the transactions achieve that objective and whether they are better explained by achieving some other objective";[16]
- it is maintained that *lack of artificiality* does *not* make a dealing *ordinary*;[17]
- but contrivance, artificiality, (excessive) complexity and being tax-driven are advanced as pointing against ordinariness.[18]

In essence, the dichotomy (from *Newton*) that a dealing cannot be both tax-driven and be ordinary is sought to be maintained.[19]

Paragraphs 106 and 107 set out instances (of an arrangement) which call for close examination of whether the contrivance, artificiality, (excessive) complexity and tax-driven factors — that indicate non-ordinariness — exist:

> "• the manner in which an arrangement is carried out has contrived or artificial features
>
> • family or commercial objectives could have been achieved more directly; for example, could the arrangement instead have simply or directly provided the benefit to the person who actually benefited, such as by making that person presently entitled to trust income
>
> • the complexity of the arrangement and the presence of additional steps that achieve no commercial purpose
>
> • the conduct of the arrangement is inconsistent with the legal and economic consequences of the beneficiary's entitlement (such as an asset or funds representing the entitlement are purportedly lent to others without any intention of being repaid).
>
> 107. Where income entitlements have actually been remitted to the beneficiary, amounts were subsequently returned or other benefits or services were provided, by way of gift or otherwise to another person (such as the trustee, another beneficiary or an associate, whether by the beneficiary or by the trustee either independently or under a power of attorney)."

The ATO repeats from TR 2022/D1, and elevates to an example in TR 2022/4, a family member's medical costs as a contextual fact for family objectives accepted as *not extraordinary*:[20]

> "Example 1 – identifying family objectives
>
> 96. In an income year, family members agree to gift their trust distributions to one family member, Paul, who has significant medical bills. The arrangement is implemented via trust distributions to the family members and a gift by each of them to Paul. That Paul has significant medical bills is not a part of the agreement; however, it is a highly relevant contextual fact which demonstrates the content of the family objectives."

The ATO introduces, in paras 109 to 113 of TR 2022/4, the idea (and examples) of cultural factors that may explain gifting between family members:

> "109. The test is objective. Cultural factors inform the question whether a dealing is to achieve family or commercial objectives.
>
> Example 2 – cultural practice of gifting
>
> 110. Azra is a member of an extended family whose members' cultural values include grandparents gifting money or goods to younger members of the family during the festive season. This cultural practice is relevant in considering whether transactions that involve Azra gifting money to her grandchildren out of funds from a trust distribution she has received have been entered into in the course of ordinary family or commercial dealing.
>
> Example 3 – cultural practice to support older relatives
>
> 111. Jack lives by the practices that have been common for centuries in the culture that he draws his heritage from. One of those practices is that children will meet the needs for shelter and living of their parents and other older relatives when they are no longer participating in the workforce. This is founded in notions of respect for elders and is practiced irrespective of what means those relatives would have to fund their own needs from available resources. This cultural practice is relevant in considering whether Jack's direction to the trustee of a trust to apply his entitlements to meet mortgage repayments for his aunt, who has retired from her employment working in a factory, is in the course of ordinary family or commercial dealing.
>
> 112. Cultural factors refer to the distinct and observable ideas, customs or practices of people or certain groups within a society. The existence of a cultural factor which is not widely understood in the broader community can be demonstrated by evidence. As the core test is applied to the whole of the agreement, rather than the individual steps, whether the presence of a cultural factor determines if a dealing is entered into in the course of ordinary family or commercial dealing will depend on the facts of the case.
>
> Example 4 – cultural practice of not accepting entitlement
>
> 113. Max and the trustee of a trust he controls agree to distribute certain income of the trust to Asher, a non-resident who for religious reasons will not accept the entitlement. While Asher's beliefs are a cultural factor that explains why the entitlement will not be called for, in these circumstances they do not, without more, explain the objectives for making the resolution to distribute in the first place."

These cultural examples are the closest that the ATO comes to directly addressing whether "simple" family sharing or joint consumption of income/assets is ordinary. Even then, the favourable examples[21] are heavily limited by:

- gifting during a festive season; and
- the gift being made irrespective of what means the giftee relative would have to fund their own needs – and described as based on a practice that has been "common for centuries"!

Update on the case law

BBlood[22]

It should first be noted that the *BBlood* decision is on appeal to the Full Federal Court (the hearing for which has been held).

Example 11 in TR 2022/4 appears to relate to the type of arrangement dealt with in *BBlood*.

While the taxpayer in this case was unsuccessful, in the author's view the reasoning adopted by Thawley J in his decision is very helpful to taxpayers in general, particularly by providing some clear guidance in respect of the exclusion from an agreement under s 100A(13) of "an agreement, arrangement or understanding entered into in the course of ordinary family or commercial dealing". The following comments focus on what was held regarding that ordinary dealing exception.

It is sufficient for present purposes to note the arrangement as:

- one in which the terms of a trust, through which a share buy-back was later passed, were amended;
- those amendments caused the share buy-back amount, treated as an assessable dividend for tax purposes but which was capital for general trust purposes, to be retained in the trust as capital;
- the tax liability for the assessable dividend amount passed to a company beneficiary as part of the net income of the trust, so that, with franking credits, tax was limited (ie no "top-up" tax over the company rate was paid); and
- the capital amount was later passed out to individuals without further tax.

After stating the provisions of s 100A,[23] Thawley J identified the issues raised for the potential application of s 100A as follows:[24]

> "76. The issues raised by s 100A in its potential application to the present case include:
>
> (1) Issue 2(1): whether there was an *agreement, arrangement or understanding* and, if so, whether it included the 'initiation of' and 'planning for' the Illuka Park steps as opposed to the agreement to implement, and implementation, of the transaction;
>
> (2) Issue 2(2): whether the agreement, arrangement or understanding was *entered into in the course of ordinary family or commercial dealing*;
>
> (3) Issue 2(3): whether a '*reimbursement agreement*' for the purposes of s 100A requires that the 'payment' referred to in s 100A(7) be, in substance, a reimbursement for the relevant beneficiary being made presently entitled to the income of the trust;
>
> (4) Issue 2(4): whether, in the terms of s 100A(8) and (9), any party to the 'agreement' entered into the agreement for the *purpose*, or for purposes that included the purpose, of securing that a person who, if the agreement had not been entered into, would have been liable to pay income tax in respect of a year of income would not be liable to pay income tax in respect of that year of income or would be liable to pay *less income tax* in respect of that year of income than that person would have been liable to pay if the agreement had not been entered into;
>
> (5) Issue 2(5): whether, in the terms of s 100A(1)(b), any or all of BE Co's present entitlement to income of the IP Trust *arose out of* the 'reimbursement agreement' (if there was one) or arose by reason of any act transaction or circumstance that occurred in connection with, or as a result of the reimbursement agreement." (emphasis added)

Thawley J *did not mix* the questions of:

- agreement, and
- arose out of,

as the ATO does in TR 2022/4 and, in his following analysis, treated *both* the matters of:

- ordinary dealing, and
- tax purpose,

as *separate* exceptions, in accordance with the words of s 100A.

Agreement

Regarding an agreement, it was held[25] that the "Iluka steps"[26] were an agreement within s 100A(13). But Thawley J rejected ATO submissions that initiation and planning were part of the agreement,[27] stating:

> "90. There either is or is not an 'agreement' (which can include a non-legally binding 'understanding') within the meaning of s 100A(13). If the Commissioner contends that there is one, he should identify it. A statement that the 'agreement' includes 'initiation' and 'planning' says nothing about what the contended 'agreement' is …"

Ordinary family or commercial dealing

Regarding the ordinary dealing exception, Thawley J first directs attention[28] to the relevant statutory question as being whether:

- the agreement was entered into in the course of ordinary family or commercial dealing. He stresses that it is not whether individual steps carried out in implementing the agreement, viewed in isolation, could be characterised as steps entered into in the course of ordinary family or commercial dealing; and
- the agreement was entered into in the course of ordinary family or commercial dealing, not whether the agreement was an ordinary family or commercial dealing.

It is made clear[29] that individual steps might be considered, but the statutory question is different.

Second, Thawley J acknowledges[30] that this statutory question "is distinct to the inquiry about purpose required by s 100A(8) and (9)" and then explains[31] some matters that may be looked at when determining the statutory question.

Those matters include:

- what is "said to be" the object to be achieved by a dealing — in the course of which the relevant agreement was entered into;
- the relevance, to the claimed object, of particular steps under the agreement;
- whether particular steps might be explained by objectives different to the objectives "said to be" behind the ordinary or commercial dealing;
- that a dealing might not be an ordinary family or commercial dealing if it is overly contrived, or artificial; and
- that a dealing might not be an ordinary family or commercial dealing if it involves more than is required to achieve the relevant objective, such as additional steps not necessary to achieving the (claimed) objective.

It is noteworthy that no mention of the decision in *Newton v FCT*[32] is made by Thawley J in relation to s 100A(13).

Third, consistent with these observations about tax purpose, when explaining[33] the relevance of the decision in *FCT v Prestige Motors Pty Ltd*[34] to determining the relevant statutory question under s 100A(13), Thawley J is careful not to refer to tax purpose as the determining factor but to instead cite the references made in *Prestige Motors* to an absence of:

- "commercial motivation" for one transaction;[35]
- "commercial justification", leaving "the only explanation for the entry into the agreement as the elimination or reduction of tax liabilities";[36] and
- "commercial necessity or justification for the transaction" or "commercial reason to raise capital from outside the group".[37]

Ultimately, Thawley J held that the arrangements were not entered into in the course of ordinary family or commercial dealing after he considered the various attributes of the arrangement as a whole — which included, but was not limited to, its objectives.

It is worth extracting the relevant paragraphs[38] in full, given their importance as direct authority on the ordinary dealing question:

> "100. The agreement comprising the Illuka Park steps as a whole was not an agreement 'entered into in the course of ordinary family or commercial dealing'. Nor was the agreement to implement the Illuka Park steps. Whether the agreement is viewed as the agreement to enter into the steps, or the steps as a whole, *the agreement was unusual*. Its *complexity was not shown to be necessary to achieving a specific outcome* sought to be achieved by a dealing aptly described as 'an ordinary family or commercial dealing'. It was *not explicable*, for example, as having been entered into *for family succession purposes. Nor* was it explicable as having been entered into as part of an ordinary commercial dealing.
>
> 101. As I have said, whilst it may be relevant to the statutory inquiry, it is *not necessarily persuasive that an individual step can be seen to be 'ordinary'*. Viewed in isolation, the generation of income in IP Co of about $300,000 might be something done in the course of an ordinary family or commercial dealing. Even that is doubtful because this was the *first time this had occurred and was accordingly not consistent with the historical behaviour of the parties*. Moreover, this component of the Illuka Park steps does not suggest that the agreement to implement the Illuka Park steps or the agreement comprising all of the Illuka Park steps were 'ordinary'.
>
> 102. It might be said that a buy-back is an ordinary commercial transaction. The statutory question, however, is whether the agreement as a whole was entered into in the course of an 'ordinary family or commercial dealing'. In any event, even viewed in isolation, the applicants *did not establish a sensible commercial or family rationale for adopting the buy-back procedure*. As is explained further below, the explanations given for the buy-back component of the agreement are unlikely. The buy-back was *not conducted for the purpose of simplifying the corporate structure as suggested. Nor was it done for succession planning purposes as suggested.*
>
> 103. It might be said that the *variations to the IP Trust Deed* were, viewed in isolation, an ordinary family or commercial transaction. Although relevant, that is not the issue. *The issue is whether the agreement as a whole was entered into in the course of a family or commercial dealing.*
>
> 104. Having examined the agreement as a whole, I am not satisfied that the agreement to implement the Illuka Park steps was an agreement which was entered into in the course of ordinary family or commercial dealing. I am also not satisfied that the agreement comprised of the Illuka Park steps as a whole was an agreement which was entered into in the course of ordinary family or commercial dealing." (emphasis added)

Tax purpose

There was extensive reasoning stated in respect of tax purpose.[39] It is sufficient to say here that the exclusion was held to be a narrow one, a summary of which may be drawn from the following extract:[40]

> "162. This language is broad, focussing simply on the question of whether the purpose was of securing that 'a person' in 'a year' of income pay either no tax when that person otherwise would have or less tax than that person otherwise would have paid.
>
> 163. Section 100A(8) does not expressly or implicitly require identification of what income tax would have been payable or necessarily by whom or in which year …"

Guardian Full Federal Court appeal[41]

Regarding s 100A, the most important reasoning the Full Federal Court appeal decision has added to that of the earlier (single judge) *Guardian* decision by Logan J, is the reasoning supporting there being no agreement within the meaning of s 100A(13) – and accordingly that there could not be any "reimbursement agreement" for the purposes of s 100A(7).[42]

An interesting part of the Full Court's reasoning was a rejection of the ATO's arguments seeking to draw on Pt IVA ITAA36 case law, about attributing the purpose of an adviser to a client, to support the client being a party to an agreement.[43] This point is acknowledged in the ATO's decision impact statement on the decision.

The reasoning incidentally highlighted the important difference between Pt IVA and s 100A – that the focus of s 100A is on the *existence of a relevant agreement, not on purpose*:[44]

> "123. … the entire object of s 177D is to require a conclusion be drawn in respect of the purpose of a party based on the factors specified in s 177D. That purpose is not the party's actual subjective purpose but an attributed purpose …
>
> 124. The inquiry in relation to the existence of a reimbursement agreement in s 100A is different. It requires the existence of an 'agreement' (as defined in s 100A(10)[sic]) invoking, as it does, a requirement of *consensus and adoption*. The scope for attribution in that context is far more limited." (emphasis added)

Also, regarding expectation versus agreement:[45]

> "111. … By contrast, an *expectation* that an arrangement *will be entered* into after the creation of the present entitlement is not sufficient for the purposes of s 100A …"

Issues with ATO guidance

Compendium to TR 2022/4

When considering the issues raised below regarding TR 2022/4, the compendium to TR 2022/4[46] (providing ATO responses to comments received on TR 2022/D1) can be a useful source of additional insight into the ATO reasoning underlying TR 2022/4. This is particularly so because some of the issues raised are matters that were also raised in respect of TR 2022/D1, but which the ATO has not accepted or to which the ATO has not fully responded.

Approach in TR 2022/4

As already discussed above, there is a reason to question the ATO's overall approach as set out in para 5 of TR 2022/4, of:

> "• The following 3 requirements are satisfied:
>   - 'Connection requirement' … ;
>   - 'Benefit to another requirement' … ;
>   - 'Tax reduction purpose requirement' … ; and
> - The 'ordinary dealing exception' is not satisfied …"

It is true that these bullet points also appeared, but as *equal* points, in TR 2022/D1 (and, with hindsight, did not get the attention deserved at that time). But, in TR 2022/4, the ATO has sought to exaggerate the incorrect distinction between tax purpose as a requirement and the ordinary dealing as an exception, by the grouping the three requirements together but separately from what is represented as a sole exception.

By doing so, para 5 of TR 2022/4 incorrectly represents both the words of s 100A and the approach taken in the case law. It:

- distracts from the primacy, and starting point, of the existence of "reimbursement agreement" when applying s 100A; and
- misrepresents the role of the tax purpose (in misstating it as a *requirement*) by both:
  - taking tax purpose to be part of the positive process of determining what arrangements are *included* in a "reimbursement agreement", rather than correctly reflecting the *absence* of tax purpose as solely a basis for *exclusion* from what is the correct primary focus of whether there a "reimbursement agreement"; and
  - as a result of that incorrect statement of the role of tax purpose, failing to adhere to the limitation of the relevance of questions of tax purpose to consideration of the *entirely separate and equally important* second exception of ordinary dealing.

It is difficult to understand why the words of s 100A are not more faithfully reflected in TR 2022/4. After all, it has been eight years since the ATO first commenced agitating s 100A matters with its 2014 examples.

It invites the conclusion that it is a deliberate decision, made to advance (continue) the ATO's preferred views about tax purpose being more central to the operation of s 100A than the actual words of the section (and the case law) allow.

Scope of agreement

The approach adopted in TR 2022/4 of claiming the existence of an agreement:

- based on tacit adoption, concerted action, an understanding over a period of time,[47] and
- from conduct of before and after the time an entitlement arises,[48]

goes too far.

It is now inconsistent with the reasoning from the *Guardian* Full Court appeal – it does not adequately reflect the need for *consensus and adoption* – and needs to be revised (narrowed). This inconsistency is not properly addressed in the decision impact statement and is not part of the changes to TR 2022/4 proposed by that decision impact statement (those changes being about the role of advisers' plans and when a beneficiary must be a party, as noted above).

It is noteworthy that:

- the ATO seeks to adopt the widest possible views of "agreement" so as to find a "reimbursement agreement" from informal understandings; and
- in contrast, when addressing what is an ordinary family dealing, the ATO does not seek to recognise/discuss the many and long-term understandings that exist in any typical family (regardless of culture) – including about the sharing of financial, physical, emotional etc resources – that make up the *course of ordinary family dealing*.

Ordinary dealing: "core test" concept

TR 2022/4 introduces the new concept of the "core test" relating to, and seeking to limit, the ordinary family or commercial dealing exceptions. Such a core test, as framed by the ATO, has no direct case law basis.

While, in *BBlood*, Thawley J had reference to objectives when applying the ordinary family dealing exception, objectives were not (and were not stated to be) the core test. Objectives were part (only) of the overall consideration undertaken by Thawley J.

In TR 2022/4, the ATO has "repackaged" its prior references to and focus on tax purpose, as drawn from *Newton*, to instead be "family objectives" as part of this claimed core test – while still retaining the same "predication test" reasoning from *Newton*.

There is nothing in *BBlood* that prioritises objectives as a "core test", much less tax-related objectives. Only (what will be referred to here as) a "whole of dealing" approach – considering all of the actual steps taken, complexity, artificiality, objectives etc – as undertaken by Thawley J in *BBlood*, is authorised by that decision.

The comment is made in TR 2022/4 at para 28:

> "If the objective of a dealing can properly be explained as the payment of less tax to maximise group wealth, rather than some other objective which is a family or commercial objective, it is not an ordinary family or commercial dealing."

This comment is an express continuation (re-packaged) of the ATO's prior tax purpose-based reasoning from *Newton*.

The ATO's refusal to depart from its *Newton*-derived approach is also indirectly evident from the ATO's persistence (see the Appendix) in equating "tax avoidance" with having a "tax purpose" when considering the ordinary dealing exception. This labelling (in advance) of certain behaviour as tax avoidance flags the preconceived conclusion the ATO wishes to see realised from s 100A – that the section applies to confirm having a tax purpose as being tax avoidance – regardless of the actual words of s 100A.

Under the "whole of dealing" approach undertaken in *BBlood*, ordinariness is not excluded by having a tax purpose/objective. Ordinariness is instead judged by reference to (all) the types of matters noted in TR 2022/4 at para 27 – whether artificial or contrived, overly complex, the objectives, the actual steps, or extra steps (but without some overriding tax purpose-related exclusion).

In that context, there is usually no conflict between what is ordinary and what is commonplace in family dealings – which includes the "simple" and frequent decisions by adult family members (based on the whole complexity of family relationships, values etc) to share resources within the family.

The distinction that the ATO has sought/still seeks to maintain from *Newton* – to exclude tax influenced family cooperation from being ordinary – does not apply, on a proper reading of s 100A and the case law.

Simple family sharing: what medical conditions justify sharing?

The ATO refusal to acknowledge "simple" family sharing as ordinary in the context of reimbursement agreements is reflected in the ATO's example 1 in TR 2022/4, regarding Paul's medical expenses being funded by gifts from family members (noted above).

The ATO acknowledgment that Paul's medical costs are a relevant contextual fact or circumstance suggests that there must be some such "special" reason for family sharing of resources for it to be ordinary.

This approach is both unnecessary on the words and structure of s 100A and naturally leads to challenges – does the ATO intend to publish guidance on what medical conditions qualify as sufficiently "special" to justify family sharing being ordinary?

In its refusal to engage with simple family sharing as being objectively ordinary, the ATO is reserving to itself the right to make what will necessarily amount to value judgments when it seeks to undertake a more in-depth assessment of a family's interactions. Such a more in-depth assessment of simple sharing within a family is not required (or authorised) by the words and structure of s 100A.

Simple family sharing: not so different between cultures

Rather than introducing new concepts that are not supported by the words of s 100A, such as cultural issues, TR 2022/4 should have directly addressed the simple and commonplace acts of sharing and of collective use/consumption within families.

The words of s 100A refer to "family", not culture as now introduced in TR 2022/4.

That simple family sharing (including to maximise wealth) may be regarded as non-ordinary can only be a sustainable argument under the tax purpose-based reasoning from *Newton* – by which ordinary family dealing is mutually exclusive with a tax purpose-based arrangement.

TR 2022/4 acknowledges[49] that *BBlood* did not contain a reference to *Newton* in Thawley J's reasoning on the ordinary dealing exception, which is in conflict with TR 2022/4's claim of *BBlood* as legal authority for the ATO's

Newton-based reasoning in respect of the ordinary dealing exception.

Agreements and reimbursement agreements

So, where are we on the questions of agreements and reimbursement agreements?

The meaning of the complete phrase "reimbursement agreement" is drawn from two provisions within s 100A:

- s 100A(13) which provides a definition for "agreement"; and
- s 100A(7) which sets out when an agreement becomes a reimbursement agreement.

Those provisions, when considered together, set out when a set of arrangements will be a reimbursement agreement.

What is an "agreement" in s 100A(13)?

Section 100A(13) defines "agreement" as follows:

> "… any *agreement, arrangement or understanding*, whether formal or informal, whether express or implied and *whether or not enforceable*, or intended to be enforceable, by legal proceedings, but does not include an agreement, arrangement or understanding entered into in the *course of ordinary family or commercial dealing*." (emphasis added)

Here are three features to note in the definition:

1. "agreement, arrangement or understanding" is very broad drafting which is likely to capture most, if not all, arrangements;
2. whether or not there is an enforceable arrangement is irrelevant – this means informal arrangements such as non-binding discussions between parties are potentially an agreement for the purposes of s 100A; and
3. finally, an arrangement is not an agreement where it is entered into in the course of ordinary family or commercial dealings, which is considered under its own heading below.

The phrase "agreement, arrangement or understanding" is drafted very broadly. But, despite this breadth, there must still be an *actual* agreement – the *Guardian* Full Court decision tells us that there must be *consensus and adoption*.[50] And it must occur *before* the present entitlement arises.[51]

The ATO may wish to point to a pattern of behaviour between trustees and beneficiaries within a family as evidence of an agreement, such as repeated occurrences over years of distributions to beneficiaries who then allow the value of the distribution to be used for the benefit of/controlled by other family members.

The ATO can be expected to claim that an agreement exists from circumstances of tacit adoption, concerted action, an understanding over a period of time, and/or conduct of before and after the time an entitlement arises.

But if each of the trustee and the beneficiary act unilaterally in each of their decisions to distribute and to not call on payment, respectively, such a pattern of conduct does not constitute an agreement, arrangement or understanding – whether formal or informal, whether express or implied, and whether or not enforceable, or intended to be enforceable, by legal proceedings.

While the correspondence of (genuine voluntary cooperation evidenced by) such unilateral behaviour for mutual benefit would not be credible in non-family (commercial) situations, it is entirely to be expected in family situations. But, to resist ATO claims, families will need to be attentive to establishing *evidence* of such *genuine unilateral* (even if cooperative) actions. The practical suggestions at the end of this article are partly directed to that evidence.

Reimbursement agreements under s 100A(7)

A "reimbursement agreement" involves:

- an agreement that *provides for* certain actions or outcomes; and
- those actions or outcomes being a payment of money, transfer of property, provision of services or other benefit to pass to a person other than the beneficiary that is presently entitled.

The act of making the beneficiary presently entitled (usually the unilateral act of the trustee) does not "provide for" the actions or outcomes noted in the second bullet point.

This fits with the view that it is not the distribution itself with which s 100A is concerned, regardless of the tax planning that may be behind the distribution. Something more – the relevant "agreement" – is needed to cause (to provide for) the actions or outcomes.

As for the actions/outcomes, they will often be the everyday ways a person will always consume or use their assets or choose to pass value to another person.

When a person:

- buys something in a shop, they "pay money" to another person;
- pays a bill for themselves or a relative, they "pay money" and/or "provide benefits" to another person;
- donates money, they "pay money" to another person;
- gives a gift of property, they "transfer property"; and
- helps in the family business, they "provide services".

The scope of these actions/outcomes is vast. As the *BBlood* facts show, the actions/outcomes can even arise (by a benefit arising to another) without the beneficiary receiving and passing on any value.

But s 100A does not apply to most of such actions/outcomes because:

- they will not have been *provided for* under any *agreement before* the person became presently entitled to a trust distribution; and

- even if so provided for, either:
  - no person will have entered into the relevant agreement with the required tax purpose; or
  - the relevant agreement will have been entered into in the course of ordinary dealing.

The attention of s 100A is always focused on the *agreement* that *provides for* these *actions/outcomes* as the essence of what defines a "reimbursement agreement".

On the words of the section, questions of tax purpose do not cause anything to be *included* in s 100A, only for certain agreements to be *excluded*. This is as one of the two *separate and independently operating* exceptions. The other, of course, is the ordinary dealing exception discussed below.

Ordinary family or commercial dealings

Where are we on the meaning of "entered into in the course of ordinary family or commercial dealing"?

As will be apparent from the earlier comments, the ATO has sought (still seeks) to interpret the ordinary dealing exception in s 100A(13) as limited by tax purpose in the manner of the reasoning from *Newton*. It is submitted that this has never been the correct law:

- from the words of the section and principles of statutory interpretation; and
- from the (albeit limited) direct case law.

In TR 2022/D1, the ATO failed to *fully* cite the comments made by Hill and Sackville JJ in *FCT v Prestige Motors Pty Ltd as trustee of the Prestige Toyota Trust*:[52]

> "*There is a danger that, when words used in a judgment are translated into the legislation, the change of context may alter the meaning of the words from that which they originally bore*. It is clear from both the judgment of the Privy Council and from the language of the High Court on the same case (*Federal Commissioner of Taxation v Newton* (1957) 96 CLR 578) *that s 260 was regarded as involving a dichotomy*. A transaction was either stamped as one entered into to avoid tax or as one about which it could be predicted that it was entered into in the course of ordinary family or commercial dealing. In the former case the transaction was caught by s 260; in the latter case it was outside the section. *We do not need to decide in the present case whether s 100A imports a similar dichotomy*. In particular we do not need to decide whether if an agreement is shown to have been 'entered into the course of ordinary commercial dealing', the operation of s 100A is spent, regardless of whether the commercial purpose was subsidiary to the purpose of tax avoidance. In our view, none of the transactions was entered into in the course of ordinary commercial dealing." (emphasis added)

Thawley J in *BBlood* applied *Prestige Motors* and did not adopt the *Newton* dichotomy, so the ATO has adjusted its comments in TR 2022/4. But, at para 28 of TR 2022/4, the ATO has still sought to retain that dichotomy:

> "28. If the objective of a dealing can properly be explained as the payment of less tax to maximise group wealth, rather than some other objective which is a family or commercial objective, it is not an ordinary family or commercial dealing."

Against these current ATO views (which may need to be dealt with in an audit), it is submitted that the correct approach, supported by the case law, is to determine whether an agreement has been "entered into in the course of ordinary family or commercial dealing" on the basis of the "whole of dealing" approach undertaken in *BBlood*.

The cases on s 100A to date have involved arrangements with some special element. This is unsurprising, in that those special elements are what have led to the dispute. This is not to say that any special elements necessarily mean that the ordinary dealing exception cannot apply to family or commercial matters.

However, because commercial dealings can generally be expected to be conducted on a basis of self-interest, a strong tax reduction purpose, even though that is not itself the test, tends to result in commercial dealings that are "non-ordinary" in objective ways, even ignoring tax purpose. This has been the story of the historical case law dealing with s 100A (eg *Prestige Motors*).

While *BBlood* related to a family, there were special elements, such as the change of trust deed and the resulting separation of the tax liability from the benefit of the capital part of the share buy-back.

The simplest scenario of sharing and collective use/consumption within families (by family members gifting and lending to each other) has not been the subject of direct judicial consideration. But (from direct experience) ATO auditors have been regarding such family sharing and collective use/consumption as "non-ordinary" and subject to s 100A in audits since 2014.

Applying the "whole of dealing" approach undertaken in *BBlood* to the simple family sharing scenario, should include a recognition that the relevant *ordinary family dealing*, in the course of which such simple *family sharing* occurs, is inseparable from the *wider family relations*.

Such family relations are complex. They are relationship-based, not transactional. Consequently, they are long-term and, by their nature, are not self-interested in the same way as commercial dealings. Tax purposes can very well co-exist with other family purposes and actions that do not follow self-interest, and which may seem "non-ordinary" if (as the ATO seeks to maintain) tax purpose is the primary measure.

It is submitted as being in the course of ordinary family dealing, in a modern context:

- for the "caretakers" of family wealth (typically parents) to be trusted to manage the family wealth for best possible return and use – conduct which is undertaken based on the very natural goal of seeking to maximise family wealth through prudent management to, among other things, ensure sufficient finances for future emergencies, care for family members who cannot finance their own care (due to age, illness or mental incapacity), or preserve value for successive generations of the family;

- for all family members to contribute to the family wealth as they choose/are able, not just parents to children but also adult children to parents/wider family; and
- for "unexpended" family wealth to be returned to/concentrated in a family trust, including possibly the family trust from which the trust entitlements originally flowed as that trust structure, by which no one family member owns that wealth, may best provide (non-tax based) protection against the risks of claims against any one family member.

Family members, including beneficiaries of family trusts, can naturally be expected to cooperate in these endeavours for the simple reason that families have long-term emotional connections. If a more mercenary view is required, family members do so because, by participating in this management, the family member can expect benefits to return to them if they require them in the future, due to illness or incapacity, or through intergenerational wealth transfer. Either way, joint management and consumption of their assets and income is what families do, in the ordinary course.

If a family cooperating to prudently preserve and deploy its wealth is ordinary, then the scenario where a trustee makes a beneficiary presently entitled to income, and that beneficiary does not call on that entitlement to be paid but instead allows the value that entitlement represents to be used for family purposes, should be taken to be an ordinary family dealing.

It is also part of this family cooperation that family members often do not require a detailed accounting of their entitlements, as long as there is trust in the "caretakers" of the family wealth (typically, parents).

In terms of the types of matters noted in TR 2022/4 at para 27, such simple sharing and collective use/consumption within families is not artificial or contrived, is not overly complex, achieves family objectives (of *funding* whatever is the object of the sharing or collective use/consumption), and does not involve any extra steps.

Any suggestion that the trust distributions "should have" gone direct to the persons with whom the family member chooses to share, ignores that it is not an *extra* step for a family member beneficiary to be genuinely made entitled to trust income, so that *they may choose* to share (or not to share) that entitlement at *their* discretion.

Entitlement arose out of

Even if an agreement exists, does the "arose out of" nexus exist?

The subject present entitlement must be one that "arose out of" or "arose by reason of" the reimbursement agreement (or any act, transaction or circumstance that occurred in connection with, or as a result of, the agreement).

Where the family member would be entirely free to use their entitlement at their sole discretion, can it correctly be said that the entitlement (the distribution decision) arose out of the reimbursement agreement?

If the trustee would have distributed the same way, for family reasons, regardless of what the beneficiary chose to do with their entitlement, the distribution would have been made and the entitlement would have arisen even if the reimbursement agreement had not existed.

It is suggested that acceptance – for personal reasons of family affection, family obligation etc – of the "risk" of the family member not complying with any prior *expectation*, breaks the "arose out of" nexus between any reimbursement agreement and the creation of the entitlement.

In such circumstances, it could not be said that, but for the transactions which form part of the reimbursement agreement, the present entitlement would not have arisen.

These are important issues that need addressing in family situations when determining whether a present entitlement is one that "arose out of" or "arose by reason of" any claimed reimbursement agreement.

Even if the meaning of "agreement" may be wide enough to extend to unenforceable and implied understandings of which a trustee may be party, the very loose nature of such an "agreement" is consistent with a trustee – who still chooses to make a distribution in family situations (based only on such an "unenforceable and implied understanding") – having made that distribution independently of any such "agreement" but rather because of reasons of family affection, obligation etc.

Practical suggestions to avoid and manage the risks

From all of the above, there are steps that taxpayers can take to help avoid/manage s 100A risks. The following comments focus on family situations, being seen as the area most in need of guidance.

As a first step, taxpayers should avoid poor trust administration matters by:

- advising all beneficiaries of their entitlements each year *in writing*; and
- obtaining the *written authority* of beneficiaries for the non-payment of their entitlements, or for the payment (as satisfaction) of their entitlements to other persons or as loans/goods/services for other persons. Such authority could be by way of a general confirmation after the relevant payments, loans etc have been made.

It is important that this advising, and obtaining of confirmations from, beneficiaries does *not* become a "paper exercise" (ie "sign here"). Care should be taken to create an environment in which the beneficiary is genuinely made aware that they may call for direct payment of their entitlement, and that they alone may authorise or not authorise its satisfaction by being otherwise used/directed.

Ensuring that the trust can demonstrate a financial position (from available funds or from borrowings against trust assets) to make payment of a beneficiary's entitlement (if called to do so) would be helpful (adding credibility).

It can be seen that the above matters are directed to supporting that any sharing by a beneficiary of their entitlement will be a *unilateral act of the beneficiary*.

Remember that, in an audit or dispute, beneficiaries may be called on in formal interviews with the ATO or, ultimately, to give evidence in court, to confirm these matters.

So that there is no agreement when the trust distribution is made, it would seem to be better for trustees not to discuss intended distributions with potential beneficiaries – only advise them afterwards.

To enhance access to the ordinary dealing exception, bearing in mind that the onus of proof rests on taxpayers, attention should be given to maintaining some records evidencing what is "ordinary family dealing" for the particular family. This may involve keeping a record of the (or summarising, now, the past) pattern/history of substantive sharing of the family resources across the family.

This is not to suggest that families need to track all of their collective expenditure, although the more that can be proven the better. But it will assist to be able to demonstrate/prove a pattern of substantial and material family sharing, such as funds shared/collectively deployed to fund family houses, as family loans, as support provided for family members in illness, misfortune etc.

To support that the trust distribution did not arise out of any reimbursement agreement, the trustee should be prepared to confirm and evidence that they distributed to the beneficiary in the full expectation of paying the beneficiary their entitlement in cash if called on by the beneficiary to do so, accepting that any other outcome would be entirely the unilateral choice of the beneficiary.

Also, a trustee should be prepared to confirm that their distribution decision is not related to any services that the beneficiary may have provided/will provide to any party (eg to a family business) but only flows from their status as a beneficiary.

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References

1 M West and A Whitney, "Trusts – 100A reimbursement agreements; identifying and reducing taxpayer risks", paper presented at The Tax Institute's Queensland Tax Forum in May 2021; M West, "Section 100A and tax purpose", (2022) 56(11) *Taxation in Australia* 701.

2 S 170(10) ITAA36.

3 *BBlood Enterprises Pty Ltd v FCT* [2022] FCA 1112.

4 (1958) 98 CLR 1.

5 *FCT v Prestige Motors Pty Ltd as Trustee of the Prestige Toyota Trust* 98 ATC 4241 at 4262, where reference is made by Hill and Sackville JJ (Beaumont J agreeing) to the "ordinary commercial dealing" exclusion wording being derived from Lord Denning in *Newton's* case.

6 Available at www.ato.gov.au/law/view/document?DocID=SGM/trusttaxation.

7 [2021] FCA 1619.

8 [2022] FCA 1112.

9 [2023] FCAFC 3.

10 For example, the comments in para 68.

11 *FCT v Guardian AIT Pty Ltd ATF Australian Investment Trust* [2023] FCAFC 3 at [111], with reference to comments by Hill J in *East Finchley Pty Ltd v FCT* [1989] FCA 481 at [74] and [76].

12 Para 86 of TR 2022/4.

13 (1958) 98 CLR 1. Where the different expression used in the judgment, not the section, was "capable of explanation by reference to ordinary business or family dealing".

14 Paras 78 and 79 of TR 2022/D1.

15 Para 98 of TR 2022/4.

16 Para 105 (first sentence) of TR 2022/4.

17 Para 105 (first sentence after the bullet points) of TR 2022/4.

18 Para 105 (bullet points) of TR 2022/4.

19 Para 28 of TR 2022/4: "If the objective of a dealing can properly be explained as the payment of less tax to maximise group wealth, rather than some other objective which is a family or commercial objective, it is not an ordinary family or commercial dealing."

20 Para 96 of TR 2022/4, drawn from para 83 of TR 2022/D1.

21 Paras 110 and 111 of TR 2022/4.

22 *BBlood Enterprises Pty Ltd v FCT* [2022] FCA 1112.

23 *BBlood* at [71]–[75].

24 *BBlood* at [76].

25 *BBlood* at [83].

26 *BBlood* at [19]–[28].

27 *BBlood* at [84]–[90].

28 *BBlood* at [91].

29 *BBlood* at [92].

30 *BBlood* at [94].

31 *BBlood* at [94]–[96].

32 (1958) 98 CLR 1.

33 *BBlood* at [97].

34 (1998) 82 FCR 195.

35 *FCT v Prestige Motors Pty Ltd* (1998) 82 FCR 195 at 222F-G.

36 *Prestige Motors* at 223C.

37 *Prestige Motors* at 223E-F.

38 *BBlood* at [100]–[104].

39 *BBlood* at [128]–[177].

40 *BBlood* at [162] and [163].

41 *FCT v Guardian AIT Pty Ltd ATF Australian Investment Trust* [2023] FCAFC 3 – an appeal from *Guardian AIT Pty Ltd ATF Australian Investment Trust v FCT* [2021] FCA 1619.

42 *Guardian* [2023] FCAFC 3 at [125].

43 *Guardian* [2023] FCAFC 3 at [121]-[124].

44 *Guardian* [2023] FCAFC 3 at [123] and [124].

45 *Guardian* [2023] FCAFC 3 at [111].

46 Available at www.ato.gov.au/law/view/document?LocID=%22CTR%2FTR2022EC4%2FNAT%2FATO%2F00001%22&PiT=99991231235958.

47 Paras 69 and 70 of TR 2022/4 as noted earlier.

48 Para 74 of TR 2022/4 as noted earlier.

49 Para 197 of TR 2022/4.

50 *Guardian* [2023] FCAFC 3 at [124].

51 *Guardian* [2023] FCAFC 3 at [111]

52 98 ATC 4241 at 4262.

Appendix. What has changed on tax purpose and ordinary family dealing

Old – TR 2022/D1 (extract, footnotes omitted, emphasis added)

Tax avoidance not relevant to ordinary dealing exception

160. It has been put to the Commissioner that the question whether the objective facts of the arrangement demonstrate tax avoidance does not affect the interpretation of "ordinary family or commercial dealing" in subsection 100A(13).

161. The alternative view acknowledges that the words "ordinary business or family dealing" are drawn from *Newton*, where it was pointed out by the Judicial Committee of the Privy Council that the categories of ordinary dealings and dealings for which there was a tax avoidance purpose were mutually exclusive for the purposes of section 260. However, proponents of this alternative view draw attention to the following observation by Hill and Sackville JJ in *Prestige Motors*:

> There is a danger that, when words used in a judgment are translated into the legislation, the change of context may alter the meaning of the words from that which they originally bore.

162. It is argued that the context of section 100A is different to section 260, with the effect that tax avoidance does not bear on the meaning of the words "ordinary family or commercial dealing". Within that context, the question of tax avoidance is reserved for subsection 100A(8).

163. We do not agree with the argument referred to in paragraph 162 of this Ruling. *Section 100A is an income tax anti-avoidance provision and the composite phrase "ordinary family or commercial dealing" derives from the judgment of Lord Denning in Newton. Section 260 was also an anti-avoidance provision and Newton reflected the contemporary meaning of ordinary family or commercial dealing as adopted by the Commonwealth Parliament in subsection 100A(13).*

164. In *Newton*, the Privy Council had formulated a predication test to determine whether the conditions of section 260 were satisfied. For the Commissioner to establish that an arrangement had the purpose or effect of avoiding tax, that purpose had to appear on the face of the arrangement. It followed that if, having regard to the overt acts by which an arrangement was implemented, it was capable of explanation by reference to ordinary business or family dealing, without necessarily being labelled as a means to avoid tax, section 260 would not apply. The primary meaning of the phrase "ordinary business or family dealing" contained an element of not being a means to avoid tax.

165. This has been confirmed by later decisions of the High Court where arrangements that achieved considerable familial or commercial objectives were held not to be "ordinary family or business dealing". In *Peate v Commissioner of Taxation (Cth)*, the High Court upheld assessments raised under section 260 for an individual, who was a partner in a medical partnership that had been re-organised into a multi-tiered corporate structure, despite the apparent commercial and familial benefits achieved. In the leading majority judgment, Kitto J (with whom McTiernan and Owen JJ agreed) explained:

> The arrangement in the present case, considered objectively as is thus required, may well seem to be characterized by several purposes and effects, some of them unconnected with taxation, including the protection of individual members of the group against liability for negligence; the making of superannuation provision for employees, including doctors employed to assist the group; the better organization of the group's activities and particularly its methods of accounting; and the making of provision for the doctors' families. (All of these purposes … were actually contemplated in the formation of the plan.) But the question remains, whether the overt acts that were done under the plan are fairly explicable without an inference being drawn that tax-avoidance is a purpose of the arrangement as a whole. Menzies J. thought they were not, and with respect I agree.

166. Members of the Court in *Gulland* concluded that the meaning of "ordinary business or family dealing" in section 260 was determined by the tax avoidance context in which it was used. Dawson J explained that the "reference to ordinary business or family dealing is a reference by way of example to transactions capable of reasonable explanation by reference to considerations other than avoidance of tax". Gibbs CJ further observed that the phrase adopted by the Privy Council was intended to "refer to what was normal or regular, rather than to what had become common or prevalent" and was made "by way of contrast to the words 'without necessarily being labelled as a means to avoid tax'".

167. Regarding section 100A, in *Prestige Motors* the Court characterised the overt circumstances of the arrangement entered into by the parties to test whether there was ordinary commercial dealing. The Court observed that a straightforward agreement for the transfer of one entity in the group (Perron Investments) to another (LSP) "might well be characterised as ordinary family or commercial dealing". However, the Court also observed absence of any commercial motivation for the sale, the replacement of LSP as trustee, the issue of further units, making of distributions to the unitholder to be offset against tax losses and making interest payments to another entity that would act in the Perron group interests. In light of this evidence, the Court characterised the sale as "… one element of a larger one-off transaction designed to avoid tax, and … not an agreement entered into in the course of ordinary commercial dealing".

Now – TR 2022/4 (extract, footnotes omitted)

Tax avoidance not relevant to ordinary dealing exception

191. It has been put to the Commissioner that the question whether the objective facts of the arrangement demonstrate tax avoidance does not affect the interpretation of "ordinary family or commercial dealing" in subsection 100A(13).

192. The alternative view acknowledges that the words "ordinary business or family dealing" are drawn from *Newton*, where it was pointed out by the Judicial Committee of the Privy Council that the categories of ordinary dealings

and dealings for which there was a tax avoidance purpose were mutually exclusive for the purposes of section 260. However, proponents of this alternative view draw attention to the following observation by Hill and Sackville JJ in *Prestige Motors*:

> There is a danger that, when words used in a judgment are translated into the legislation, the change of context may alter the meaning of the words from that which they originally bore.

193. It is argued that the context of section 100A is different to section 260, with the effect that tax avoidance does not bear on the meaning of the words "ordinary family or commercial dealing". Within that context, the question of tax avoidance is reserved for subsection 100A(8).

194. Reference is also made to this observation of Thawley J in *BBlood*:

> The inquiry about whether the agreement was "entered into in the course of ordinary family or commercial dealing" within the meaning of s 100A(13) is distinct to the inquiry about purpose required by s 100A(8) and (9).

195. While the Commissioner accepts that the requirements of subsection 100A(13) differ from the purpose required by subsections (8) and (9), the Commissioner nonetheless considers that if the objective facts of the arrangement demonstrate tax avoidance, those facts *can be* relevant for whether or not a dealing is ordinary family or commercial dealing.

196. The core test for section 100A, as explained in this Ruling, *can involve* the inquiry into what is sought to be achieved by the dealing and whether the steps that comprise the dealing would achieve that objective. *If the steps that comprise the dealing reveal that the objective of the dealing is something other than a family or commercial objective (such as the payment of less tax), the core test will not be satisfied.*

197. This formulation of the core test *derives from* the judgment of Thawley J in *BBlood*, which did not contain a reference to *Newton* in respect of this test. Although Thawley J did refer to subsection 100A(13) having a "distinct" operation from subsections 100A(8) and (9), his Honour additionally observed:

> That does not mean that one cannot look at the object of what was sought to be achieved by a dealing said to be an ordinary family or commercial dealing in the course of which the agreement was entered into or that one cannot assess whether particular steps were relevant to achieving that object.

198. Thawley J concluded that a dealing might not be "ordinary" if it is contrived, artificial, or involves more than required to achieve the relevant objective. *Therefore, if there are particular steps that are not relevant to achieving a family or commercial objective, but are more clearly related to tax avoidance, that may take the dealing outside of being an ordinary dealing.*

The impact of NDAs on state and federal taxes

by Michael Bearman, CTA, Barrister, and Piotr Klank, CTA, Barrister, Victorian Bar

The High Court's decision in *Addy v FCT* has drawn greater attention to the "non-discrimination article" in certain Australian double tax agreements. Australia is in the process of extending its treaty network and the article is an expected feature of future agreements, increasing its significance. The article prohibits each country from engaging in "tax discrimination" by imposing more burdensome taxation on nationals of the other country than is imposed on other taxpayers in the same circumstances. Importantly, the article potentially applies to state taxes as well as federal taxes. For example, Revenue NSW recently determined that "surcharge purchaser duty" and "surcharge land tax" will no longer be imposed on nationals of certain countries with double tax agreements with Australia containing a non-discrimination article. The authors discuss the history, structure and key elements of the article. They consider recent developments and implications in its application to both state and federal taxes.

Introduction

A non-discrimination article (NDA) in a double tax agreement (DTA) prohibits each country that is a party to the DTA from imposing more burdensome domestic tax treatment on nationals of the other country than is imposed on other taxpayers in the same circumstances. All Australian DTAs entered into since 2003 contain an NDA (except for the DTA with France). Until recently, the NDA in those DTAs has received limited attention. That was changed by the High Court's decision in *Addy v FCT*.[1] For example, following that case, Revenue NSW determined that surcharge provisions in New South Wales taxes imposed on certain foreign nationals are to be treated as inconsistent with Australia's DTAs with New Zealand, Finland, Germany and South Africa, whereas the Victorian State Revenue Office has taken the view that the NDA does not affect similar Victorian taxes. On any basis, as *Addy* itself demonstrates, the application of the NDA to federal taxes engages significant complexity, even before the constitutional difficulties involved in identifying inconsistency between federal law and state law are engaged.

History of the NDA in Australia

An NDA is included as art 24 of the OECD *Model Tax Convention on Income and on Capital* (OECD Model).[2] Prior to 2003, Australia did not include this article in its DTAs (with the exception of the DTA with the United States, but this does not give rise to legally enforceable domestic rights for taxpayers[3]). Instead, Australia reserved its position in respect of the OECD Model.[4] This was on the ground that it was necessary for Australia to protect its source country taxing rights, given its narrow tax base prior to 1985.[5]

Australian policy changed in 1999 following a recommendation arising from the *Review of business taxation*.[6] That was at least partly in response to a finding that Australia's domestic tax law constituted one of the least discriminatory tax regimes applying to non-residents and that Australia's position made it more difficult to renegotiate treaties.[7] It was noted that the inclusion of an NDA may benefit Australian enterprises that expand overseas, protecting them against tax discrimination in foreign countries.[8]

With the exception of France, all Australian DTAs entered into since 2003 contain an NDA.[9] Moreover, several existing DTAs contain a requirement (commonly referred to as a "most favoured nation" obligation) for Australia to notify and negotiate with the other country to include an NDA, if such an article has been included by Australia in a treaty with another country.[10]

General structure of the NDA

The NDA in Australian treaties broadly follows the structure of art 24 in the OECD Model. Generally, the first paragraph sets out the general principle that the treatment in respect of taxation or any connected requirement cannot be other or more burdensome than for a national of the other country. That applies to both the taxation itself and any requirement connected with such taxation. Accordingly, discrimination in the administration of the tax law of a treaty country is also generally precluded.

The second paragraph deals with permanent establishments. It provides that tax on permanent establishments of the other country will not be levied less favourably than on the country's own enterprises carrying on the same activities. That applies to all residents of a treaty country, irrespective of their nationality, who have a permanent establishment in the other country.

The third paragraph provides that the two treaty countries must allow the same deductions for interest, royalties and other disbursements paid to residents of the other country as they do for payments to their own residents.

The fourth paragraph concerns enterprises owned or controlled abroad, providing a country cannot give less favourable treatment to an enterprise, the capital of which is owned or controlled, wholly or partly, directly or indirectly by one or more residents of the other country. However, that does not apply to differential tax treatment based on residence, or require the same treatment of non-resident shareholders in a company as resident shareholders.

In some treaties, a fifth paragraph sets out the taxes to which the NDA applies. Other treaties also include a specific paragraph listing exclusions from the scope of the NDA, which relate to tax laws designed to prevent avoidance or evasion of taxes. For example, art 24(5) of the DTA with New Zealand.[11]

Key elements of the NDA

Nationality

Generally, DTAs operate by reference to tax residence. However, the NDA operates by reference to whether a taxpayer is a "national" of a country. The distinction is significant. The term "national" is generally defined in art 3. In most cases, an individual will be a national if they are a citizen or national of a country, and a company will be a national if it derives its status as such from the laws in force in that country. For example, in the case of Australia, a company that is incorporated in Australia would be a national of Australia for the purposes of the NDA.[12]

> "The NDA therefore has the potential to apply to state taxes, as well as territory taxes."

Relevant differences between NDAs predominantly relate to the types of entities that are included in the definition of a national. For example, the German DTA adopts a broad definition, referring to "any legal person, partnership or association deriving its status as such from the laws in force in … [Australia/Germany]".[13] Other DTAs are more limited, and only refer to "companies" (eg Australia's DTAs with Finland[14] and South Africa[15]).

Because the NDA operates by reference to nationality, it can apply to persons who are not residents of either country. Provided they are a national of one country that is a party to the DTA, a non-resident will be entitled to the benefits of the NDA. This is included in the OECD Model[16] and in some Australian treaties (eg the Australia–Germany DTA[17]) but not all.[18]

Other or more burdensome taxation

The essence of the NDA is "tax discrimination", being the existence of "other or more burdensome" tax and connected requirements founded on nationality.

Relevant tax discrimination may arise in terms of the quantum of taxation, such as a higher tax rate applying to foreign nationals. That was the case in *Addy*, as is discussed below. It may also arise if an additional tax is imposed by reference to foreign nationality. An example would be a special tax on foreign nationals, which applies regardless of whether the foreign national was an Australian tax resident. Tax discrimination also covers administrative or compliance requirements that a taxpayer may be called on to meet if those requirements were to differ based on nationality.

Comparison to identify tax discrimination

The focus in the NDA is on the differential treatment of nationals "in the same circumstances, in particular with respect to residence". The expression "in the same circumstances" refers to persons who, from the point of the application of the ordinary tax laws, are in substantially similar circumstances, both in law and in fact.[19]

The expression "in particular with respect to residence" identifies that the residence of taxpayers is only one of the factors relevant to determining whether taxpayers are in the same circumstances.[20] Accordingly, differential treatment based solely on residence does not constitute discrimination for the purposes of the NDA. This is consistent with the allocation of taxing rights between treaty countries based on tax residence – a key purpose of DTAs – not itself being contrary to the NDA. Rather, a breach of the NDA may only occur if two persons who are residents of the same country are treated differently solely by reason of one being a national of the other country.

Taxes covered

In the case of Australia, DTAs generally apply to federal taxes, such as income tax, FBT and resource rent tax.

However, in line with the OECD Model, in some Australian DTAs, the NDA is specifically expressed to apply to a wider range of taxes, being "taxes of every kind and description".[21] The NDA therefore has the potential to apply to state taxes, as well as territory taxes. That so much was contemplated is confirmed by the explanatory memorandum to those treaties.[22] The obligation is bilateral, and the application to state taxes is not limited to Australia. This is in contrast to the scope of art 2 (Taxes Covered) which often sets out the specific taxes for each country.

There is also potential for the NDA to apply to other sub-national taxes, such as taxes imposed by local government. For example, the Swiss DTA expressly applies to taxes on income imposed by Swiss political subdivisions or local authorities,[23] and the Finland DTA also expressly applies to communal and church taxes.[24]

The decision in Addy

In *Addy*, the High Court of Australia found that the so-called "backpacker tax" was inconsistent with the NDA in the UK DTA. Ms Addy was a national of the UK but an Australian tax resident, deriving employment income in Australia while working on a working holiday visa. Because of her visa status, she was taxed at a higher tax rate than Australian nationals, due to the operation of special provisions in Pt III of Sch 7 to the *Income Tax Rates Act 1986* (Cth) (the Rates Act).

The High Court found that the text, context, object and purpose of the NDA rendered it necessary to identify a relevant comparator, being a hypothetical taxpayer in the same circumstances apart from the criterion on which the claim of discriminatory taxation was based, in order to determine whether the NDA applied. The term "in the same circumstances" was found to mean the same circumstances apart from those circumstances attached to the prohibited basis for discriminatory taxation.

The Rates Act differentiated between Australian residents for tax purposes who held certain forms of visa and others who did not hold a visa. The working holiday visas in issue were sought by and issued to non-citizens of Australia.[25] The question was therefore whether more burdensome taxation was imposed on those holding a working holiday visa.

The High Court found that applying the ordinary tax laws to a hypothetical case of an Australian national in substantially similar circumstances to Ms Addy deriving the same income from the same source (ie "in the same circumstances" in all respects relevant to taxation, excluding the protected characteristic and the consequences flowing from the protected characteristic) would have resulted in the Australian national being taxed at the lower rates under Pt I of Sch 7 of the Rates Act.[26] As Ms Addy's visa status was a characteristic which depended on her nationality (namely, a person not being an Australian national), being the very attribute protected by the NDA,[27] the "backpacker tax" was discriminatory.

In contrast, in the Full Federal Court,[28] a majority (Derrington and Steward JJ, Davies J dissenting) reasoned that the characteristic on which the tax was imposed was Ms Addy's visa status, not her nationality. The majority observed that a British national might be permitted to enter Australia on another type of visa, and earn income, and would be taxed at the same rates as other residents or non-residents, rather than the special rates which applied to working holiday visa holders, in Pt III of Sch 7 of the Rates Act. In turn, that indicated that the rates in Pt III of Sch 7 of the Rates Act were not based on nationality. Accordingly, the holding of a visa was a relevant tax-related characteristic for the purposes of the required comparison.[29]

The majority thereby stressed the *type* of income that was taxed. Part III of Sch 7 of the Rates Act applied to "working holiday taxable income".[30] That was defined in s 3A of the Rates Act and did not apply to *all* income earned by a visa holder. Rather, it only applied to income earned by a visa holder from sources in Australia, and excluded certain other income, namely, superannuation and employment termination remainders.[31] Thus, for example, the Rates Act definition would not cover income derived by the visa holder in their country of nationality or in a third country (eg New Zealand, earned on a temporary trip).

That view was rejected by the High Court (which preferred the approach of the dissenting judgment of Davies J in the Full Federal Court and of Logan J in the Federal Court). It found that the Rates Act differentiated by reference to the holding of a visa, which depended on the holder not being an Australian national.[32] The question then was whether more burdensome taxation was imposed on those holding a working holiday visa, in contravention of art 25(1).[33] The type of income subject to the differential treatment was not relevant to that analysis.

In the authors' view, the divergence between the High Court and the majority of the Full Court is attributable to their differing interpretations of the domestic provisions in identifying the criterion for differential treatment, namely, whether that criterion was the earning of a certain type of income[34] or the holding of a visa.[35] On that basis, the authors consider that, although *Addy* has resolved the appropriate identification of the relevant comparators by which differential tax treatment falls to be identified under the article, it is otherwise largely constrained in its application and gives limited guidance with respect to the application of the article to other provisions or taxes.

In that regard, the ATO has adopted such a limited approach in its promulgated response to *Addy* which accepts that *Addy* has application to working holiday visa holders who were or are Australian residents for tax purposes from Chile, Finland, Germany, Israel, Japan, Norway, Turkey and the UK.[36] It has not promulgated any position on the wider ramifications of an NDA, or any application to other taxes.

Application of the NDA to state taxes

The application of the NDA to state taxes is less clear. Australia's DTAs are given "the force of law according to their tenor" by s 5 of the *International Tax Agreements Act 1953* (Cth). That Act principally contemplates the application of the DTAs to income tax as, with certain exceptions, the Income Tax Assessment Acts are incorporated into that Act and to be read as one with it.[37] But it gives no guidance as to the potential application of DTAs to state taxes.

Section 109 of the Australian Constitution provides that "[w]hen a law of a state is inconsistent with a law of the Commonwealth, the latter shall prevail, and the former shall, to the extent of the inconsistency, be invalid".

Section 109 has not been judicially applied to an NDA. Inconsistency for the purposes of s 109 may occur directly or indirectly. A direct inconsistency will arise where a state law, if allowed to operate, would impose an obligation greater than that provided by the federal law.[38] An indirect inconsistency will arise where there is an overlap in the field covered by federal and state laws, and there is an express intention for the federal law to cover the field.[39] A state law is invalid to the extent of any inconsistency.[40] The reference to "a law of a state" and "a law of the Commonwealth" is to legislation, including subordinate legislation such as regulations.[41]

In the case of NDAs, DTAs expressly take effect as federal law according to their tenor. In the authors' view, it follows that, if a state tax were to be discriminatorily imposed on a foreign national of a DTA country with an NDA, a direct inconsistency between the federal law and the state law would arise, as the latter would impose a tax contrary to the relief granted by the former. That is, if allowed to operate, the state law would impose a greater tax obligation on the taxpayer than that provided by the federal law, namely, the tax treaty. The state law would thereby be invalid.

Local governments are lawfully constituted by state legislation which creates, empowers and regulates local government.[42] Thus, the same principle should apply in the case of any taxes imposed by local councils and like state authorities, as well as the Australian Capital Territory and the Northern Territory.[43]

NSW surcharge purchaser duty

In February 2023, Revenue NSW announced that foreign persons from New Zealand, Finland, Germany and South Africa may no longer be required to pay the "surcharge purchaser duty" and the "surcharge land tax". The announcement referred to "individuals" and "non-individuals" (such as corporations, trusts or partnerships). Individuals who are citizens of the nations concerned will no longer be required to pay surcharge purchaser duty and surcharge land tax. "Non-individuals" may also be affected where a tax liability arises because of the entity's affiliation with these nations. It is not clear why the determination does not refer to other Australian DTAs with an NDA. In particular, DTAs with India, Japan, Norway and Switzerland also include an NDA expressed to apply to "taxes of every kind and description".

In broad terms, the NSW "surcharge purchaser duty" applies in addition to transfer duty at 8% of the dutiable value where a "foreign person" acquires residential-related property in NSW. A "foreign person" is defined by reference to the definition in the *Foreign Acquisitions and Takeovers Act 1975* (Cth) but is modified to exclude Australian citizens.[44] That definition of a "foreign person" is then adopted for the purposes of the "surcharge land tax".[45]

The Victorian State Revenue Office has stated that it is aware of the issue but considers that the legal position in Victoria has not changed.[46]

It is not clear what approach other states will take in respect of existing taxes, although the authors understand that taxpayers have commenced proceedings to enforce the NDA in at least one other state.

Moreover, in respect of possible future state taxes, as discussed above, an NDA does not operate where discriminatory tax treatment applies by reference to tax residence as provided for by a DTA. As "tax residence" is not a concept that is otherwise generally or necessarily engaged by state taxes, there may be opportunities for states to impose discriminatory taxation on foreign nationals founded on their tax residence in a manner which does not conflict with an NDA in a DTA.

Dispute resolution

The dispute resolution options where taxes may conflict with an NDA will depend on the circumstances. Where there is an assessment process, objection and appeal rights will usually be engaged, although that may depend on the specific case. For example, in Victoria in the context of land tax, there are generally two overlapping schemes which may apply for the purposes of seeking a refund of overpaid tax,[47] although this will depend on whether the refund arises in the context of the invalidity of a tax law.[48]

In addition, Australian DTAs contain their own dedicated dispute resolution scheme in the form of the mutual agreement procedure (MAP) article (recently strengthened by the multilateral instrument[49]). The MAP enables a taxpayer to present a case to the relevant tax authority of either country for dispute resolution, where they consider that the actions of a country have resulted in taxation not in accordance with the provisions of the treaty. This is in addition to, and irrespective of, domestic law remedies. If the case remains unresolved, the taxpayer may request that the arbitration mechanism be used, if this is included in the MAP, as an option.

As the relevant tax authority for the MAP is the federal Commissioner of Taxation, questions arise as to how the MAP practically might be engaged in a dispute with a state tax authority. Those considerations are beyond the scope of this article.

Nevertheless, care must be taken in that process to ensure that time limits are met. For example, both NSW and Victoria have a one-year limitation period for proceedings to recover invalidly imposed taxes.[50] That might require proceedings to be issued for the recovery of taxes paid in mistake of law, notwithstanding that objection rights or the engagement of a MAP remained undetermined.

Conclusion

As *Addy* exemplifies, the relevant inquiry for the application of an NDA is fact-specific and complex, requiring consideration of the interaction between the DTA and the domestic legislation to determine whether there is an inconsistency. The analysis and outcomes may differ depending on the relevant tax, text of the legislation, and nature and circumstances of the taxpayer. For example, an application may now be relatively straightforward in the case of resident individuals on working visas who are nationals of DTA countries with an NDA, but less so in the case of corporations, trusts and partnerships, which may involve, for example, a tracing exercise.

In the event of ambiguity, regard to the principles of interpretation of DTAs is necessary. That requires consideration of the text, context, object and purpose of treaty provisions.[51] Regard may be required not just to the domestic explanatory memorandum, but also to the commentary to the OECD Model and other international guidance. When dealing with fiscally transparent entities, it will be necessary to consider whether the treaty provides for this, either in the original form or as modified by the multilateral instrument (eg the DTA with New Zealand is modified by art 3 of the multilateral instrument). Moreover, as the majority decision in the Full Federal Court in *Addy* demonstrated, any answer on those considerations is difficult and reasonable minds may differ as to the outcome.

Moving forward, Australia is in the process of extending and updating its treaty network. In November 2022, the federal government announced that new negotiations were planned with Bulgaria, Colombia, Croatia, Cyprus, Estonia, Latvia and Lithuania. This is in addition to the existing program covering Portugal, Slovenia, Greece and Luxembourg. It may be expected that these treaties will contain an NDA, although whether these follow the OECD Model and encompass state taxes will depend on the outcome of bilateral negotiations. Either way, the NDA will become more relevant to Australian international taxation in the future.

At this stage, the only conclusion that may be reached is that the law is unclear and evolving. Rapidly.

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3 *Convention between the Government of the Commonwealth of Australia and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income* [1983] ATS 16 (US DTA), art 23(4).

4 OECD, *Model Tax Convention on Income and on Capital*, condensed version, 2003, p 273, para 6.

5 Treasury, *Review of business taxation: a tax system redesigned*, 1999, p 678.

6 Ibid pp 678–679.

7 Ibid.

8 Ibid.

9 It is understood that the Australia–France DTA does not contain an NDA because France would not agree to the carve-outs that Australia was seeking. See CJ Taylor, "Some distinctive features of Australian tax treaty practice", (2011) 9(3) *eJournal of Tax Research* 294 at 325.

10 DTAs with Korea, Mexico, Romania, Spain and Taipei.

11 *Convention between Australia and New Zealand for the Avoidance of Double Taxation with respect to Taxes on Income and Fringe Benefits and the Prevention of Fiscal Evasion* [2010] ATS 10.

12 With respect to the 2016 treaty with Germany, see para 1.399 of the explanatory memorandum to the International Tax Agreements Amendment Bill 2016 (German DTA EM).

13 *Agreement between Australia and the Federal Republic of Germany for the Elimination of Double Taxation with Respect to Taxes on Income and on Capital and the Prevention of Fiscal Evasion and Avoidance* [2016] ATS 23 (German DTA), art 3(1)(k)(ii).

14 *Agreement with the Government of Finland for the Avoidance of Double Taxation with Respect to Taxes on Income and the Prevention of Fiscal Evasion, and Protocol* [2007] ATS 36 (Finland DTA), art 3(1)(m)(ii).

15 *Protocol Amending the Agreement with the Government of the Republic of South Africa for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income*, 1999, [2008] ATS 18, art 2, amending art 3.

16 OECD Model, art 24(1).

17 German DTA, art 24(1).

18 Several treaties exclude the final sentence of para 1 of art 24 of the OECD Model, which states that the article applies to persons who are not residents of either state. Consequently, residents of third countries are not able to seek the benefits of this article under those treaties. See the DTAs with Israel, Norway, Turkey and United Kingdom.

19 German DTA EM, para 1.400; *Addy* at [33].

20 German DTA EM, para 1.402.

21 This is included in the treaties with Finland, Germany, India, Japan, New Zealand, Norway, South Africa and Switzerland. A narrower definition is included in treaties with Chile, Iceland, Israel, Turkey, the UK and the United States.

22 For example, German DTA EM, para 1.415.

23 *Convention between Australia and the Swiss Confederation for the Avoidance of Double Taxation with respect to Taxes on Income, with Protocol* [2014] ATS 33 (Swiss DTA), art 2(3)(b); para 1.9 of the explanatory memorandum to the International Tax Agreements Amendment Bill (No. 2) 2007.

24 Para 1.13 of the explanatory memorandum to the International Tax Agreements Amendment Bill (No. 2) 2007.

25 *Addy* at [29].

26 *Addy* at [31].

27 *Addy* at [28].

28 *FCT v Addy* [2020] FCAFC 135 (*Addy FFC*).

29 *Addy FFC* at [223]–[226] (Derrington J) and [342]–[348] (Stewart J).

30 *Addy FFC* at [223] (Derrington J) and [343] (Stewart J).

31 S 3A(2) and (3) of the Rates Act.

32 *Addy* at [29].

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36 ATO, decision impact statement, *Addy v FCT*, 31 March 2022.

37 S 4 of the *International Tax Agreements Act 1953* (Cth).

38 *Blackley v Devondale Cream (Vic) Pty Ltd* (1968) 117 CLR 253 at 258.

39 *Ex parte McLean* (1930) 43 CLR 472 at 483.

40 *Wenn v Attorney-General (Vic)* (1948) 77 CLR 84 at 122.

41 *O'Sullivan v Noarlunga Meat Ltd* [1954] HCA 29.

42 For example, in Victoria, refer to the *Local Government Act 2020* (Vic), the *Local Government Act 1989* (Vic), and Pt IIA of the *Constitution Act 1975* (Vic).

43 For example, see s 122 of the Constitution.

44 Ch 2A of the *Duties Act 1997* (NSW).

45 S 2A of the *Land Tax Act 1956* (NSW).

46 State Revenue Office Victoria, *Taxes on foreign property investors*, 15 March 2023. Available at www.sro.vic.gov.au/news/taxes-foreign-property-investors.

47 *North West Melbourne Recycling Pty Ltd v Commissioner of State Revenue* [2017] VSC 647.

48 S 18(3) of the *Taxation Administration Act 1997* (Vic).

49 Ch 6 of the explanatory memorandum to the Treasury Laws Amendment (OECD Multilateral Instrument) Bill 2018.

50 S 20A of the *Limitation of Actions Act 1958* (Vic); s 2 of the *Recovery of Imposts Act 1963* (NSW).

51 *Addy* at [23].

A Matter of Trusts

by Magdalena Njokos, Sladen Legal

Mutual will agreements

In the absence of fraud, a mutual will agreement does not create a trust obligation on the surviving spouse in favour of other beneficiaries of the will.

It has generally been accepted that a mutual will is not a trust. However, does the existence of a mutual will agreement (MWA) create a trustee obligation on a surviving spouse over the assets of the deceased estate, thus providing a caveatable interest over estate assets in favour of other beneficiaries? The recent Queensland Supreme Court case of *Forster v Forster*[1] has provided a detailed analysis of the law on MWAs, finding that, in the absence of fraud, the trust obligations fall on the executors of the surviving spouse when they in turn die, rather than on the surviving spouse.

What are mutual wills?

Mutual wills are wills made, often between spouses of blended families, whereby there is an agreement on how their estates are to be distributed (ie to each other initially and then to particular agreed beneficiaries), and then a promise that the survivor of the spouses will not change their will, therefore maintaining the gifts/distributions made to the particular agreed beneficiaries. The agreement may restrict the use of assets/spending/gifts or may leave the surviving party unrestricted access to assets.

Generally, an MWA will set out in writing (although it is possible to evidence an oral agreement) that each party agrees to:

- execute a will with the agreed distribution;
- do all things necessary to ensure that the property of the respective estates devolved in the manner provided by the will;
- not intentionally do or omit in doing anything to diminish the respective estate (save for spending to maintain their lifestyle enjoyed at the date of the agreement, for example); and
- not revoke the will without notice to the other party.

An MWA can be an effective tool, especially for blended families, where the couple would like to ensure that the survivor of them is looked after with flexibility, on the understanding that the survivor will uphold the mutual wishes for the distribution of the estate on the death of both of them. Enforceability by beneficiaries can be problematic.

Trust obligations

Notwithstanding an MWA and the contractual promises made under it, a will is a revocable instrument and an MWA cannot prevent a person from making a new will. However, if an MWA is in place, equity can intervene:[2]

> "Equity will not permit the surviving party to an MWA to deal with the property the subject of the MWA in a way that is contrary to the MWA by revoking their mutual will and executing another. Notwithstanding the later will, equity will *specifically enforce* the MWA, including by way of imposing a constructive trust upon the property the subject of the MWA for the benefit of those whom the property was ultimately promised."

Forster v Forster has demonstrated that often (in the absence of fraud and breach of the MWA) the "trust" obligation exists only on the death of the surviving party to the MWA (ie the executors of the last spouse to die will hold property on constructive trust for the beneficiaries named in the will the subject of the MWA).

Background

Mrs Forster and Mr Forster were married and each had children from previous relationships. They entered into an MWA under which they agreed to execute wills which left their respective estates to each other on the death of one of them and their combined estate equally between all five of the children/step-children. Pursuant to the MWA, on the death of one of them, they agreed to not make a new will unless such will distributed their estate between the children, and also to not diminish the estate other than for their own reasonable living expenses.[3]

Mr Forster passed away.

His son (the applicant) did not trust Mrs Forster and was worried that she would dispose of properties inherited by her from Mr Forster or change her will. He subsequently filed proceedings seeking a declaration that the estate, in particular residential properties, Mrs Forster had inherited from Mr Forster would be held on trust by Mrs Forster for all of the children (arguing that the terms of the MWA created a constructive trust of which Mrs Forster was the trustee, therefore creating trustee obligations on Mrs Forster). In addition, the applicant requested that Mrs Forster disclose (relying on s 8 of the *Trusts Act 1973* (Qld)[4]) her assets and liabilities on an annual basis.[5]

Mrs Forster argued that she had not done anything to breach the MWA and that the applicant's application was "entirely misconceived and based on a misapprehension of the law of mutual wills and constructive trusts". She recognised that, while the MWA imposed obligations on her which she intended to maintain, the MWA did not "create" a trust at the time of executing it, nor at the time of the deceased's death. Mrs Forster highlighted that a constructive trust is a remedy imposed by the Courts of

Equity to prevent fraud, and in this case, no fraud existed, therefore there was no trust obligation.[6]

Questions for the court

The key issues considered by the court were:

1. whether Mrs Forster held the property inherited from Mr Forster's estate, the subject of the MWA, as constructive trustee for her children and step-children; and
2. whether the court should make an order under s 8 of the *Trusts Act 1973* (Qld) requiring Mrs Forster to disclose her financial position to the applicant annually.

The applicant and Mrs Forster proceeded on the basis that the success of the applicant's application depended on the court's findings as to question 1, which may then render question 2 as applicable. However the court had noted that this was an oversimplification, stating that a finding that Mrs Forster was a constructive trustee of the property did not automatically result in requiring her to account to the applicant.[7]

Decision

After considering each of the cases relied on by the applicant to address question 1, which included the Australian landmark case on mutual wills, *Birmingham v Renfrew*,[8] and evidence of fraud (or lack thereof) provided by the applicant, the court stated that Mrs Forster is the:[9]

> "absolute owner of the deceased's property and (of course) her own property, subject to a floating obligation[10] to deal with it only in accordance with the MWA (which may see her use some of it up); which obligation crystallises upon her death into a trust over the property which remains, to ensure its distribution as per the terms of the MWA."

The court found that there was no evidence established by the applicant that Mrs Forster was in breach of the MWA or that there was any fraud on her behalf. The applicant relied only on suspicion and mistrust, and fell short of establishing reasonable grounds that Mrs Forster might do an aggrieving act or decision.[11] Therefore, as to question 1, Mrs Forster did not hold the property the subject of the MWA on constructive trust for the applicant (or for the other four children) during her lifetime.

If an order was to be made by the court that the estate property was held on trust for the children, the court noted that this would deprive Mrs Forster of the right to enjoy the estate property during her lifetime. Based on the authorities analysed by the court in this case, the court would not intervene to make such declarations unless it was satisfied by the evidence that Mrs Forster breached the MWA by disposing of property and changing her will.

The proceedings were dismissed.

Conclusion

Despite various opinions on the general use of MWAs in an estate planning context, it is clear that they are very much an effective tool for creating binding obligations between parties that will be enforced by the courts. *Forster v Forster* has endorsed this and has provided a thorough analysis of the obligations of a surviving party to the MWA, when trustee obligations are created, and the circumstances of when a court is likely to intervene with a finding of a constructive trust over estate property.

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References

1 [2022] QSC 30.

2 *Forster* at [47].

3 *Forster* at [17].

4 In other jurisdictions such disclosure powers may appear in the relevant General Civil Procedure Rules or Probate and Administration Acts for that jurisdiction.

5 *Forster* at [33]–[34].

6 *Forster* at [41].

7 *Forster* at [38].

8 [1937] HCA 52.

9 *Forster* at [79].

10 It is worth noting that the court referred several times to the Victorian case of *Flocas v Carlson* [2015] VSC 221 when discussing the "floating obligation" of the surviving party to an MWA, and the crystallisation of such a floating obligation resulting in a trust on the death of the surviving party.

11 *Forster* at [10].

Superannuation

by William Fettes and Daniel Butler, CTA, DBA Lawyers

The new 15% tax on $3m+ member TSBs

Considerable controversy relates to the proposed tax on unrealised gains, especially when the new tax is expected to predominantly impact SMSFs and SMSFs can report taxable earnings.

Overview

Broadly, from 1 July 2025, where a member's total superannuation balance (TSB) exceeds $3m, an increase in their TSB at the end of the relevant financial year (as adjusted for withdrawals and contributions) will be assessed to them personally as ordinary income. The increased amount of TSB will be subject to a maximum 15% tax, levied on a proportionate basis to the extent that the member's TSB exceeds $3m.

This article provides an analysis of several tax aspects of the proposed new 15% tax that is intended to apply from 1 July 2025. The key point of this article is for trustees, advisers and members to be aware of these tax points in order to be better informed in relation to the new tax. The authors remain "neutral" on the proposed tax and do not seek to influence a particular outcome in relation to the differing policy proposals that are being considered as part of Treasury's consultation process.

For ease of expression, the term "TSB" is referred to throughout this article rather than "TSB (as adjusted for withdrawals and contributions)", apart from extracts taken from Treasury's *Better targeted superannuation concessions* (consultation paper).[1] This article assumes that the new tax will include the design features outlined in the consultation paper. After a brief industry consultation, the 2023–24 Federal Budget confirmed that the new tax would proceed. However, there were no details of any changes relating to that consultation process.

How the new tax will work

The consultation paper outlines a helpful three-step process regarding how the new tax works:

> "First, earnings in relation to an individual's TSB are calculated as the difference between their TSB for the current year (adjusted for withdrawals and contributions) and their TSB from the previous financial year.
>
> $$\text{Earnings} = (\text{TSB}_{\text{Current Financial Year}} + \text{Withdrawals} - \text{Net Contributions}) - \text{TSB}_{\text{Previous Financial Year}}$$
>
> … under the second step, earnings are then attributed to superannuation balances of more than $3 million on a proportional basis. The proportion is equal to the proportion of the TSB over $3 million.
>
> $$\text{Proportion of Earnings} = \frac{\text{TSB}_{\text{Current Financial Year}} - \$3\text{ million}}{\text{TSB}_{\text{Current Financial Year}}}$$
>
> For example, Sarah's TSB on 30 June 2026 is $6 million. The proportion of her TSB more than $3 million is 50 per cent ([$6 million – $3 million] ÷ $6 million). In this case 50 per cent of the calculated earnings from step 1 will attract the additional tax.
>
> Finally, a flat tax rate of 15 per cent is applied to the proportion of earnings attributable to an individual's balance over $3 million.
>
> $$\text{Tax Liability} = 15\text{ per cent} \times \text{Earnings} \times \text{Proportion of Earnings}$$
>
> For example, Sarah's calculated earnings are $650,000, however only 50 per cent of these earnings are attributed to her TSB more than $3 million and attract the additional 15 per cent tax.
>
> Sarah's tax liability is $48,750 (15 per cent x $650,000 x 50 per cent)."

Is an increase in TSB a good proxy for earnings?

The consultation paper states:

> "The approach to estimate earnings seeks to be simple and minimise unnecessary or additional compliance costs by largely relying on data reported through existing arrangements."

In summary, any increase in a member's TSB above $3m will be assessed as ordinary income, subject to certain adjustments made for withdrawals and contributions. Moreover, Treasury has flagged that modifications for other factors are being actively considered. Treasury requested feedback on the proposed regime outlined in the consultation paper prior to 17 April 2023.

Note that numerous submissions to Treasury have requested changes to the current definition of "total superannuation balance" in s 307-230 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) as this definition applies to the proposed new tax. These submissions cover a range of proposed modifications, including in relation to family law splits, insurance proceeds (eg for permanent incapacity and terminal illness), and other matters.

Helpfully, Treasury has informally confirmed that a member's share of an outstanding borrowing, in relation to a limited recourse borrowing arrangement that is added to a member's TSB under s 307-230(1)(d), will not be counted for the purposes of the new tax.

While Treasury is seeking to minimise the costs and complexity, it is likely that further complexity, reporting, costs and disputes will arise in relation to administering and collecting the new tax. The relevant question to be asked is whether the level of cost and complexity of the current proposal will, after more considered analysis, especially to cater for defined benefit funds, result in a simpler model being decided on that might be based on a "simple" deemed rate of return on a member's opening TSB for the relevant financial year where the deemed rate for that year does not reflect unrealised gains.

The Federal Budget confirmed that interests in defined benefit schemes will be appropriately valued and will have earnings taxed under this measure in a similar way to other interests to ensure commensurate treatment.

Unrealised gains will be subject to the new tax

Broadly, a member's TSB generally reflects the withdrawal value of their superannuation interests. This includes unrealised gains and losses on fund assets.

Large funds implement tax effect accounting (TEA) which, among other things, provides for the estimated tax on any unrealised gains or losses. While we suspect that TEA is not widely employed by self-managed superannuation funds, members with SMSFs that will be subject to the new tax may wish to consider and obtain advice on whether TEA is appropriate for their fund.

Recent media coverage on certain submissions made by industry and the professions to Treasury has taken issue with the proposal insofar as it seeks to bring unrealised gains to tax. Although, naturally, there are diverse views on the best way to proceed on this issue, some have submitted that:

- tax should only be on realised gains;
- funds should be given the option to report actual taxable income on a member basis; and
- a deemed rate of return (adjusted for unrealised gains) should be used as a proxy for earnings.

In terms of what actually eventuates, we will of course need to await the draft legislation and the prospect of further consultation.

Let's assume for now that tax will be levied on TSB increases, reflecting unrealised gains – this will be a substantive change to our current tax system that predominantly relies on taxing realised gains. The realisation principle has been with us since the CGT regime was introduced on 19 September 1985, and it relies on a CGT event to crystallise a capital gain or capital loss.

Members can apply for a release of superannuation

The new tax will be levied on the member and not the fund itself. However, a member will be given the opportunity to withdraw moneys to pay the tax under a "release authority" arrangement that is similar to what is in place for Div 293 ITAA97 tax. Division 293 tax is imposed on a member where their adjusted taxable income exceeds $250,000 in a financial year, and an extra 15% tax applies to their concessional contributions that exceed $250,000 (this is a simplification of the Div 293 tax regime which is more complex than this broad summary).

Submissions were also made that members impacted by the new tax should be entitled to withdraw any excess above $3m from the superannuation environment even if they have not satisfied a condition of release such as retirement after attaining 60 years. However, constitutional reasons may make this difficult to implement.

Negative earnings

The consultation paper states:

> "**Negative earnings**
>
> Investment losses or fund expenses could cause an individual's TSB to be less at the end of a financial year than it was at the end of the previous financial year. Reductions of this kind are recognised in the earnings calculation and will mean that individual has negative earnings for the financial year. Where this occurs, the amount of the negative earnings will be able to be used to offset positive earnings in future years. This will be done on a gross basis (that is, before proportioning of earnings occurs).
>
> Negative earnings can be applied against any future positive earning, would not expire and could be applied over multiple years. Capital losses that are reflected in negative earnings can be used to offset any future positive earnings that relate to income, including rent and interest."

The consultation paper proposes that negative earnings are quarantined and can only offset future earnings in relation to an increase in the member's TSB. This may result in members who have paid tax on an increased TSB obtaining a benefit in the future if their TSB decreases. However, it may also result in members who have paid tax on an increased TSB not obtaining any benefit from the offset, eg where the member's TSB does not recover above the threshold for tax. In that case, the member would have effectively overpaid the amount of tax if they can no longer recover the amount of negative earnings from a future increase in TSB from their superannuation interests.

There are a range of circumstances that may arise where members may not be in a position to benefit from an offset due to fund balances being adversely impacted, eg due to:

- poor investment decisions; and
- cyber-crime and scams (which is an increasing threat) which can easily result in substantial losses.

Further, we are aware of some SMSFs that have suffered substantial losses from investing or trading in "crypto", options, contracts for differences, and similar types of investments, and in several cases, where the fund went into a considerable negative asset territory and the individual trustee lost assets in their own name (unfortunately, one fund did not have a corporate trustee).

Thus, the proposed quarantining of losses against earnings will result in the potential for tax to be paid on unrealised losses or negative earnings. There is also the potential for some double taxation as superannuation fund trustees are entitled to a one-third CGT discount on assets held for more than 12 months. In contrast, the new 15% tax on members does not reflect any CGT discount. Moreover, there is the time value of money to consider as tax is payable on positive earnings, with negative earnings only ever being of any value if and when future positive earnings arise.

Some submissions have also noted that members with more than $3m in superannuation will be taxed at a higher tax rate on capital gains on their superannuation balances under the new 15% tax compared to the tax rate that an individual would pay on the disposal of an asset held outside the superannuation environment for more than 12 months after the 50% CGT discount is taken into account (eg 45% x 50% = 22.5% (ignoring Medicare)). This results in a potential 25% tax being paid on superannuation assets (assuming that the one-third CGT discount applies) compared to a 22.5% that would apply to assets outside of superannuation. This appears at odds with tax equity.

Options for negative earnings

Some submissions, such as The Tax Institute's submission,[2] suggested that a loss "carry-back" regime should be considered. Broadly, under this regime, a loss in a subsequent financial year could be carried back to apply for a refund of tax overpaid in a prior financial year.

It is interesting to note that there has been a temporary loss carry-back regime for company losses under Div 160 ITAA97 in recent years. Broadly, an eligible corporate entity can choose to "carry back" a tax loss that it incurs in the 2019–20, 2020–21 or 2021–22 financial year and offset it against the income tax liability of earlier income years as far back as the 2018–19 income year to generate a refundable tax offset. This regime ends on 30 June 2023.

There may be other options that could also overcome the downside to those who pay tax on negative earnings that may arise under the current proposal in the consultation paper.

Naturally, if funds are provided the option to report taxable income (including realised capital gains), this would overcome the issue. Moreover, given the substantive move to tax positive earnings (including unrealised gains) as ordinary income, a loss carry back or deduction for negative earnings has merit compared to quarantining negative earnings to only offset future positive earnings.

The SMSF Association has submitted that 75% of those predicted to be impacted by the new tax are likely to be SMSF members and, as a result, SMSFs should be given the option of reporting actual taxable income or opting for a deemed rate of return.

Conclusion

The current proposal of tracking earnings on the movement in a member's TSB raises several issues. While there may be some appeal to relying on what might initially appear to be a simple method for the ATO to collect the relevant data, taxing unrealised gains is a substantive change that warrants further consideration of options to alleviate the concerns raised.

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References

1 Treasury, *Better targeted superannuation concessions*, consultation paper, 31 March 2023. Available at https://treasury.gov.au/consultation/c2023-373973.

2 The Tax Institute, *Better targeted superannuation concessions*, submission to Treasury, 17 April 2023.

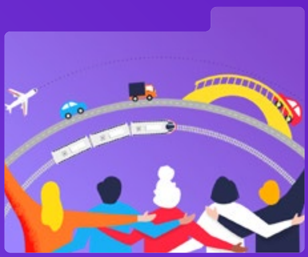
Events Calendar

Upcoming months

JUNE
7–8
Wed–Thu

NSW

National Infrastructure Conference



12 CPD hours

JUNE
9
Fri

Online

Regional Masterclass

7 CPD hours

JUNE
15–16
Thu–Fri

QLD | Online

Agribusiness Intensive

13 CPD hours

JUNE
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VIC | Online

Not-for-profit Tax Intensive

7 CPD hours

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NSW | Online

International Masterclass

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