The Tax Institute

Tax Update

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About Brown Wright Stein

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At Brown Wright Stein, we believe in excellence in everything we do for our clients. It's this commitment that enables us to develop creative, innovative solutions that lead to positive outcomes.

Contents

Our tax training notes are prepared by Marianne Dakhoul, Jane Harris, Rose McEvoy, Matthew McKee, Gillian Tam, and Hayden Rudd.

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The Tax Update Pitstop provides a quick reference to the top 5 tax matters from the month as determined by our experts.

Tax Update Matter	Impact Summary	Further Detail
2.2 BQKD	The AAT has held that car benefits provided to directors of a corporate trustee were fringe benefits as the directors were not employees of the corporate trustee and, in any event, the benefits were not provided in connection with employment.	Page 8
2.3 Robson	The Federal Court has held that a bankruptcy trustee will be personally liable under section 254 of the ITAA 1936 for the tax on assets of the bankrupt that are sold during the bankruptcy.	Page 11
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8.1 New obligations for Code of Professional Conduct	On 2 July 2024 the Deputy Treasurer, Stephen Jones, made the Tax Agent Services (Code of Professional Conduct) Determination 2024, which creates additional obligations on tax agents under the *Tax Agents Services Act 2009* (Cth).	Page 58

2. Cases

2.1 Kilgour – non arm's length dealing

Facts

Punters Paradise Pty Ltd carried on a gambling business in the horse racing industry.

The shares in Punters were held by three trusts associated with Lucas Pettett and his wife Melissa Pettett, Heath Kilgour and his wife Sarah Alice Kilgour, and Nathan Isterling and his wife Tamara Isterling.

Heath, the Chief Operating Officer of Punters, leveraged his prior experience in the gambling industry and assisted Punters in building relationships with racing authorities and media companies like News Corp. Heath was connected to Nick Babos, the Head of Product Strategy & Distribution in a News Corp Australian subsidiary. By 2014, Punters' content was being published on News Corp platforms, increasing its visibility.

In around 2015, Lucas, Heath and Nathan resolved to sell Punters or its business if an opportunity arose. Lucas considered that the Punters should be sold at a price that reflected a multiple of 10 x EBITDA.

On 1 January 2016, Punters engaged a sales agent, Daniel Bernstein, to prepare an information memorandum on Punters and to start setting up an online data room for the purposes of its sale.

On 17 February 2016, Nick initiated a meeting between representatives of Punters and News Corp, where Damien Eales, who was the Managing Director of News Corp's Australian operating companies, expressed interest in acquiring Punters.

On 22 March 2016, following a site visit to Punters' office in early March, News Corp executed a non-disclosure agreement relating to the possible acquisition of Punters.

In subsequent meetings between representatives of Punters and News Corp between March and April 2016, Simon Anderson, a representative of New Corp, also expressed enthusiasm for the acquisition.

Throughout mid-2016, detailed discussions and site visits took place, leading to several non-binding indicative offers from News Corp. In meeting between Damien and Simon of News Corp, and Lucas and Heath of Punters, it was made clear that Punters sought a 100% cash deal and expected a valuation around $30 million.

Initially within News Corp, the acquisition team prepared a detailed internal document on 28 April 2016 outlining the potential acquisition strategy, benefits, risks, and financial implications of acquiring Punters. Importantly, this internal document identified the enterprise value for Punters to be $30 million.

On 13 May 2016, a memorandum was submitted by News Corp's internal team to News Corp's Executive Chairman and to the CFO on the potential acquisition of Punters. In early July 2016, News Corp Australia executives prepared another memorandum for the Office of the Chief Executive Officer in New York.

By July 2016, the internal review in News Corps Australia and News Corp head office in New York had culminated in a recommendation to proceed with the acquisition.

On 4 October 2016, the Share Sale Agreement was executed, marking the formal acquisition of Punters by News Corp's Australian subsidiaries for a total consideration of $30 million, paid entirely in cash.

In the 2017 income year, the trusts that had held the shares in Punters made distributions of the capital gains arising from the sale to Lucas and Melissa, Heath and Sarah, and Nathan and Tamara.

The tax returns of the beneficiaries were lodged based on the capital proceeds actually received. The beneficiaries then objected to their income tax assessments on the basis that Punters and News Corp did not deal at arm's length and the market value substitution rules should apply to modify the capital proceeds of the shares from $30 million to $18.2 million.

Sarah and Tamara sought to apply the small business CGT concessions to reduce or eliminate their capital gains.

The Commissioner disallowed the objections.

The beneficiaries sought review of the objection decisions in the Federal Court.

The beneficiaries claimed that the tax assessments based on the actual sale proceeds were excessive because they did not reflect the true market value of the shares. They argued that the market value was less than the sale price received, suggesting that the price paid by News Corp included a strategic premium or special value to the buyer that should not be considered in determining the market value for tax purposes.

The beneficiaries contended that due to the non-arm’s length nature of the transaction, the "market value substitution rule" under section 116-10(2) of ITAA 1997 should apply. This rule allows for substituting the actual sale price with a market value determined by the ATO, if the transaction is not at arm’s length.

The beneficiaries also tendered expert evidence from professional valuers that:

1. the “enterprise market value” of all the shares in Punters immediately prior to the sale was $18.2 million; and
2. that the purchase price paid by News Corp was inflated and included a “special” or “strategic price”, in the order of $12.5 million.

The valuers considered the "special price" represented a synergistic benefit that News Corp saw in the shares in Punters.

Sarah and Tamara argued that if the market value substitution rule was applied and the market value was determined to be lower, they would meet the maximum net asset value test requirements for the small business CGT concessions under Division 152 of the ITAA 1997.

Issue

Were the shareholders of Punter at arm’s length to News Corp in relation to the sale of shares in Punters?

Decision

Logan J observed that, when determining if parties were dealing at arm's length, the considerations are:

1. what connection existed between the parties “in connection with” the dealing; and
2. if so, to what extent, there was any connection between the parties.

In the context of News Corp’s acquisition of Punters, the evidence was that News Corp and the vendor shareholders of Punters were unrelated parties who formed their views independently and dealt with each other based on their own assessments of the share value.

Logan J also noted, if the capital proceeds deviate from the market value, this may suggest non-arm's length dealings. An examination of the circumstances, including the asset’s features, market conditions, and comparable sales, may reveal whether the price is aberrant. However, merely proving that a disposal was at or below market value is not sufficient to demonstrate whether the dealing was at arm's length.

In relation to market value, Logan J concluded that the actual sale proceeds from the arm's length transaction accurately reflected the market value of the shares. Therefore, even if the price included a "special" or "strategic" element, Logan J considered that it formed part of the "market value" as understood in the relevant provisions. Logan J cited authorities including *Inland Revenue Commissioners v Clay* [1913] UKLawRpKQB 227 and *Commissioner of Taxation v Miley* [2017] FCA 1396; (2017) 106 ATR 779, and observed that hypothetical market attributes of an asset that are of value to a specific purchaser should be included in valuing the shares in Punters.

News Corp's decision, made at the highest level and remote from Australia, was influenced by its strategic commercial interests and perceived synergistic benefits of owning Punters. The evidence demonstrated that the negotiations were conducted independently, with genuine bargaining and strategic commercial considerations. The lack of any pre-existing relationship, the thorough internal decision-making process within News Corp, and the multiple rounds of offers and counteroffers all supported the conclusion that the transaction was at arm's length.

On this basis, Logan J concluded that the vendor shareholders in Punters and News Corp dealt with each other at arm's length in the disposal of all the shares in Punters.

The market value substitution rule did not apply, and the strategic premium specific to News Corp was considered part of the market value. As a result, the tax assessments based on the actual sale proceeds were upheld, and Sarah and Tamara did not qualify for the small business CGT concessions due to exceeding the maximum net asset value threshold.

Citation *Kilgour v Commissioner of Taxation* [2024] FCA 687 (Logan J, Queensland)
w https://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/FCA/2024/687.html

2.2 BQKD – non-cash benefit

Facts

BQKD was the corporate trustee of a discretionary family trust.

BQKD was in the business of operating convenience stores with petrol stations and fast food restaurants, and tobacco and convenience stores.

The deed which established the family trust was signed on 1 October 1987.

The family trust was established by Mr Smith's parents. The trust deed allowed for distributions to a wide class of eligible beneficiaries, including family members and associated entities.

Originally, BQKD's directors were Mr Smith's parents and the oldest son. After the father's passing in 2009 and the mother's retirement from her directorship in 2014, Mr Smith and his brothers became the directors and shareholders of BQKD. The brothers, together with their mother, continued to be eligible beneficiaries under the family trust.

Under the trust deed, BQKD was permitted to allow beneficiaries to have custody of and use any immovable property or chattels forming part of the trust fund.

BQKD was the principal operating company within the wider network of operating vehicles and the profits of other companies were paid into the trust. BQKD employed most of the staff and paid for common services such as IT, finance and advisory services.

The brother made collective board decisions for the group, but also focused on different aspects of the operations. They employed executives to manage different functions, reporting primarily to Mr. Smith. The directors were committed to the family business and devoted much of their time and effort into the business.

Between the 2016 and 2020 FBT years, luxury motor vehicles purchased in the name of BQKD were made available for use by the three directors. Each director used the vehicles allocated to him for business and personal use during the relevant FBT years.

The Commissioner included the taxable value of the private use of the cars in amended FBT assessments, on the basis that the directors were employees of BQKD and the non-cash benefit were paid to them as employees.

BQKD contended that the directors managed its affairs, as directors, or as owners or beneficiaries under the trust, not as employed managers. BQKD further argued that even if the directors were employees, the benefits were not made available to them in respect of their employment. Rather, the benefits were made available to them as directors, or as beneficiaries under the trust.

At hearing, there was limited evidence of formal decisions being made by the trust to supply the vehicles to the directors as beneficiaries. The value of private use was not recorded as a distribution to the individual brothers. Benefits such as the use of motor vehicles were attributed to the mother's beneficiary account and debited accordingly.

Issues

1. Were the directors' employees of BQKD?
2. If it was found that there was an employment relationship, were non-cash benefits paid to the directors as employees?

Decision

The AAT allowed the objection decision to allow the interest deduction but affirmed it in all other aspects.

The Deputy President noted in the context of corporation law, the relationship between corporation and its human actors, which could be shareholders, directors or employees, required consideration. In determining whether an employment relationship existed, the Deputy President considered the High Court decisions of *Construction, Forestry, Maritime, Mining and Energy Union v Personnel Contracting Pty Ltd* [2022] HCA 1 and *ZG Operations Australia Pty Ltd v Jamsek* [2022] HCA 2 and the emphasis on the contractual terms in ascertaining the relationship between the parties.

In this case, the Deputy President held that the absence of formal written employment contracts, the lack of control, the directors' position at the apex of the company, and the overall indicia, did not support the characterisation of an employment relationship. The directors behaved as owners with substantial autonomy rather than employees, pointing towards a relationship based on shared ownership and collective management rather than employment.

Even if it was found that there was an employment relationship, the benefits would only be regarded as fringe benefits if they were provided in respect of employment. The Deputy President concluded the brothers had access to the motor vehicles not to reward them as directors or employees, but as beneficiaries.

COMMENT – these principles also apply on the 'flip-side'. That is, where an operating entity is a private company and you want FBT to apply and Division 7A not to apply. Further, it is necessary to consideration the deductibility of the expenses if the person to whom the benefits are provided is not an employee.

Citation *BQKD and Commissioner of Taxation (Taxation)* [2024] AATA 1796 (Deputy President Bernard J McCabe, Adelaide)
w https://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/AATA/2024/1796.html

2.3 Robson – liability of a bankruptcy trustee for tax on sale of bankrupt's assets

Facts

On 14 July 2015 Clifford Lanning purchased two properties in Noosa, Queensland.

On 12 December 2019 Clifford was made bankrupt and William Robson was appointed as his trustee in bankruptcy.

On 14 November 2020, a contract was executed for the sale of one of the properties for $155,000 with settlement occurring on 14 December 2020.

On 1 May 2021, a contract was executed for the sale of second property with a purchase price of $233,000, with settlement occurring on 31 May 2021.

On 18 May 2022, William applied for a private ruling. The question asked by William and the answers by the Commissioner were as follows:

> **Question 1**
>
> *In respect of the capital gains tax payable on the gain made from the sale of the Properties, [is the applicant] liable for the payment of tax in [his] capacity as Trustee for the Bankrupt Estate of Clifford Dylan Lanning having regard to the operation of s 106-30 of the Income Tax Assessment Act 1997 (ITAA 1997)?*
>
> ***Answer:*** *Yes, to the extent of [the applicant's] obligations under section 254 of the Income Tax Assessment Act 1936 (ITAA 1936).*
>
> ***Question 2***
>
> *In [the applicant's] capacity as Trustee for the Bankrupt Estate of Clifford Dylan Lanning:*
>
> *(a) [is he] answerable by operation of s 254(1) of the ITAA 1936 or otherwise, in respect of the income, or capital gains made from the sale of the Properties?*
>
> ***Answer:*** *Yes.*
>
> *(b) [is he] subject to the retention obligations under [s 254(1)(d)] of the ITAA 1936?*
>
> ***Answer:*** *Yes.*
>
> *(c) will [he] be made personally liable under [s 254(1)(e)] of the ITAA 1936 in respect of any tax payable on the gains made from the sale of the Properties, prior to the issue of a Notice of Assessment, if [he fails] to retain monies or [he pays] away monies that have been retained, in respect of the tax liability?*
>
> ***Answer:*** *No.*
>
> *(d) will [he] be made personally liable under [s 254(1)(e)] of the ITAA 1936 in respect of any tax payable on the gains made from the sale of the Properties, post the issue of a Notice of Assessment but prior to the*

assessed liability becoming due and payable, if [he fails] to retain moneys or [he pays] away monies that have been retained, in respect of the tax liability?

Answer: *Yes.*

On 22 December 2022, William objected to the ruling on two grounds. Firstly, William contended that section 106-30 of the ITAA 1997 operated to deem the assets to be assets of the bankrupt despite the assets having vested in William as the bankruptcy trustee. Section 106-30 of the ITAA 1997 relevantly provides as follows:

(1) For the purposes of this Part and Part 3-3 (about capital gains and losses) and Subdivision 328-C (What is a small business entity), the vesting of the individual's CGT assets in the trustee under the Bankruptcy Act 1966 or under a similar foreign law is ignored.

(2) This Part, Part 3-3 and Subdivision 328-C apply to an act done in relation to a CGT asset of an individual in these circumstances as if the act had been done by the individual (instead of by the trustee etc.):

(a) as a result of the bankruptcy of the individual by the Official Trustee in Bankruptcy or a registered trustee, or the holder of a similar office under a foreign law;

(b) by a trustee under a personal insolvency agreement made under Part X of the Bankruptcy Act 1966 , or under a similar instrument under a foreign law;

(c) by a trustee as a result of an arrangement with creditors under that Act or a foreign law.

Further, William contended that section 254 of the ITAA 1936, which can make trustees personally liable for tax in certain scenarios, had no application to him as a trustee in bankruptcy is not a trustee for the purpose of section 6 of the ITAA 1936. Section 254 of the IAA 1936 relevantly provides as follows:

(1) With respect to every agent and with respect to every trustee, the following provisions shall apply:

(a) He or she shall be answerable as taxpayer for the doing of all such things as are required to be done by virtue of this Act in respect of the income, or any profits or gains of a capital nature, derived by him or her in his or her representative capacity, or derived by the principal by virtue of his or her agency, and for the payment of tax thereon.

(b) He or she shall in respect of that income, or those profits or gains, make the returns and be assessed thereon, but in his or her representative capacity only, and each return and assessment shall, except as otherwise provided by this Act, be separate and distinct from any other.

...

(d) He or she is hereby authorized and required to retain from time to time out of any money which comes to him or her in his or her representative capacity so much as is sufficient to pay tax which is or will become due in respect of the income, profits or gains.

(e) He or she is hereby made personally liable for the tax payable in respect of the income, profits or gains to the extent of any amount that he or she has retained, or should have retained, under paragraph (d); but he or she shall not be otherwise personally liable for the tax.

…

The Commissioner disallowed the objection, noting that William is a trustee under section 6 of the ITAA 1936 and that, once an assessment is issued, William is subject to the retention obligation in section 254 of the ITAA 1936 such that he will be personally liable for any tax should he not retain the proceeds for sale payment of the tax.

Section 6 of the ITAA 1936 defines ‘trustee’ as follows:

> ***Trustee** in addition to every person appointed or constituted trustee by act of parties, by order, or declaration of a court, or by operation of law, includes:*
>
> *(a) an executor or administrator, guardian, committee, receiver, or liquidator; and*
>
> *(b) every person having or taking upon himself the administration or control of income affected by any express or implied trust, or acting in any fiduciary capacity, or having the possession, control or management of the income of a person under any legal or other disability.*

William sought review of the objection decision in the Federal Court of Australia. William did not contend he was not a trustee within the meaning of section 6 of the ITAA 1936 at the hearing, but argued that section 106-30 of the ITAA 1936 meant that he was not liable under section 254 of the ITAA 1936 as the capital gains from the sale of the properties were not 'income, or any profits or gains of a capital nature, derived by him or her in his or her representative capacity'. The capital gains were derived by the bankrupt.

William also contended that an interpretation of section 254 in the manner proposed by the Commissioner, in effect, gave preferential treatment to the Commissioner.

Issue

Whether William is liable under section 254 for the tax on the sale of the properties if he does not retain the proceeds after an assessment is issued?

Decision

Downes J in the Federal Court held that William, as a bankruptcy trustee, is a trustee within the meaning of section 6 of the ITAA 1936. Downes J considered that section 254(1)(a) creates a liability on the trustee that is ancillary to the liability of the beneficiary. It is not an answer to section 254 to say that the primary liability under the taxing acts was imposed on the beneficiary.

Further, the deeming of the capital gain to the beneficiary in section 106-30 of the ITAA 1997 only applies for Part 3-1 and Part 3-3 of the ITAA 1997. It does not mean that trustee has not derived the capital gain in an ordinary sense under section 254 of the ITAA 1936.

Downes J noted that a liability to pay capital gains tax, which liability crystallises upon the sale of an asset by a trustee in bankruptcy, is not a debt provable in the bankruptcy. The trustee has a right to be indemnified from the bankrupt for any tax required to be paid to the Commissioner.

COMMENT – this is considered a very significant decision by insolvency practitioners as it is contrary the previously understood position. An appeal is expected.

Citation *Robson as trustee for the bankrupt estate of Lanning v Commissioner of Taxation* [2024] FCA 720 (Downes J, Brisbane) w https://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/FCA/2024/720.html

2.4 ZWBX – early stage innovation company

Facts

ZWBX is an individual.

ZWBX was involved in the development of 'ZYX Software', a cloud-based client communications management platform. In around July 2016, ZWBX and the other individuals involved in the development of the software engaged an accountant to provide advice on an appropriate corporate structure to own and operate the software business, reduce risk and provide flexibility.

On 27 July 2016, ABC Pty Ltd was incorporated, with ZWBX being the sole director/secretary and holding 10 ordinary shares, being 100% of the capital. ABC was appointed as trustee of the BC Trust, which was also established on 27 July 2016. ZWBX is the appointor and principal beneficiary of the BC Trust.

On 14 September 2016, Holding Co Pty Ltd and IP Co Pty Ltd were incorporated, with ZWBX, Mr EE, Mr EF and Mr F being appointed as the directors of both companies (Mr F retired as a director on 30 May 2018). All of IP Co's shares were issued to Holding Co. The shares in Holding Co were issued to various members, including, relevantly, 50,000 "A" Class shares at $0.01 per share to the BC Trust.

On 15 September 2016, ZWBX, Mr EE, Mr EF and Mr F were appointed as directors of Trading Co Pty Ltd, a company which had been incorporated on 16 January 2015 (Mr F retired as a director on 30 May 2018). On 19 September 2016, the 100 issued shares in Trading Co, being 100% of the capital, were transferred to Holding Co.

On 22 September 2016, IP Co and Trading Co entered into a software licence agreement, under which, Trading Co was entitled to use the licence of the ZYX Software, as a service to third parties, in return for payment of fees to IP Co.

The role of Holding Co was to finance and oversee the corporate group by the providing loans to Trading Co. The source of Holding Co's income was the potential dividends from IP Co and/or Trading Co.

Trading Co undertook the development and commercialisation of the ZYX Software and IP Co owned the IP relevant to the software.

ZWBX self-assessed their entitlement to the ESI Tax Offset. On 29 June 2017, ABC resolved to distribute 100% of the net profits of the BC Trust and the ESI Tax Offset for the year ended 30 June 2017 to ZWBX. The amount of the ESI Tax Offset distributed to ZWBX was $39,704.80.

On 28 July 2017, Holding Co lodged an early stage innovation company (**ESIC**) report pursuant to Item 10 of section 396-55(b) of Schedule 1 to the TAA 1953.

On 27 November 2017, ZWBX lodged their 2017 income year tax return.

On 27 February 2018, Trading Co lodged a R&D Incentive Application to the Department of Industry, Innovation and Science in relation to the research and development of the ZYX Software in the 2016-2017 income tax year. In the application, Trading Co outlined that it was conducting the ZYX Software research and development on its own behalf and did not have an ultimate holding company.

On 8 March 2018, after reviewing the claim for the ESI Tax Offset, the Commissioner issued a notice of assessment for the 2017 income year.

On 17 May 2018, the Commissioner commenced a review in respect of whether of Holding Co qualified as an ESIC. The Commissioner determined that Holding Co did not qualify as an ESIC and issued ZWBX with reasons for the decision on 13 December 2018.

Subdivision 360-A of the ITAA 1997 provides the framework for tax incentives for early stage investors in innovation companies. Importantly, section 360-40 of the ITAA 1997 sets out the requirements for a company to be considered an ESIC. It relevantly provides:

> *(1) This subsection applies to a company at a particular time (the test time) in an income year (the current year) if:*
>
> *(a) the company was:*

(i) incorporated in Australia within the last 3 income years (the latest being the current year); or

(ii) incorporated in Australia within the last 6 income years (the latest being the current year), and across the last 3 of those income years before the current year it and its 100% subsidiaries (if any) incurred total expenses of $1 million or less; or

(iii) registered in the Australian Business Register within the last 3 income years (the latest being the current year); and

(b) the company and its 100% subsidiaries (if any) incurred total expenses of $1 million or less in the income year before the current year; and

(c) the company and its 100% subsidiaries (if any) had a total assessable income of $200,000 or less in the income year before the current year; and

(d) at the test time, none of the company's equity interests are listed for quotation in the official list of any stock exchange in Australia or a foreign country; and

(e) at the test time, the company has at least 100 points under section 360 - 45, or:

(i) the company is genuinely focussed on developing for commercialisation one or more new, or significantly improved, products, processes, services or marketing or organisational methods; and

(ii) the business relating to those products, processes, services or methods has a high growth potential; and

(iii) the company can demonstrate that it has the potential to be able to successfully scale that business; and

(iv) the company can demonstrate that it has the potential to be able to address a broader than local market, including global markets, through that business; and

(v) the company can demonstrate that it has the potential to be able to have competitive advantages for that business; and

(f) at the test time, the company is not a foreign company (within the meaning of the Corporations Act 2001).

Section 360-40(1) of the ITAA 1997 has two limbs that must be satisfied, namely, the 'early-stage limb', which refers to the requirements of section 360-40(1)(a) to (d), and the 'innovation limb', which refers to the two alternate tests, being the 'principle-based tests' in section 360-40(1)(e) and the 100-points innovation test under section 360-45 of the ITAA 1997.

The Commissioner did not dispute that Holding Co satisfied the early stage limb requirements, as, at the test time, Holding Co:

1. had been incorporated in Australia within the previous 3 income years;
2. together with IP Co and Trading Co, as Holding Co’s 100% subsidiaries:
   (a) incurred total expenses of $1 million or less in the 2016 income year; and
   (b) had a total assessable income of $200,000 or less in the 2016 income year; and
3. had no equity interest listed for quotation in the official list of any stock exchange in Australia or a foreign country.

As ZWBX did not rely on Holding Co satisfying the 100-points innovation test, in order to be considered an ESIC, Holding Co was required to satisfy the principle-based tests. The Commissioner argued that Holding Co did not meet the principle-based tests as Holding Co did not develop the innovation. The Commissioner's argument was centred on the requirements of section 360-40(1)(e) of the ITAA 1997 applying to a specific company and not a group of companies. In support of its argument, the Commissioner noted that section 360-40(1)(e) only makes references to "*the company*", which, the Commissioner contended, demonstrated a clear legislative intent that the ‘principle-based tests’ be satisfied only by the company, being Holding Co, and not with *“its 100% subsidiaries”*.

ZWBX argued that the requirements of section 360-40(1)(e) of the ITAA 1997 are met on the basis that Holding Co, IP Co and Trading Co have the same business and the same common purpose, being to develop and commercialise the ZYX Software. ZWBX argued that a 'unity of purpose' or 'single business approach' should be taken so that the actions of Holding Co, IP Co and Trading Co, as a group, are taken into consideration in assessing whether Holding Co was required to satisfy the principle-based tests. In support of this argument, ZWBX contended that making reference to a company and its wholly owned subsidiaries in section 360-40(1)(a) to (c) of the ITAA 1997 should also mean that the requirements in section 360-40(1)(e) extend to the group, and that it is not the purpose of the Commissioner or the tax laws to tell taxpayers how to arrange their business affairs or how to run their businesses.

On 11 March 2019, ZWBX lodged an amended income tax return for the 2017 income year.

On 4 April 2019, the Commissioner issued ZWBX with an amended notice of assessment. ZWBX's taxation liability was calculated on the basis that they were not entitled to the ESI Tax Offset in the claimed amount of $39,705.

On 25 August 2021, ZWBX made an application for an extension of time and objected to the notice of amended assessment.

Despite allowing the objection to be treated as having been lodged within time, the Commissioner disallowed the objection on 22 February 2022.

Issue

Is Holding Co an ESIC as defined in section 360-40(1) of the ITAA 1997?

Decision

The AAT considered that section 360-40(1)(e) of the ITAA 1997 clearly refers to the actions of a specific company in relation to the focus on development of the innovation and, as such, the company, in this case, Holding Co, must demonstrate that it has the potential to meet the associated requirements. The Member noted that Holding Co was responsible for financing and overseeing the corporate group, whereas, Trading Co, a subsidiary of Holding Co was the entity actually undertaking the development and commercialisation of the ZYX Software. The Member also noted that while the group structure may have been sensible from a risk and taxation perspective, it did not fit with the ESIC requirements.

The AAT held that Holding Co was not an ESIC, with the effect being that the ESI Tax Offset was not available in relation to investment into Holding Co.

The Commissioner's decision to disallow the objection was affirmed.

COMMENT – this case confirms a concern with the ESIC provisions since they were introduced – only activities conducted by the entity in which the shares are issued can be regarded for the innovation test. This significantly limits the structuring options for companies that wish to use the ESIC concessions to attract investors. It is difficult to understand the policy reasons for this limitation.

Citation *ZWBX v Commissioner of Taxation* [2024] AATA 2065 (Member Mitchell, Brisbane)
w https://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/AATA/2024/2065.htm

2.5 Ecosse – creditable acquisition

Facts

Ecosse Group Holdings Pty Ltd (**Ecosse**) is an investment management business providing financial services in the agricultural sector. Anthony Guy and his wife were the shareholders of Ecosse and Anthony was the sole director.

Anthony was also the sole director and shareholder of Siltstone Pty Ltd (**Siltstone**), which purportedly held assets used by Ecosse.

On 28 June 2021, a licence agreement was created, allowing Ecosse to use certain intellectual property supposedly owned by Siltstone, though no licence fees were paid. No evidence or explanation was provided to prove that Siltstone in fact owned the assets or how it came to hold or own them.

On 1 July 2021, a document purporting to be an employment agreement between Siltstone and Anthony was established, with a high remuneration rate, but no evidence of actual employment activity was provided.

On 30 November 2021, a sale agreement was executed for Siltstone to sell various business assets to Ecosse for $3,400,000, but no actual payment was made. The schedules to the sale agreement detailed the following assets to be sold:

1. Plant and Equipment (unencumbered);
2. Interest in Secured Assets;
3. Stock;
4. Work in Progress (WIP);
5. Goodwill;
6. Intellectual Property, including:
   (a) The business name "Ecosse Capital Partners";
   (b) The domain name www.ecosse.com.au;
   (c) All email addresses associated with "ecosse.com.au";
   (d) Rights pursuant to any employment agreement between Siltstone and Anthony Guy;
   (e) Customer lists;
   (f) Broker database;
   (g) Investor database;
   (h) Benefits of all employee contractual restraints;
7. Employee Entitlements;
8. Offsets/Allowances;
9. Retentions;
10. Pre-payments;
11. Shares in Ecosse Bare Fund 7 Pty Ltd; and
12. Shares in Ecosse Bare Fund 8 Pty Ltd.

On completion, Ecosse was required to pay the purchase price of $3,400,000 *less* the 'Deferred Price' which was defined as $3,400,000. The effect of those clauses was Ecosse would pay nothing on completion. The Deferred Price was to be paid 'On demand by the Siltstone'. The sale agreement provided a 'Final Date for Payment' of 30 November 2022, but it was not clear what effect the 'Final Date for Payment' had if no demand was ever made.

On 21 December 2021, Ecosse lodged a Business Activity Statement (**BAS**), claiming an input tax credit of $340,000, which led to an audit by the Commissioner.

Under section 11-5 of the GST Act, you make a creditable acquisition if:

(a) *you acquire anything solely or partly for a creditable purpose; and*
(b) *the supply of the thing to you is a taxable supply; and*
(c) *you provide, or are liable to provide, consideration for the supply; and*
(d) *you are registered, or required to be registered*.

On 1 April 2022, the Commissioner issued a notice of amended assessment, disallowing the input tax credit claim, and on 6 April 2022, issued a notice of assessment for a shortfall penalty of $136,000.

On 1 June 2022, Ecosse objected to both assessments, but the objections were disallowed by the Commissioner on 10 March 2023.

Ecosse applied to the AAT for review of the objection decisions.

The Commissioner submitted that Ecosse had not made a creditable acquisition as required under the GST Act because the purported assets were either non-existent, not owned by Siltstone, or lacked sufficient evidence of existence and ownership.

The Commissioner argued that no consideration was paid by Ecosse, and there was no liability to pay consideration under the terms of the sale agreement, as payment was deferred and dependent on a demand that was never made.

The Commissioner highlighted the questionable nature of the transactions, including the licence agreement, employment agreement, and sale agreement, suggesting they were created for the purpose of claiming the input tax credit rather than reflecting genuine business activities.

Anthony argued that the assets listed in the sale agreement did exist and were used by Ecosse in conducting its business, justifying the transaction and the input tax credit claim. He suggested that the tax invoice issued by Siltstone on 30 November 2021 constituted a demand for payment. Despite the invoice referencing contractual terms for payment on demand, Anthony contended that it effectively created an obligation to pay. Anthony maintained that Ecosse had made a creditable acquisition under the GST Act by acquiring the assets from Siltstone, and that Ecosse was entitled to claim the input tax credit.

Issues

1. Was Ecosse entitled to claim an input tax credit of $340,000 for the period 1 November 2021 to 30 November 2021 under the GST Act?
2. Was Ecosse entitled to attribute the input tax credit to the period 1 November 2021 to 30 November 2021 under section 29-10 of the GST Act?
3. Was the penalty assessed justified, and if so, should it be remitted in whole or in part?

Decision

<u>Entitlement to credit</u>

The AAT found that Ecosse was not entitled to claim an input tax credit of $340,000 for the period 1 November 2021 to 30 November 2021 under the GST Act. The AAT determined that Ecosse did not make a creditable acquisition because it did not acquire anything for a creditable purpose.

There was no taxable supply, as Siltstone was merely an asset-holding company and did not conduct business activities.

In relation to whether Ecosse had provided consideration, the AAT found that Anthony's argument that the tax invoice itself was a demand for payment was contradicted by the content of the invoice and the terms of the sale agreement. The AAT also referred to the objection form submitted by Ecosse to the Commissioner, which explicitly stated that no consideration had been demanded or paid.

The AAT found that Ecosse did not provide or was not liable to provide consideration for the purported acquisition. The tax invoice issued did not create an obligation to pay, as it referred to contractual terms that required payment only on demand, and no demand was ever made.

Attribution of credit

As there was no creditable acquisition, it was not necessary to consider to which period the credit would be attributed.

Penalty

The AAT determined that Ecosse made a false or misleading statement in its Business Activity Statement (BAS) by claiming an input tax credit when no creditable acquisition had occurred.

The statement was made recklessly, as Anthony, the sole director and controlling mind of both Ecosse and Siltstone, had sufficient knowledge and expertise to recognise the inaccuracies and the lack of genuine business activity behind the transactions.

The AAT found that Anthony's conduct exhibited gross carelessness, given his qualifications and the evident anomalies in the transactions and agreements.

The Commissioner had already remitted 20% of the penalty due to Anthony's cooperation and other mitigating factors, and the AAT saw no basis for further remission of the penalty.

COMMENT – in concluding that the supply of assets to Ecosse was not a' taxable supply, the AAT did acknowledge that a taxpayer will be carrying on an enterprise if the taxpayer engages 'in an activity or series of activities, done...on a regular or continuous basis in the form of lease, licence or other grant of an interest in property’. However, given the statement by Anthony that Siltstone was "only an asset owning company" the AAT concluded that this meant that any license agreement in relation to the assets was never in fact performed. It is questionable whether such a conclusion follows from that premise, particularly as Anthony was explaining his understanding as a lay person.

Citation *Ecosse Group Holdings Pty Ltd and Commissioner of Taxation (Taxation)* [2024] AATA 2073 (Member Reitano, Sydney)
w https://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/AATA/2024/2073.html

2.6 PepsiCo – royalties and diverted profits tax

Facts

PepsiCo Bottling Singapore Pty Ltd (**Seller**), an Australian entity, is part of PepsiCo Inc. (**PepsiCo**) group, which includes Stokely-Van Camp Inc. (**SVC**). Both PepsiCo and SVC are US-based companies.

From July 1, 2017, to June 30, 2019, Schweppes Australia Pty Ltd was the exclusive distributor and bottler of Pepsi, Mountain Dew, and Gatorade in Australia. Schweppes purchased concentrate from PepsiCo Bottling Singapore Pty Ltd, with invoices reflecting concentrate rates, plus freight, insurance, and handling fees under "exclusive bottling arrangements" (EBAs).

The EBAs set out the prices for the relevant concentrates. The EBAs also included a grant by PepsiCo/SVC of the right to use the trade marks and other intellectual property associated with each beverage, such as can and bottle designs. It was accepted that the Pepsi EBA implied the grant by law, and the SVC EBA specifically provided a license to use the designs. There were strict terms for the use of the trade marks and further requirements relating to testing and inspection of bottling facilities.

Neither of the EBAs made any provision for the payment of royalties for the use of the trade marks.

The Commissioner issued to PepsiCo and SVC:

1. notices of royalty withholding tax applying section 128B of the ITAA 1936 and Art 12 of the Australia-US tax treaty, imposing around $3.6 million in RWHT; and
2. in the alternative, DPT assessments applying Part IVA of the ITAA 1936, imposing around $28.9 million in additional tax for the relevant years.

The Commissioner's primary case was that the payments made by Schweppes to the Seller for the concentrate included a royalty component. This is based on the argument that the provisions of the EBA show that payments made by Schweppes to the Seller were in consideration for the use of the trade marks. The Commissioner then construed that the payments were "paid" to PepsiCo/SVC, but that at their direction amounts were physically paid to the Seller. On this basis, the amounts were derived as income by PepsiCo/SVC.

In the alternative, the Commissioner argued that if on the proper construction of the EBAs is that there is no royalty component, then PepsiCo entered into a scheme with a "principal purpose" of obtaining a tax benefit, resulting in PepsiCo being liable for diverted profits tax under section 177J of the ITAA 1936. The tax benefits that the Commissioner asserted were obtained by PepsiCo were twofold:

1. that PepsiCo was not liable for withholding tax in Australia since there was no royalty on which section 128(2B) of the ITAA 1936 could operate; and
2. that no royalty could be brought to tax, no foreign tax laws could operate to tax the royalty.

Moshinsky J heard the matter at first instance. Moshinsky J agreed that the EBAs included an "embedded" royalty component which could be brought to tax. His Honour noted that had the Commissioner's first case not been successful, he would have accepted that drafting the EBAs in such a way was a scheme that was entered into for the principal purpose of deriving a tax benefit, for the purposes of the diverted profits tax provision in section 177J.

PepsiCo and SVC appealed the first instance decision to the Full Court of the Federal Court of Australia.

Issues

1. Whether the payments made under EBAs included amounts that were "royalties"?
2. Whether there was a scheme with a "principal purpose" of obtaining a tax benefit, such that PepsiCo and SVC should be liable to diverted profits tax under section 177J of Part IVA of the ITAA 1936?

Decision

<u>Royalty withholding tax</u>

To determine if Schweppes' payments to the Seller included consideration for the use of trademarks and intellectual property, the Court looked solely at the contractual documents, including the EBAs.

The EBAs specified that the Seller would sell the concentrate to Schweppes at prices listed in the agreements. Future sales prices would be based on these rates once quantities were specified. The contracts suggested that payments were for the concentrate only.

The Commissioner argued that payments also included a component for trademark use, noting that the EBAs did not explicitly state payments were solely for the concentrate. If no payment was made for trademarks, Schweppes would use them for free, which seemed unlikely given their value.

The Court found this argument overly simplistic, failing to consider that the licensing terms also benefited PepsiCo/SVC by maintaining and enhancing their goodwill. The rights to use the trademarks did not transfer goodwill to Schweppes but allowed PepsiCo/SVC to benefit from their sustained value.

Additionally, Schweppes faced strict product and marketing restrictions and contractual burdens like testing and inspection. These factors, combined with the goodwill benefit to PepsiCo/SVC, led the Court to reject the idea of an "embedded" royalty payment.

Since the Court ruled there was no royalty payment, it didn't need to consider whether the amounts were derived by PepsiCo/SVC. Nonetheless, the Court noted that PepsiCo/SVC were neither agents nor trustees for the Seller, had no possession or title to the concentrate, and did not deliver it. Therefore, Schweppes was not obligated to pay PepsiCo/SVC for the concentrate.

The Court concluded that the payments were not income for PepsiCo/SVC, and no payments were subject to royalty withholding tax.

<u>Diverted Profits Tax</u>

As part of the argument that this was a scheme to which diverted profits tax should apply, The Commissioner needed to provide valuation evidence of the EBA, assuming the concentrate price included a royalty component. However, there was no evidence to support this assumption.

Their Court compared this to transfer pricing, where the price for one item includes the value of something else. The Commissioner’s schemes for PepsiCo and SVC were identical:

1. Schweppes was the exclusive licensee to bottle, sell, and distribute PepsiCo drinks;
2. Schweppes agreed to buy concentrate from PepsiCo or its subsidiaries;
3. Schweppes obtained rights to use PepsiCo's intellectual property, technical knowledge, and assistance; and
4. no royalty was paid for these items.

The two main issues were whether PepsiCo/SVC obtained a tax benefit and whether they did so to reduce their US tax liability.

The Court explained that section 177J of the ITAA 1936 addresses diverted profits tax but does not impose it; sections 177N and 177P impose the tax at 40% of the benefit, or the "DPT base amount." The Commissioner had claimed this amount would be the royalty that did not exist due to the scheme.

The Court needed a reasonable alternative to the scheme. If no alternative existed, it could not be said the tax effect might reasonably have occurred without the scheme. Section 177CB(4) and (5) disregard tax consequences under the ITAA 1936 and foreign tax laws. The Commissioner’s alternatives were:

1. the EBA would have included payments for all provided property, not just concentrate.
2. the EBA would have specified a royalty for trademark use.

The Court found no evidence supporting the commercial arrangement including a royalty component. The valuations assumed royalties without evidence. The Court concluded the commercial and economic substance was the sale of concentrate.

The Court held the Commissioner’s alternatives were not reasonable and did not correspond to the scheme. Therefore, it was not reasonable to expect royalty withholding tax liability on payments to the Seller for concentrate. The principal purpose question did not need to be considered but the Court noted that had the "highly artificial assumption" that the concentrate price did include a royalty, it would have concluded that the requisite purpose was established. However, this assumption was not proved.

PepsiCo's appeal against the royalty withholding tax assessments was allowed, and they were awarded costs.

COMMENT – whether a payment is a 'royalty' is relevant to the application of the base rate entity rules as a 'royalty' is base rate entity passive income (BREPI).

Citation *PepsiCo, Inc v Commissioner of Taxation* [2024] FCAFC 86 (Perram, Colvin and Jackman JJ, Victoria) w https://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/FCAFC/2024/86.html

2.7 Agrinova – duty and marriage breakdown

Facts

In January and October 2019, during divorce proceedings under the *Family Law Act 1975* (Cth), the Family Court of Australia issued property settlement orders.

These orders, made under Part VIII of the Family Law Act, required transferring specific parcels of land from various entities to Agrinova Pty Ltd. The transfers were completed in December 2019.

The Chief Commissioner assessed the transfers, resulting in a duty of over $1.8 million. Agrinova Pty Ltd objected to these assessments, seeking exemption under section 68 of the *Duties Act 1997* (NSW) and/or section 90 of the Family Law Act. The objection was disallowed.

Agrinova Pty Ltd then appealed to the NCAT.

Section 90 of the Family Law Act provides as follows:

> *(1) The following agreements, deeds and other instruments are not subject to any duty or charge under any law of a State or Territory or any law of the Commonwealth that applies only to or in relation to a Territory:*
>
> *(a) a deed or other instrument executed by a person for the purposes of, or in accordance with, an order made under this Part;*

The Chief Commissioner considered that section 90 of the Family Law Act in invalid, consistent with decision of the High Court in *Gazzo v Comptroller of Stamps (Vic)* (1981) 149 CLR 227, in which a predecessor provision was found to be invalid under the Commonwealth Constitution on the basis that it was not incidental to the subject matter of any power for which the Commonwealth is permitted to make laws for under section 51 of the Constitution.

Agrinova Pty Ltd claimed that the majority reasoning in *Gazzo* was flawed and unpersuasive and later judgments (*Fisher v Fisher* [1986] HCA 61 and *Spence v Queensland* [2019] HCA 15) criticized *Gazzo*, implying its reasoning should be confined to its facts.

Agrinova Pty Ltd contended that section 90 of the Family Law Act has a sufficient connection to the powers in s 51 of the Constitution, specifically the powers related to taxation (s 51(ii)), marriage (s 51(xxi)), and divorce and matrimonial causes (s 51(xxii)).

The Chief Commissioner contended that *Gazzo* remains good law, given the similarity between the current provision and former provision and, therefore, the decision should be followed here.

Issue

Whether section 90 of the Family Law Act applied to exempt the transfer from duty?

Decision

The NCAT considered it was bound to follow the High Court decision in *Gazzo* given the similarities in the provisions.

Accordingly, the NCAT held that section 90 of the Family Law Act was not a valid law of the Commonwealth.

TRAP – when relying on the duties exemption in section 68 of the Duties Act, a condition is that the property being transferred must be 'matrimonial property'. Our experiences with these matters where a transferred is being undertaken pursuant to court orders is that, if the court orders do not declare the property to be matrimonial property, Revenue NSW is reluctant to accept that this condition is satisfied, despite the fact that the Family Court only has jurisdiction to make orders with respect to matrimonial property.

COMMENT – in this case, Agrinova Pty Ltd could not rely on the concession in section 68 of the Duties Act as it the concession only applies where the property is being transferred ***to*** the parties to the marriage and relationship. The concession can apply where it is being transferred ***from*** a person/entity that is not a party to the marriage or relationship.

Citation *Agrinova Pty Ltd v Chief Commissioner of State Revenue* [2024] NSWCATAD 170 (Senior Member Frost, Sydney) w https://www7.austlii.edu.au/cgi-bin/viewdoc/au/cases/nsw/NSWCATAD/2024/170.html

2.8 Nawaf Mualla – land tax and special trust

Facts

On 4 December 2020, the N Mualla Trust was established with Nawaf Mualla as the trustee. It is a discretionary trust. The Trust deed defines a "beneficiary" as anyone who may be entitled to income or capital. The specified beneficiaries are Nawaf, Sam, Alexander, and Alina Mualla, along with their descendants, family members, spouses, companies they hold voting shares in, secondary trusts, and charitable trust trustees.

Clause 3.4 of the Trust deed excludes any beneficiary who would make the trustee a foreign person under the Land Tax Act 1956 (NSW).

In 2021, Nawaf, as trustee, purchased a property in Yagoona, New South Wales for the Trust. On 6 September 2022, the Chief Commissioner issued a land tax assessment to Nawaf for 2022, treating the Trust as a special trust and imposing surcharge land tax, deeming the trustee a foreign person. On 9 September 2022, Nawaf lodged a variation return noting the exclusion of foreign beneficiaries. The Chief Commissioner reassessed the Trust as a special trust but without the surcharge land tax.

On 20 December 2022, a Deed of Variation changed the Trust from a discretionary to a fixed trust, which the Chief Commissioner accepted effective from that date.

On 18 September 2023, Nawaf objected to the 2022 land tax assessment. The Chief Commissioner disallowed this objection on 22 November 2023.

Nawaf then sought review by the NCAT, arguing that:

1. the Trust should not be classified as a special trust due to conflicts of interest between the Trustee and beneficiaries and inconsistencies in the Trust Deed regarding tax laws;
2. the Trust should be classified as a concessional trust because Nawaf is precluded from being a beneficiary under clause 8, and the remaining beneficiaries are his children, all under 18; and

3. the Chief Commissioner should have informed Nawaf about the option to apply for revocation of the special trust classification.

Issue

Was the Trust a special trust or concessional trust for the purposes of the *Land Tax Management Act 1956* (NSW) (**LTMA**)?

Decision

The NCAT stated that under section 3A(3B) of the LTMA, the beneficiaries of a trust will be taken to be owners of the equitable interest in the land if the trust deed provides that the beneficiaries of the trust are presently entitled to the income and capital of the trust and those entitlements cannot be removed, restricted or affected by the exercise of, or failure to exercise a discretion conferred on a person by the trust deed.

The NCAT confirmed that under the Trust deed, and prior to the Deed of Variation, the Trust was a discretionary trust where the beneficiaries were not presently entitled to the income or capital of the Trust. Accordingly, the NCAT determined that the Trust was not a fixed trust as defined by section 3A(2) of the LTMA for the 2022 land tax year.

In respect of a concessional trust, each beneficiary under a concessional trust must be either under the age of 18 years, or a person in respect of whom a guardianship order is in force, or a person who is in the target group within the meaning of the *Disability Inclusion Act 2014* (NSW). Therefore, the NCAT confirmed that Nawaf would need to prove that every person falling within the classes of beneficiaries in clause 3.1 meets the criteria required for a concessional trust set out in section 3B(1)(b) of the LTMA. Nawaf did not prove this.

Therefore, the NCAT was not satisfied that each person who was a beneficiary of the Trust was a person under the age of 18 years, a person in respect of whom a guardianship order was in force or a person in the target group within the meaning of the *Disability Inclusion Act 2014* (NSW). Therefore, the NCAT determined that the Trust was not a concessional trust for the 2022 land tax year.

In respect of Nawaf's contention that he was not told by the Chief Commissioner that he could apply for a revocation of the classification of the Trust by a special trust, the NCAT stated that even if Nawaf had made such an application within time, it would have been open to and appropriate for the Chief Commissioner to reject such an application because the Trust was correctly classified as a special trust. The NCAT noted that Nawaf was "frustrated" that he was not informed of the option to make an application for revocation. The NCAT did not consider that Nawaf had suffered any prejudice as a result because any such application should have been rejected by the Chief Commissioner.

The NCAT confirmed the assessment under review.

TIP – it will not always be the case that it will be better not to a special trust. This is because, while the trustee of a special trust does not receive the benefit of the land tax threshold, where a trust is a fixed trust, such that the trustee will receive the benefit of the land tax threshold, the unitholders/beneficiaries are also assessed on their proportionate interest in the land. This could cause the unitholder/beneficiary, if they have other assessable landholdings, to exceed the premium rate threshold with the outcome being an increased overall land tax liability.

Citation ***N****awaf Mualla ATF N Mualla Trust v Chief Commissioner of State Revenue* [2024] NSWCATAD 159 (Senior Member S Dunn, New South Wales)
w https://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/nsw/NSWCATAD/2024/159.html

2.9 Vatner – principal place of residence exemption

Facts

The property at 25 Kenneth Street, Tamarama consists of a split-level apartment building with Units 1 to 3 at the rear and Units 4 to 6 at the front.

In 2003, Antony Vatner bought Unit 3. He then bought Units 2 and 1 in 2004 and 2006, respectively. From 2006 to 2008, Antony lived in Unit 2 and rented out the other units. In 2007, the Owners Corporation for SP4655 decided that significant repairs were needed due to structural issues, including 'concrete cancer'.

On 3 July 2017, a modification application was lodged, and updated plans were submitted on 28 November 2017. The modifications approved by the council included:

1. demolishing Units 1 to 3 and replacing them with a new four-level unit (Unit 7);
2. changing the boundaries of Antony's units, incorporating some common property and removing areas previously part of Units 1 to 3; and
3. installing a lift and staircase for all units.

Antony intended to make the new unit his main residence, designing it for his family's needs. In May 2021, Antony received approval to add an inground plunge pool.

On 18 April 2018, the Owners Corporation and the unit owners signed a Deed of Agreement outlining the cost allocation for the redevelopment, construction obligations, and future plans for the strata. Units 1, 2, and 3 were vacated by June 2019, and redevelopment began in July 2019, finishing in July 2022. The Owners Corporation covered redevelopment costs, while Antony paid for his unit's fit-out, which began in July 2021. Occupation certificates were issued in August 2022.

Antony and his family moved into Unit 7 in September 2022. Unit 7 differed significantly from the original units:

1. it had a floor area of 507 m², including a garage;
2. areas of common property transferred to Unit 7 were 178.7 m², valued at $3,444,881, with a net increase of 174.45 m² from Units 1 to 3;
3. Unit 7 has four levels, compared to three in the original units;
4. the walls, floors, and ceilings were newly configured;
5. the living area was in a new section of the building;
6. the garage replaced the previous parking spaces; and
7. Unit 7 has 62.5% of the unit entitlements in the new strata plan, compared to 50% for Units 1 to 3.

The Chief Commissioner assessed Antony for land tax on Units 1, 2, and 3 for 2020, 2021, and 2022 land tax years. Antony objected, but his objections were disallowed in April and August 2022.

In September 2022 Antony appealed to the Supreme Court of New South Wales

Antony claimed the principal place of residence (PPR) exemption for Units 1, 2, and 3, arguing that his use and occupation met the requirements of the *Land Tax Management Act 1956* (NSW) (**LTMA**). Clause 6 of Schedule 1A of the LTMA allows a PPR exemption for unoccupied land intended to become the owner's main residence after construction. Clause 14 of Schedule 1A of the LTMA allows a PPR exemption for multiple strata lots used as a single residence with adjoining walls or floors.

Clause 6 of Schedule 1A to the LTMA provides for a concession which extends the principal place of residence exemption in clause 2 to unoccupied land which is not at the taxing date, but is intended after completion of construction works, to be the owner's principal place of residence.

Clause 14 of Schedule 1A to the LTMA provides an entitlement to claim the principal place of residence exemption in respect of two or more lots which are used or occupied as the owner's principal place of residence where the strata lots have adjoining walls or floors, are in the same ownership and comprise a single residence.

Issues

1. Was clause 6 of Schedule 1A to the LTMA satisfied in respect of Units 1, 2 and 3 in SP4655 for any of the 2020, 2021 or 2022 land tax years?
2. If clause 6 of Schedule 1A to the LTMA is otherwise satisfied, does clause 6(7)(c) of Schedule 1A to the LTMA disentitle the plaintiff from claiming the exemption because the land was 'capable of having more than 2 residences or residential units lawfully built on it'?
3. Does clause 14 of Schedule 1A to the LTMA disentitle Antony from claiming the principal place of residence exemption?

Decision

Richmond J in the Supreme Court of New South Wales stated that clause 6(1) requires the owner of unoccupied land to intend to use and occupy it as their principal residence. The "land" refers to this unoccupied land, which the taxpayer can claim as their principal residence if they have the necessary intention.

The unoccupied land on the relevant taxing dates (midnight on 31 December 2019, 2020, and 2021) was Units 1 to 3 in SP4655. Richmond J defined this as the "total cubic meterage of air space" for those units.

The key question was whether Antony intended to use and occupy this cubic meterage of air space as his principal residence once construction was completed. Richmond J determined that Antony did not have this intention. Instead, he intended to occupy Unit 7, a new four-level apartment with different cubic meterage, including some areas from common property and excluding parts of Units 1 to 3.

Richmond J emphasised that there must be conformity between the unoccupied land and the land intended for the principal residence. This is consistent with clause 6(2)(a) of Schedule 1A of the LTMA, which requires that the works facilitate the intended use of the land as a principal residence.

Although not required, the Court briefly addressed clauses 6(7)(c) and 14 of Schedule 1A to the LTMA:

1. clause 6(7)(c) excludes land capable of having more than two residences built on it. The Deed of Agreement and development consent allowed only one residence to replace Units 1 to 3, so this clause did not apply;
2. if clause 6 had been satisfied, clause 14 would not have prevented claiming the exemption. Clause 14 should be applied considering clause 6(1), which deems the owner to use Units 1 to 3 as their residence, even if they weren't physically capable of being a residence.

The Court affirmed the Chief Commissioner's assessments.

Citation *Vatner v Chief Commissioner of State Revenue* [2024] NSWSC 769 (Richmond J, New South Wales) w https://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/nsw/NSWSC/2024/769.html

2.10 Merristock – land tax and beneficial ownership

Facts

On 23 June 1972, Merristock Pty Ltd was incorporated.

From 31 December 2019 to 31 December 2020 the shares in Merristock were held as follows: Kate Looker (20%), Prue Looker (20%), Kate and Prue as executors of Jean Looker's estate (40%), and Clare and Fiona

Looker as trustees of the David Looker Children's (DLC) Trust (20%). Kate and Prue are sisters, their mother was Jean Looker, and their brother was David Looker. Clare and Fiona are David's daughters.

The DLC Trust, established on 30 June 1998, is a discretionary trust with Clare and Fiona as trustees since 12 April 2019. The Trust Deed identifies capital beneficiaries but not income beneficiaries. Unallocated income at the end of an accounting period is held for the capital beneficiaries or their children.

Merristock owns four properties in Beveridge and Wallan, Victoria. For 2020 and 2021, Merristock was assessed for land tax on these properties. Merristock argued for exemption under section 67(1) of the Land Tax Act 2005 (Vic) because:

1. the properties are used primarily for primary production (**Farming Use Condition**); and
2. Merristock, as a proprietary company not acting as a trustee, meets the ownership requirements in section 67B (**Ownership Requirements**).

The Ownership Requirements are as follows:

1. the company's principal business is primary production (**Principal Business Condition**);
2. all shares are beneficially owned by natural persons (**Beneficial Owner Condition**); and
3. at least 50% of shares are held by individuals substantially engaged in full-time primary production (**Beneficial Owner Farming Requirement**).

The Commissioner agreed that Merristock met the Farming Use Condition, Principal Business Condition, and Beneficial Owner Farming Requirement. The issue was whether the Beneficial Owner Condition was satisfied.

The Commissioner accepted that 80% of shares were owned by natural persons but disputed the beneficial ownership of the 20% held by Clare and Fiona as trustees of the DLC Trust.

Merristock argued that "beneficially owned" means looking beyond the registered owner to the person benefiting from the shares, referencing the High Court's decision in *Commissioner of Taxation v Linter Textiles Australia Ltd* [2005] HCA 20. They contended that Parliament deliberately used "beneficially owned" in the Land Tax Act to include such broader interpretations.

Issue

Were all the shares held in Merristock beneficially owned by natural persons?

Decision

The VCAT reviewed the legislative history of the primary production exemption and highlighted several key changes.

The VCAT noted that in 1973, a distinction was made between the exemption for land inside and outside an urban zone, using the term "beneficially owned" about 21 years after a High Court decision defined "beneficially held."

On 26 April 2005, the High Court in *Linter Textiles* distinguished "beneficially held" from "beneficially owned," noting that "beneficially owned" allows looking beyond the share register.

On 28 September 2005, in *CPT Custodian Pty Ltd v Commissioner of State Revenue* [2005] HCA 53, the High Court ruled that a unitholder was not the landowner, rejecting the notion that where land is vested in a trustee the equitable ownership must be vested in someone other than the trustee.

On 29 November 2005, amendments to the *Land Tax Act 1958* (Vic) introduced new rules for taxing land held in trust.

The VCAT concluded that the Victorian parliament considered these decisions when updating land tax laws. They retained the requirement that all shares in a proprietary company be "beneficially owned by natural persons" for the primary production exemption. The purpose of this exemption is to ensure genuine farming activities are tax-exempt, especially in urban zones where the farming is conducted by individuals associated with the landowner. Denying the exemption solely because shares are held in trust by family members who farm would be inconsistent with this purpose.

The VCAT ruled that the Beneficial Owner Condition is met if shares are held in trust. They determined that Clare and Fiona, as trustees of the DLC Trust, were the legal and beneficial owners of the 20% of Merristock shares they held. Thus, all shares in Merristock were "beneficially owned by natural persons," satisfying section 67B(1)(c) of the Land Tax Act. The assessments were set aside.

Citation *Merristock Pty Ltd v Commissioner of State Revenue* [2024] VCAT 535 (Senior Member R Tang AM, Melbourne)
w https://austlii.edu.au/cgi-bin/viewdoc/au/cases/vic/VCAT/2024/535.html

2.11 Appeal update – MJH Trading Trust – dividend stripping

Facts

The Hayes family comprised Cecil (now deceased) and Shirley and their four sons Michael, John, Bryan and Paul. The family operated businesses in the transport, fuel storage and distribution and primary production industries through various entities, including four operating companies.

In late 2007, the Hayes family engaged Raymond Miller of PMW to provide accounting services. Raymond reviewed the affairs of the family and made the following recommendations:

1. each Hayes brother should have a discrete family trust for which a new corporate trustee would be established (Family Trusts) 'to eliminate the possibility of personal liability to each family should any part of the family operation be attacked by outside creditors or other persons who may wish to sue the family operation';
2. each family member's salary and wage income from the business operations should be held at $35,000 each (which was less than 10% of total income for each family member) to allow for further superannuation deductions;
3. a separate superannuation fund should be set up for contributions made on behalf of each family members' spouse; and
4. further discussions should be held regarding distributions to family members' children.

Raymond stated that the objectives of these recommendations were to 'spread the wealth within the families, develop conduits to enable the funds owing to, or by, each family to be traced, while protecting the risk aspect and limiting the impact of Division 7A.' Raymond remained concerned about the business risks and quantum of retained earnings within the group.

After attending a conference session on asset protection presented by a solicitor from Cleary Hoare, Raymond suggested that the Hayes family should meet with Cleary Hoare to discuss the business risks and retained earnings. In early 2010, the Hayes family engaged Cleary Hoare solicitors to review these risks and advise on asset protection and simplifying intragroup debt and entitlements.

<u>Asset protection and risk management for Operating Companies</u>

Broadly, in relation to asset protection and risk management, Cleary Hoare recommended:

1. creating new entities;

2. creating a new class of shares (Z Class) in the Operating Companies and issuing those Z Class shares to the new entities;
3. the Operating Companies declaring and paying discretionary dividends on the Z Class shares; and
4. the Z Class shareholder lending amounts back to the Operating Companies.

In February 2010, members of the Hayes family acquired four companies to be trustees of newly formed public trading trusts as follows:

1. Michael John Hayes Trading Pty Ltd as trustee of the MJH Trading Trust;
2. John Hayes Trading Pty Ltd as trustee of the JPH Trading Trust;
3. Bryan Hayes Trading Pty Ltd as trustee of the BGH Trading Trust; and
4. Paul Hayes Trading Pty Ltd as trustee of the PAH Trading Trust.
(the **Trading Trusts**).

Shortly after the Trading Trusts were established, in different proportions, the Trading Trusts acquired 10 Z Class shares (shares with special rights to dividends only) for $1 per share in each of the Operating Companies. Later on the same day that the Trading Trusts acquired the Z Class shares, the Operating Companies declared and paid fully franked dividends totalling $8,008,460 to the holders of the Z Class shares.

Each of the Trading Trusts included the fully franked dividend income in its income tax return for the income year ended 30 June 2010 and had no further tax to pay due to the tax offset for franking credits. Under the public trading trust provisions, the Trading Trusts are taxed as companies at the company tax rate.

These dividends were not paid by cash. Rather, the Operating Company issued Bonded Promissory Notes, which were either:

1. returned to the Operating Company as a loan from the Trading Trust; or
2. provided to an individual as a loan from the Trading Trust, then returned by the individual to the Operating Company as repayment of an existing Division 7A loan owed by the individual to the Operating Company.

<u>Simplifying intragroup debt</u>

To simplify intragroup debt, Cleary Hoare recommended:

1. the trusts in the group pay the total amount of unpaid present entitlements to corporate beneficiaries ($4.6 million), which would be funded via entering into loan agreements and repaying the loans over seven years using dividends declared;
2. utilising the Trading Trusts that are taxed at the same rate as a company but still regarded as a trust eligible for discount capital gains; and
3. having the Trading Trusts lend funds to the borrowers so they could use the funds to repay their loans.

These steps were implemented and greatly reduced the quantum and complexity of debts between entities in the Hayes group.

<u>Personal asset protection for individuals</u>

Around the same time as these arrangements, the Hayes family also implemented Cleary Hoare's recommendations regarding managing intragroup debt by:

1. estimating each Hayes brother's equity in his real property assets;
2. each Hayes brother executing a Bonded Promissory Note for the estimated equity amount;
3. each Hayes brother gifting the Bonded Promissory Note to his related/connected family trust;
4. each family trust lending the funds represented by the gift back to the Hayes brother donor; and
5. cancelling the Bonded Promissory Note because it was in the possession of the issuer.

The purpose of the arrangement was for each family trust to be an unsecured creditor who would stand equally with any other unsecured creditors to whom each Hayes brother owed money. It was acknowledged that the degree of asset protection created by these steps could be affected by the quantum of the amounts that the individual owed to other unsecured creditors.

The Commissioner issued a notice of amended assessment to each Trading Trust denying the franking offsets under section 207-145 of the ITAA 1997 on the basis that the dividends were part of a dividend stripping operation. Section 207-155 defines a dividend stripping operation as a scheme that:

1. was by way of, or in the nature of, dividend stripping; or
2. had substantially the effect of a scheme by way of, or in the nature of, dividend stripping.

The trustees of the Trading Trusts objected to the amended assessments. The Commissioner disallowed the objections. The trustees of the Trading Trusts appealed to the AAT.

The Commissioner contended that the Trading Trusts were involved in schemes, the dominant purpose of which was to extract the accumulated, retained earnings in each of the Operating Companies in a manner that would cause the brothers, being the ordinary shareholders to receive the benefit of those profits but to avoid tax on that distribution.

In particular, the Commissioner contended:

1. that the Operating Companies' existing shareholders and their associates:
   (a) avoided tax by receiving amounts which were not income (the amounts advanced by way of loan represented by the Bonded Promissory Notes) that were used to discharge loans that were subject to Division 7A conditions; and
   (b) received 'a capital sum for the shares in an amount the same as or very close to the dividends paid to the purchasers'; and
2. the scheme was carefully planned, with all the parties acting in concert, for the predominant if not the sole purpose of the ordinary shareholders avoiding tax on dividends from the Operating Companies.

The trustees of the Trading Trusts argued that:

1. the schemes were implemented to achieve improved asset protection and better and diversified asset ownership arrangements;
2. the Trading Trusts received taxable dividends and the entitlement to tax offsets on account of franking credits does not change that assessment; and
3. the latent tax liability in the pre-existing retained profits (that were moved from the Operating Companies to the Trading Trusts) remains or continues to be a latent tax liability that will come home when the Trading Trusts' profits are distributed beyond the corporate environment.

The Commissioner did not apply Part IVA to the arrangements.

The AAT did not accept that because the Trading Trusts had a tax liability (which was reduced to nil by the franking credit offsets), the dividends could be said to have been 'taxed'. The AAT referred to the case law authorities in relation to dividend stripping operations, and found that the relevant test is to look to whether the dividend received, after associated credits or deductions or rebates, including tax offsets, bears taxation liability in a net sense. Therefore, the dividends were not 'taxed', because the Trading Trusts had no tax liability on the dividends after the application of the franking credit offsets.

The AAT found that the proportion of the dividends that made their way back to the Hayes brothers in the form of loans was 30.46% of the total amount. The AAT found that this was well short of the extent of the substitute required for this amount to be a capital sum required for a dividend stripping operation.

The AAT noted that the availability of franking credit tax offsets was not determinative when considering whether the Trading Trusts intended to avoid tax. Subject to meeting applicable at-risk rules, franking credit tax offsets would be available in the same amount to an original shareholder and a new shareholder in a company.

In relation to the arguments that the purpose of the transactions was asset protection, the AAT found as follows:

1. upon a change of accountant, the situation of the group was identified, and steps were taken before Cleary Hoare was engaged to begin distributing money to discretionary trusts and superannuation funds rather than the Hayes brothers individually;
2. the Hayes brothers and at least some of their entities were involved in businesses where it was possible for exposures to arise that would give rise to a need for asset protection, and at least one of those entities had previously been sued;
3. Cleary Hoare was engaged as a result of the new accountant attending a conference session specifically about asset protection;
4. the transactions recommended by Cleary Hoare extended to broader asset protection within the family;
5. the relevant profits were not transformed to become non-taxable amounts, or moved beyond the Hayes family; and
6. the amount of loan capital available to the family members associated with the dividend stripping operations was substantially all of the profit stripped from the Operating Companies.

The AAT found that the predominant purpose of the scheme was not tax avoidance and that the dividends paid to the Trading Trusts were not taken to have been made as part of a dividend stripping operation. The AAT allowed the objections in full.

The Commissioner appealed to the Full Federal Court.

On appeal, the Commissioner submitted that it is sufficient if tax avoidance was an “incidental purpose” of a scheme and that a scheme did not need to have a dominant tax avoidance purpose in order for it to be found to be a scheme by way, of or in the nature of, dividend stripping. The Commissioner considered that "incidental purpose" was a purpose less than a dominant purpose, but more than a trivial or *de minimis* purpose.

Issue

Did the AAT err in its construction of section 207-155 as to whether the arrangement was a dividend stripping operation?

Decision

The Full Federal Court found that the AAT erred in its statutory construction of section 207-155 of the ITAA 1997. Specifically, the AAT failed to properly interpret the expansive language of "by way of, or in the nature of," which was intended to capture variations of the central characteristics of dividend stripping schemes. This misinterpretation significantly impacted the AAT's analysis and conclusion.

Regarding the tax avoidance purpose, the Court held that the AAT incorrectly focused on potential future tax liabilities rather than the immediate purpose of the schemes. The proper test is whether there was a dominant purpose of avoiding tax on the distribution of profits to the original shareholders. The Court found that the schemes avoided immediate tax on dividends paid to the Trading Trusts, which was sufficient to establish a tax avoidance purpose.

The Court also addressed the issue of profits not being removed from the Australian tax system. It concluded that this fact was not determinative. The relevant issue was the avoidance of tax on the immediate distribution to shareholders, not potential future tax liabilities.

Additionally, the AAT erred in its assessment of the dividend loan-back arrangements. The Court found that the majority of dividends being loaned back to Operating Companies did not preclude the schemes from being classified as dividend stripping operations. This aspect of the AAT's reasoning failed to account for the immediate tax avoidance purpose of the transactions.

The Commissioner's argument that an incidental purpose of tax avoidance was sufficient was rejected by the Court. The Court emphasised that a dividend stripping scheme must have a dominant tax avoidance purpose. This higher threshold was necessary to align with the historical context and statutory language of dividend stripping.

Ultimately, the appeal was allowed, and the matter was remitted to the AAT for redetermination according to law.

Citation *Commissioner of Taxation v Michael John Hayes Trading Pty Ltd as trustee of the MJH Trading Trust* [2024] FCAFC 80 (Bromwich, Thawley and Hespe JJ)
w https://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/FCAFC/2024/80.html

2.12 Appeal update – Quy

The taxpayer (Trong Quy) has successfully appealed the decision in *Quy and Commissioner of Taxation (Taxation)* [2024] AATA 245 (see our March 2024 Tax Training Notes) which concerned whether Trong was a resident of Australia for the income years ended 30 June 2016 to 30 June 2020.

At first instance, the AAT had found that Trong was a resident in those years, despite him having worked and lived outside of Australia for a significant proportion of days in each year. In coming to that conclusion, the AAT had held the following:

1. Trong was a resident under ordinary concepts as he had not demonstrated behaviour consistent with the formation of any definite plan in any of the tax years in question to abandon Australia completely; and
2. Trong was a resident under the domicile test as, due to him not having abandoned his home in Australia indefinitely, he had not established a permanent place of abode outside of Australia.

Trong appealed to the Federal Court.

In the Federal Court, Logan J considered the AAT had misapplied the relevant principles as, firstly, in determining the application of the ordinary concepts test, it had applied principles that are relevant to whether a person has changed their domicile, which is a different test to that applied in determining if a person has ceased to be residing in Australia. Justice Logan referred to the comments of Lord Scarman in *R v Barnet London Borough Council; Ex parte Shah* [1983] 2 AC 309:

> *The notion of a permanent or indefinitely enduring purpose as an element in ordinary residence derives not from the natural and ordinary meaning of the words "ordinarily resident" but from a confusion of it with domicile.*

Secondly in applying the domicile test, the AAT had misunderstood the meaning of 'permanent' in the permanent place of abode exclusion to the domicile test. In *Applegate v Federal Commissioner of Taxation* [1979] 9 ATR 899, Northrop J had explained the concept as follows:

> *The word "permanent" as used in par. (a)(i) of the extended definition of "resident", must be construed as having a shade of meaning applicable to the particular year of income under consideration. In this context it is unreal to consider whether a taxpayer has formed the intention to live or reside or to have a place of abode outside of Australia indefinitely, without any definite intention of ever returning to Australia in the foreseeable future. The Act is not concerned with domicile except to the extent necessary to show whether*

> *a taxpayer has an Australian domicile. What is of importance is whether the taxpayer has abandoned any residence or place of abode he may have had in Australia. Each year of income must be looked at separately. If in that year a taxpayer does not reside in Australia in the sense in which that word has been interpreted, but has formed the intention to, and in fact has, resided outside Australia, then truly it can be said that his permanent place of abode is outside Australia during that year of income. This is to be contrasted with a temporary or transitory place of abode outside Australia.*

The approach of Northrop J was followed in *Harding v Commissioner of Taxation* [2019] FCAFC 29.

Given these errors, Logan J allowed Trong's appeal and remitted the matter to the AAT for re-consideration.

Citation *Quy v Commissioner of Taxation (No 3)* [2024] FCA 726 (Logan J, Brisbane)
w https://www7.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/FCA/2024/726.html

2.13 Other tax and superannuation related cases in period of 13 June 2024 to 11 July 2024

Citation	Date	Headnote	Link
Ierna v Commissioner of Taxation (No 2) [2024] FCA 670	17 June 2024	COSTS – where the applicants were wholly successful in the tax appeals – where the applicant had made what were said to be offers of compromise under the Federal Court Rules 2011 – where the respondent Commissioner consented to the awarding of indemnity costs against him from the date of the so-called offers of compromise – where offers of compromise were merely for the Commissioner to compromise any right of recovery under the amended assessments (as opposed to putting forward genuine alternative bases for the assessments) and the tax appeals concerned novel provisions – whether Court should award indemnity costs on the basis of the consent of legally represented parties – whether determination offers any precedential value – orders for indemnity costs as agreed made	https://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/FCA/2024/670.html
Chen v Chief Commissioner of State Revenue [2024] NSWCATAD 164	18 June 2024	TAXES AND DUTIES — Land tax — Surcharge land tax — “foreign person” — Exemption for principal place of residence — Circumstances outside the control of the owner	https://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/nsw/NSWCATAD/2024/164.html
Rossi v Chief Commissioner of State Revenue [2024] NSWCATAD 172	18 June 2024	TAXES AND DUTIES – Land tax – Surcharge land tax – Foreign person – Liability TAXES AND DUTIES – Land tax – Surcharge land tax – Exemptions – Principal place of residence	https://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/nsw/NSWCATAD/2024/172.html

Citation	Date	Headnote	Link
GSM Pty Ltd v Commissioner of Taxation [2024] FCA 653	18 June 2024	COSTS – apportionment in light of mixed success – applicant to pay 90% of respondent's costs	https://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/FCA/2024/653.html
Bennelong Medical Pty Ltd v Commissioner of Taxation (No 4) [2024] ACTSC 190	18 June 2024	PRACTICE AND PROCEDURE – Leave to represent a corporation to start and carry out proceeding – rule 30(4)(b) of the Court Procedure Rules 2006 (ACT) – self-represented litigant – sole director, secretary, and shareholder – previous application for leave refused – appeal to Supreme Court dismissed – appeal in Court of Appeal struck out – whether current application is an abuse of process – whether current application is precluded by Anshun estoppel – current application drafted in same terms as previous application – no material change in evidence – abuse of process found – application dismissed with costs	https://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/act/ACTSC/2024/190.html
Hyder v Commissioner of Taxation [2024] FCA 654	18 June 2024	COSTS – applications for variations of costs orders – where applicants assert that proceedings were commenced by "unlawful" claims made by the respondent – where Calderbank offers related to multiple proceedings – no unreasonable rejection of offer – no issue of principle	https://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/FCA/2024/654.html
Commissioner of State Revenue v McCabe (No 2) [2024] FCA 662	21 June 2024	CORPORATIONS – voluntary administration – resolution of creditors of corporate group to execute Deed of Company Arrangement (DOCA) – application by Commissioner of State Revenue under ss 445D(1) or s 447A of the Corporations Act 2001 (Cth) to set aside DOCA	https://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/FCA/2024/662.html
GNBF and Commissioner of Taxation (Taxation) [2024] AATA 2152	24 June 2024	TAX – review under Part IVC of the Taxation Administration Act 1953 (Cth) – amended assessments of income tax pursuant to section 167 of the Income Tax Assessment Act 1936 – whether evasion – consideration of section 170(1) (item 5) of the ITAA 1936 – onus of proof – limited documentation – consideration of extent of corroboration required – penalties – whether intentional disregard, recklessness or lack of reasonable care – whether base penalty uplift applies – whether penalties should be remitted – whether shortfall interest charge should be remitted – decisions affirmed	https://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/AATA/2024/2152.html
Mesha Feet Pty Ltd v Allen acting as Deputy	24 June 2024	CORPORATIONS – application for review of a decision of a Registrar pursuant to s	https://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/FCA/... gi-

Citation	**Date**	**Headnote**	**Link**
Commissioner of Taxation [2024] FCA 680		35A(5) of the Federal Court of Australia Act 1976 (Cth) – where originating process seeks to set aside a statutory demand issued to the Plaintiff by the Defendant – where Plaintiff claims to have discharged its taxation liabilities by a “Promissory Note” and a “Bill of Exchange” –where Registrar dismissed the originating process – where Plaintiff’s claims are unmeritorious and misconceived – where no “genuine dispute” arises as to the existence or amount of the debt the subject of the statutory demand – application dismissed with costs	bin/viewdoc/au/cases/cth/FCA/2024/680.html
Fleuren v Chief Commissioner of State Revenue [2024] NSWCATAD 177	28 June 2024	ADMINISTRATIVE LAW – administrative review – assessment - objection – review by Civil and Administrative Tribunal STATE TAXES - surcharge land tax – whether applicant a “foreign person” – whether applicant “ordinarily resident” in Australia – whether applicant was actually in Australia during 200 or more days in the calendar year – exceptional circumstances – brief absence - discretion – estoppel	https://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/nsw/NSWCATAD/2024/177.html
Century Mining Pty Limited v Commissioner of State Revenue [2024] 143	4 July 2024	ENERGY AND RESOURCES – MINERALS – MINING FOR MINERALS – ROYALTIES – where the appellant exports zinc concentrate from the Port of Karumba on a vessel called the MV Wunma – where the appellant lodges quarterly royalty returns with the respondent, the Commissioner of State Revenue – where the appellant must pay to the respondent a royalty in respect of ‘prescribed minerals’, including zinc concentrate – where the royalty payable depends on the ‘value of the prescribed mineral’, which does not include ‘marine cost’ – where the respondent conducted a desktop audit of quarterly royalty returns and declared that the deducted expenses associated with the MV Wunma were not deductible ‘marine cost’ within the definition of s 54 of the Mineral Resources Regulation 2013 (Qld) – where the appellant, at the invitation of the respondent, conducted a self-review for the quarterly royalty returns it lodged over several years – where the respondent served reassessment notices following the self-review, the appellant lodged objections to those reassessment	https://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/qld/QSC/2024/143.html

Citation	Date	Headnote	Link
		notices, and the respondent disallowed the appellant's objections – where the respondent decided that the transport costs associated with the MV Wunma were not deductible 'marine cost' – whether the transport costs were deductible 'marine cost' within the definition of s 54 of the Mineral Resources Regulation 2013 (Qld)	
Maguire v Commissioner of Taxation [2024] FCA 761	8 July 2024	INCOME TAX – where the applicant appeals from objection decisions of the respondent Commissioner of Taxation in respect of amended assessments based on determinations under s 177EA of the Income Tax Assessment Act 1936 (Cth) that deny the applicant the use of imputation benefits from franking distributions, as well as penalties and interest – where, on the first day of trial, the parties jointly promote orders to the Court allowing the appeal and setting aside the Commissioner's objection decisions – where the Commissioner admitted that the objection ought to have been allowed for the grounds specified in the notice of objection – appeal allowed	https://classic.austlii.edu.au/au/cases/cth/FCA/2024/761.html

3. Federal Legislation

3.1 Progress of legislation

Title	Introduced House	Passed House	Introduced Senate	Passed Senate	Assented
Superannuation (Objective) Bill 2023	16/11	19/3	20/3		
Superannuation (Better Targeted Superannuation Concessions) Imposition Bill 2023	30/11				
Treasury Laws Amendment (Better Targeted Superannuation Concessions and Other Measures) Bill 2023	30/11				
Taxation (Multinational—Global and Domestic Minimum Tax) 2024	4/7				

3.2 Withholding rates from 1 July 2024

On 30 May 2024, the Commissioner released Legislative Instrument LI 2024/18. The instrument, which commenced on 1 July 2024, sets out fifteen withholding schedules that specify the amounts, formulas and procedures to be used for calculating the amount required to be withheld from certain payments by an entity from a withholding payment covered by Subdivision 12-B, 12-C or 12-D in Schedule 1 to the TAA.

The instrument repeals and replaces the previous legislative instrument *Taxation Administration Withholding Schedules 2023* (F2023L00743), and repeals the redundant legislative instrument *Taxation Administration Act 1953 - Pay as you go withholding - Tax table for additional amounts to withhold as a result of an agreement to increase withholding* (F2014L01665) which was registered on 10 December 2014.

ATO reference *Legislative instrument LI 2024/18*
w https://www.ato.gov.au/law/view/document?docid=OPS/LI202418/00001

3.3 Cents per kilometre deduction rate

The rate of cents per kilometre for work-related car expense deductions for income years commencing on or after 1 July 2024 is 88 cents per kilometre. This is an increase from 85 cents per kilometre in the income year ended 30 June 2024.

ATO reference *Legislative instrument LI 2024/19*
w https://www.ato.gov.au/law/view/document?docid=OPS/LI202419/00001

4. State Legislation

4.1 New South Wales budget

On 18 June 2024, the NSW Government handed down the 2024-2025 State budget. On 21 June 2024, the NSW Parliament passed the Revenue Legislation Amendment Bill 2024 which implemented the measures announced in the State budget.

The key revenue changes are as follows:

1. the *Duties Act 1997* (NSW) was amended to increase the surcharge purchaser duty payable and surcharges on acquisitions payable by foreign persons from 8% to 9%;
2. the *Land Tax Act 1956* (NSW) was amended to increase the surcharge land tax payable from midnight on 31 December 2024 to 5%;
3. the *Land Tax Management Act 1956* (NSW) was amended to freeze the review of land tax thresholds to 1 June 2027. The land tax threshold for a land tax year after the 2023 land tax year is $1,075,000. The premium rate threshold for a land tax year after the 2023 land tax year is $6,571,000; and
4. the *Payroll Tax Act 2007* (NSW) was amended to exempt from payroll tax 'relevant general practitioner wages' and wages paid to certain other general practitioners at medical centres where the payroll tax is unpaid and the wages are paid or payable before 4 September 2024. Wages are 'relevant general practitioner wages' if the wages are paid to a general practitioner at a medical centre that bulk bills for most of the general practitioner services provided by the medical centre. The proportion of general practitioner services that must be provided under the bulk billing arrangements at the medical centre is at least 80% for medical centres in metropolitan Sydney and at least 70% for medical centres located elsewhere. An employer is entitled to a rebate of payroll tax payable for relevant general practitioner wages paid or payable on or after 4 September 2024.

w https://www.parliament.nsw.gov.au/bills/Pages/bill-details.aspx?pk=18614
w https://www.revenue.nsw.gov.au/help-centre/resources-library/budget/2024-state-budget

4.2 South Australia budget

On 6 June 2024, the South Australian Government handed down the 2024-2025 State budget. On 6 June 2024, the South Australian Government introduced into Parliament the Statutes Amendment (Budget Measures) Bill 2024 which contains the measures announced in the State budget.

The key revenue changes are as follows:

1. the *Stamp Duties Act 1923* (SA) is to be amended to remove the property value cap for stamp duty relief for eligible first home buyers who enter into a contract to purchase eligible new homes and vacant land used to build a new home on or after 6 June 2024;
2. the First Home and Housing Construction Grants Act 2000 (SA) is to be amended to remove the property value cap for the First Home Owner Grant for contracts entered into on or after 6 June 2024 to purchase a new home or comprehensive building contract;
3. the *Payroll Tax Act 2009* (SA) is to be amended to provide an exemption from payroll tax on the wages of general practitioners related to bulk billed services from 1 July 2024. The exemption will be calculated based on the proportion of bulk billed items relative to the total number of billed items by general practitioners. This percentage deduction will then be applied against the medical practices' total annual

general practitioners' wages bill. The amendments foreshadow the introduction of regulations which may provide for further relief from payroll tax.

w https://www.legislation.sa.gov.au/__legislation/lz/b/current/statutes%20amendment%20(budget%20measures)%20bill%202024/b_as%20introduced%20in%20ha/statutes%20budget%20measures%20bill%202024.un.pdf
w https://www.revenuesa.sa.gov.au/StateBudgetUpdates/2024-25-state-budget

4.3 Victorian commercial and industrial property tax

From 1 July 2024, land transfer duty on commercial and industrial properties will be abolished and replaced with an annual property tax. The annual property tax is to be payable from 10 years after the sale transaction.

The annual property tax for commercial and industrial property will be 1 per cent of the property's unimproved land value.

w https://www.legislation.vic.gov.au/as-made/acts/commercial-and-industrial-property-tax-reform-act-2024

4.4 Western Australia build to rent land tax exemption

On 15 May 2024, the *Land Tax Assessment Amendment (Build-to-rent) Bill 2023* (WA) was passed which amends the *Land Tax Assessment Act 2002* (WA) to introduce a 50% land tax exemption for land used for a new build-to-rent development. The exemption applies to eligible build-to-rent developments from the 2023–24 assessment year.

w https://www.parliament.wa.gov.au/parliament/bills.nsf/BillProgressPopup?openForm&ParentUNID=9908145C8F28C7E3482589B10029707A

5. Rulings

5.1 Hybrid mismatch rules

Background

The ATO has released taxation ruling *TR 2024/4 Income tax: hybrid mismatch rules - application of certain aspects of the 'liable entity' and 'hybrid payer' definitions*.

Division 832 of the ITAA 1997 contains hybrid mismatch rules designed to prevent multinational corporations from exploiting tax treatment differences across jurisdictions.

The ruling addresses two issues:

1. whether hypothetical income or profits can be used to identify a 'liable entity' in a country for section 832-325 purposes; and
2. whether a 'non-including country' under subsection 832-320(3) can be a jurisdiction other than where the payee resides.

Subdivision 832-D neutralises a hybrid payer mismatch if it involves a deduction or non-inclusion in Australia. This mismatch occurs when a payment by a hybrid payer would not have arisen, or would have been less, if made by an ungrouped entity. The relevant parties must be in the same control group or the mismatch must arise under a structured arrangement.

A hybrid payer is an entity whose payment is disregarded for tax purposes in one country (resulting in non-inclusion) but is deductible in another country. The neutralising amount for the mismatch is reduced by dual inclusion income.

<u>Liable entity</u>

The concept of a 'liable entity' is central to Division 832, particularly for identifying hybrid entities, including hybrid payers. According to section 832-325, an entity can be a liable entity in respect of its own income or profits or the income or profits of another entity. Additionally, an entity can be a liable entity in more than one country.

The general test for whether an entity is a liable entity in a country in respect of its own or another entity's income or profits is whether tax is imposed on the entity in respect of all or part of those income or profits for an income year.

In determining whether an entity is a liable entity under section 832-325, subsection 832-325(4) clarifies that actual income or profits are not required, nor does the entity need to be liable to pay tax. The word 'imposed' in subsections 832-325(1) and (2) can include hypothetical income or profits within the tax base of the relevant country. The purpose is to determine if an entity could be liable to tax, not whether it actually pays tax, focusing on whether the entity is a taxable entity in that country regardless of actual income or profits.

<u>Hybrid payer</u>

A payment results in a hybrid payer mismatch if it is made by a 'hybrid payer.' According to section 832-320, an entity is considered a hybrid payer for a payment if subsection 832-320(2) applies to the entity in relation to a country and the payment, and subsection 832-320(3) applies to the entity in relation to a different country and the payment. Subsection 832-320(2) pertains to the deducting country, while subsection 832-320(3) pertains to a non-including country.

Relevantly, section 832-320(3) provides:

> ***Non-including country – entity is grouped with recipient***
>
> *This subsection applies to a test entity in relation to a country (a* ***non-including country****) and a payment the test entity makes if:*
>
> *(a) the test entity, or another entity, is a liable entity in the non-including country in respect of income or profits of the test entity (or a part of the income or profits); and*
>
> *(b) that liable entity is also a liable entity in the non-including country in respect of income or profits of the recipient of the payment.*

The opening text of section 832-320(3) of the ITAA 1997 includes the terms 'a country' and 'a non-including country,' indicating that more than one country can be considered when identifying the non-including country.

Ruling

In relation to the first issue, the ATO ruled that the identification of a 'liable entity' or entities in a country in respect of income or profits for the purpose of section 832-325 can be based wholly on hypothetical income or profits within the tax base of the country. This will be necessary where, for example:

1. an entity has not actually derived any income or profits in a particular period; or
2. an entity has derived income or profits in a particular period, but no part of those income or profits are within the tax base of the country.

Section 832-325 does not restrict when hypothetical income or profits within the tax base of a country can be used to identify a liable entity in the country. For example, there is no requirement that the entity being tested as a liable entity in the country must:

1. be a tax resident of the country;
2. have previously carried on, currently carry on, or propose to carry on, activities that produce or may produce income or profits within the tax base of the country; or
3. normally derive income or profits within the tax base of the country.

In relation to the second issue, the ATO ruled that for the purpose of subsection 832-320(3), a non-including country can be a jurisdiction other than the country where the payee of the relevant payment is located or resides. Therefore, the laws of a jurisdiction other than the country where the payee is located or resides may fall for consideration in determining whether there is a hybrid payer within the meaning given by section 832-320.

ATO reference *Taxation Ruling* TR 2024/4 w https://www.ato.gov.au/law/view/document?docid=TXD/TD20244/NAT/ATO/00001#H42

5.2 The addition of water to beer – Alcohol excise

On 12 June 2024, the ATO published Draft Excise Determination ED 2024/D1 for public comment. The draft Determination explains the Commissioner’s preliminary view about how much water can be added before a beverage will no longer meet the definition of 'beer' in the Schedule to the *Excise Tariff Act 1921*.

Broadly, to be classified as 'beer', a beverage must be a product of yeast fermentation of an aqueous extract from cereals. A beverage with more unfermented than fermented content does not meet this requirement. If water and other unfermented substances exceed half the final beverage volume, it is not classified as beer.

Such beverages are classified as 'other excisable beverages' and are subject to excise duty.

The final Determination, when issued, is proposed to apply from 1 July 2024.

ATO reference *Draft Excise Determination* ED 2024/D1
w https://www.ato.gov.au/law/view/document?docid=DEX/ED2024D1/NAT/ATO/00001

5.3 Withdrawal of superannuation guarantee ruling

On 25 June 2004, the ATO published a notice confirming that *Superannuation Guarantee Ruling SGR 2005/1* is withdrawn with effect from 26 June 2024.

The ATO's views in SGR 2005/1 have been updated and incorporated into Appendix 2 of Draft Taxation Ruling TR 2023/4DC1 *Income tax and superannuation guarantee: who is an employee?*

ATO reference *Superannuation Guarantee Ruling SGR 2005/1W*
w https://www.ato.gov.au/law/view/document?docid=SGR/SGR20051/NAT/ATO/00001

5.4 Who is an employee for income tax and superannuation guarantee

The Commissioner has introduced draft consolidation TR 2023/4DC1 which outlines proposed changes to TR2023/4 to update and incorporate Superannuation Guarantee Ruling SGR 2005/1 *Superannuation guarantee: who is an employee?* (now withdrawn) into proposed draft Appendix 2.

Under section 12(1) of the SGAA, if a person is an employee at common law, that person is an employee under the SGAA. Subsections 12(2) to (10) of the SGAA list a number of further persons who are also treated as employees. These subsections deem persons who fall within these provisions to be employees for the purposes of the SGAA.

Under subsection 12(3) of the SGAA, a person who works under a contract that is wholly or principally for their labour, will be an employee of the other party to the contract. Firstly, this requires there be a contract which requires attention to the rights under the contract and not the actual performance of the contract. Secondly, the person needs to work under the contract. This requires personal exertion. Therefore, section 12(3) only applies the worker is a natural person who was a party to the contract in his or her individual capacity and not in any other capacity such as a trustee of a personal services trust or a partner in a partnership. Thirdly, whether the contract is wholly of principally 'for' the labour of a person, is to be assessed from the perspective of the engaging entity and is to be determined by reference to the terms of the contract.

A contract is not wholly or principally for the labour of a person where:

1. the contract leaves the worker free to do the work themselves or to employ another person to carry it out . That is, the contract contains a right to delegate, subcontract or assign the work. The existence of the right to delegate is important, not the exercise of that right;
2. the contract is for the provision or production of a result and the worker is paid for that result (that is, results contracts); or
3. the contract is principally for a benefit other than the labour of the worker (for example, the contract is principally for the provision of equipment).

The drat consolidation confirms that in determining if a person is an employee under subsections 12(2) to (10) consideration of whether the personal services provided were done so in an employment-like setting will not be relevant. Further, it is confirmed that a partner in a partnership cannot be an employee of the partnership.

ATO reference *Draft Taxation Ruling* TR 2023/4DC1
w https://www.ato.gov.au/law/view/document?docid=DTC/TR20234DC1/NAT/ATO/00001

5.5 Superannuation income streams

On 26 June 2024, the ATO issued an Addendum to Taxation Ruling TR 2013/5 to reflect amendments made by the *Treasury Laws Amendment (Fair and Sustainable Superannuation) Act* 2016, which introduced the transfer balance cap provisions and the concept of retirement phase for superannuation interests, and the *Income Tax Assessment (1997 Act) Regulations* 2021, which replaced the *Income Tax Assessment Regulations 1997*.

The Addendum also clarified ATO's view on when a superannuation income stream commences and ceases in the context of successor fund transfers.

ATO reference Taxation Ruling TR 2013/5A1 - Addendum
w https://www.ato.gov.au/law/view/document?docid=TXR/TR20135A1/NAT/ATO/00001&PiT=20240626000001

6. Private Binding Rulings

6.1 Division 149 and class shares

Facts

Company A is a private company incorporated before 20 September 1985.

Company B acquired shares in Company A before 20 September 1985. Company B recently sold these shares to an unrelated third party.

Individual A, Individual B and Company C acquired shares in Company B before 20 September 1985. Individual A and Company C still own these pre-CGT shares.

Individual A and their spouse own all the shares in Company C. Individual A acquired their shares in Company C before 20 September 1985 and their spouse acquired their shares in Company C after 20 September 1985.

In 199X, Company B's Articles of Association were amended and Company B issued a new class of 'D' class shares to Company D and Company E.

The 'D' class shares carried a right to dividends to be paid to the exclusion of all other share classes at the discretion of the directors.

All of the shares in Company D are owned by Trust A, which is a discretionary trust established after 20 September 1985 for the benefit of Individual A and their family.

The ultimate owner of Company E is Individual B. Company E has since transferred its D class shares in Company B to Company D.

The pre-CGT shares that Individual B acquired in Company B were bought back after the D class shares were issued.

Questions

1. Has Division 149 been triggered?
2. If yes, is the Commissioner satisfied or does the Commissioner think it reasonable to assume that at all times on or after 20 September 1985 the majority underlying interests in the shares in Company A held by Company B were held by ultimate owners who held majority underlying interests in these shares immediately before 20 September 1985?

Ruling

<u>Change in majority underlying interests</u>

As Company B is not a natural person, it is necessary to determine if natural persons held more than one-half of the beneficial interests in Company A shares and any income derived from them up until the end of the 1997 income year.

The assessment follows former section 160ZZS of the ITAA 1936 for the period before 1997 and subsection 149-15(3) of the ITAA 1997 for the period after 1997.

The issue of D Class shares enabled dividends to be paid to Company D and potentially distributed to Trust A beneficiaries, excluding Individual A.

This created a possibility that Individual A might receive between 0% and 50% of the income derived from Company A shares.

Section 82KZC of the ITAA 1936 (now section 149-30 of the ITAA 1997) requires more than one-half of the beneficial interests in an asset and its income to constitute a majority underlying interest.

Since Individual A and Individual B together could not maintain more than 50% interest in the income, the majority underlying interest was not held by them after 20 September 1985.

The ATO referred to ATO ID 2011/17, which concluded that issuing new shares with discretionary dividend rights disrupted the continuity of majority underlying interests.

Discretion

Subsection 149-30(2) of the ITAA 1997 allows for discretion where the Commissioner is satisfied or considers it reasonable to assume that majority underlying interests in an asset have been held by the same ultimate owners since immediately before 20 September 1985.

The ATO referred to IT 2340, in which the Commissioner would find it reasonable to assume that majority underlying interests in an asset have been held by the same ultimate owners in circumstances where a trustee continues to administer a trust for the benefit of members of a particular family. However, in this case, Trust A was not established until after 20 September 1985. The guidance in IT 2340 does not apply to assess the beneficial interest of beneficiaries in the assets of, or ordinary income of, discretionary trusts which have been settled after 20 September 1985 for the purpose assessing majority underlying interests.

In this case, the issue of 'D' Class shares to Company D and Company E introduced the possibility that dividends and beneficial interests could be distributed to parties who did not hold interests immediately before 20 September 1985.

Consequently, under former subsection 160ZZS(1) of the ITAA 1936, Company B is deemed to have acquired the shares in 199X when the 'D' Class shares were issued.

This deemed acquisition date aligns with the provision that majority underlying interests ceased to be held by Individual A and Individual B on the issue date of the 'D' Class shares.

ATO reference *Private Binding Ruling* Authorisation No. 1052197160571
w https://www.ato.gov.au/law/view/document?docid=EV/1052197160571

6.2 Relationship breakdown roll-over

Facts

The taxpayer and their former spouse shared a de facto relationship.

Whilst in the relationship, the taxpayer and their former spouse established a company.

The taxpayer was as the sole director, and the shares were held by both the taxpayer and their former spouse.

The taxpayer and their former spouse separated and agreed to a binding financial arrangement executed under section 90G of the *Family Law Act 1975* (Cth).

This binding financial arrangement put the following terms into effect:

1. the former spouse would be appointed the director of the company;

2. the taxpayer and their former spouse would retain their respective interests in the company until there was mutual termination of business interests;
3. if either party were to exit the business, the exiting spouse would give 60 days' notice of this intention and offer an option to the other spouse of purchasing the remaining interest in the business at a value calculated by a formula;
4. the remaining party would pay out the other 50% of the business value and 50% of the remaining stock subject to stocktake;
5. save for the business value, the terms and conditions of the sale of the business shall be as agreed between the parties and in default of such agreement as nominated by the President of the Real Estate Institute and their nominee;
6. the remaining party must accept the option in writing; and
7. if the option was declined, the business would be sold, and the terms and conditions of the sale shall be as agreed between the parties.

The grant of the option under this financial arrangement gives rise to a CGT event D2. If the option is exercised, the capital gain or loss on the CGT event D2 is disregarded and becomes a CGT event A1.

The taxpayer advised their former spouse that they wished to exercise their rights under the agreement to exit the business, gave notice to them in accordance with the requirements of the agreement, and granted an option to them to purchase the taxpayer's share of the business, triggering a CGT event D2.

The former spouse exercised the option on the shares and paid the taxpayer an amount consistent with the valuation at the time, triggering a CGT event A1.

The share sale agreement included reference to the financial arrangement and stated that it was carried out in accordance with the arrangement.

The taxpayer resigned as a director of the company, and the final settlement of the share transfer occurred on XXXX.

There is no reasonable likelihood that cohabitation will be resumed.

Question

Will the roll-over under section 126-5 of the *Income Tax Assessment Act 1997* (ITAA 1997) apply to the transfer of shares to the taxpayer's former spouse?

Ruling

The ATO ruled yes.

Section 126-5 of the ITAA 1997 allows for a roll-over where there is a transfer of a CGT asset to a former spouse because of a court order, binding financial agreement, or arbitral award following the breakdown of a marriage or de facto relationship.

The disposal of shares in these circumstances was contemplated by the binding financial agreement, even though the actual transfer took place some time after the binding financial agreement was signed. This enables the taxpayer to use the relationship breakdown roll-over in section 126-5 of the ITAA 1997. Any capital gain or loss incurred on the exercise of the option and subsequent transfer of shares will be subject to the roll over and is disregarded.

ATO reference *Private Binding Ruling* Authorisation No. 1052247898508
w https://www.ato.gov.au/law/view/document?docid=EV/1052247898508

6.3 Input taxed supply

Facts

The taxpayer is registered for GST.

The taxpayer purchased a property in Australia with two residential duplexes situated on the land.

Originally, the property was acquired to provide accommodation for related parties at a nominal rent to cover running expenses. Later, the duplexes were leased to third parties as input taxed supplies.

The duplexes were destroyed by a fire. The burnt structure was removed from the land as the fire destroyed the building beyond repair.

The land remained vacant and has not been used since the fire.

The taxpayer intends to sell the vacant land.

Question

Is a taxpayer making an input taxed supply under section 9-30(4) of the GST Act when the taxpayer sells its property as vacant land after residential premises was destroyed in fire, which prior to the fire were used solely to make input taxed supplies by way of lease?

Ruling

The ATO ruled that the taxpayer will be making input taxed supplies under section 9-30(4) of the GST Act.

The supply of residential premises is generally input taxed. However, GSTR 2012/5 outlines that residential premises must be suitable for and capable of being occupied as a residence, which the vacant land was not.

However, section 9-30(4) of the GST Act provides that:

> *A supply is taken to be a supply that is input taxed if it is a supply of anything (other than new residential premises) that you have used solely in connection with your supplies that are input taxed but are not financial supplies.*

The ATO referred to ATO ID 2009/18 which addresses the GST implications when selling vacant land after removal of a fire-damaged house that had been used solely in connection with input taxed supplies. The ATO's view in ATO ID 2009/18 was that the vacant land must have been used exclusively in connection with the entity's input taxed supplies. According to ATO ID 2009/18, when determining whether land has been exclusively used in connection with input taxed supplies, the ATO must consider several factors, including:

1. how the land has been exploited or enjoyed, including whether it has been used privately by the entity, for business purposes, or leased to a third party;
2. any actions the entity has taken to change or develop the land and whether these actions are connected to input taxed supplies;
3. the entity's reason for holding the land, such as whether it is held dormant to achieve profits through appreciation in capital value.

Additionally, the ATO considers the broader context of the entity's activities to determine if they are connected with input taxed supplies or if they serve a different purpose. In cases where significant changes have occurred, such as the destruction of a residential structure, the steps taken to deal with the aftermath, such as demolition, should be viewed as connected to the input taxed supply if they are consequential to the incident rather than indicating a new use. Finally, the ATO considers whether the entity's activities reflect a separate purpose unrelated to input taxed supplies, such as significant commercial development or personal use that would indicate a different intention for the land.

The ATO considered that in the taxpayer's situation, the property was exclusively used for leasing activities before the duplexes were destroyed by fire. Since the fire, the taxpayer had not undertaken steps to enhance the value of the property or occupy it in a manner suggesting a purpose unrelated to residential leasing. Importantly, the demolition of the burnt structure was not regarded as a separate and distinct use of the land, but rather as a consequential step between the end of the leasing activities and the sale of land.

Therefore, the sale of vacant land will be an input taxed supply.

ATO reference *Private Binding Ruling* Authorisation No. 1052243564521
w https://www.ato.gov.au/law/view/document?docid=EV/1052243564521

6.4 Non-arm's length income

Facts

The Company carried on a business of providing equipment hire services to clients in Australia.

The shares in the Company were held by two family trusts, Family Trust A and Family Trust B.

Due to growth in the business, a third shareholder and director is to be brought into the Company. As part of the restructure, it is intended that:

1. Family Trust A will dispose of its shares in the Company;
2. Family Trust B will dispose of its shares in the Company;
3. the shares in the Company will be held by SMSF A (a related entity of Family Trust A), SMSF B (a related entity of Family Trust B), and SMSF C (a related entity of Family Trust C) in equal proportions.

Post restructure, the Company will have three directors, each related to one of the SMSFs. None of the SMSFs will hold a controlling interest in the Company. All ordinary shareholders will be entitled to dividends on the same basis as all other ordinary shareholders.

The controllers of the SMSFs are not related and are engaging with each other at arm's length.

The SMSFs and the Company are unrelated and the SMSFs' members have independently decided to invest in the Company due to the growth and long-term investment opportunity of the business.

The shares in the Company have been valued by a third party to facilitate the disposal and acquisition of the shares.

The Commissioner has made the following assumptions with respect of the facts:

1. the ordinary shares in the Company will be acquired at market value;
2. the return on the ordinary shares in the Company in an income year will represent a commercial and arm's length rate of return on the shares;
3. there will be no change to the rights attaching to any of the classes of shares in the Company;
4. there will be no shares issued in satisfaction of a dividend;
5. the Company will not enter into non-arm's length dealings that inflate the income of the Company; and
6. the Company received income from parties as a result of any scheme that the parties were not dealing with each other at arm's length.

Question

Will the SMSFs' future receipt of fully franked dividends from the Company result in non-arm's length income of the SMSFs under section 295-550 of the ITAA 1997?

Ruling

Section 295-550(2) of the ITAA 1997 deems that a dividend from a private company, or ordinary or statutory income that is reasonably attributable to that dividend, is non-arm's length income unless the amount is consistent with an arm's length dealing.

Section 295-550(3) provides 6 criteria to which the Commissioner is to have regard when considering whether the amount is consistent with arm's length dealings. They include:

1. the value of shares in the company that are assets of the entity; and
2. the cost to the entity of the shares on which the dividend was paid; and
3. the rate of that dividend; and
4. whether the company has paid a dividend on other shares in the company and, if so, the rate of that dividend; and
5. whether the company has issued any shares to the entity in satisfaction of a dividend paid by the company (or part of it) and, if so, the circumstances of the issue; and
6. any other relevant matters.

The Commissioner considered each of these criteria and noted the following supported a conclusion that dividends from the Company shares will be consistent with an arm's length dealing for the purposes of section 295-550(2) of the ITAA 1997:

1. the shares will be purchased at a value determined by an independent valuation;
2. all shares will be held by the SMSFs in equal proportions and the rate of dividend for each SMSF will be the same;
3. each of the directors and shareholders is at arm's length from the other shareholders in the Company;
4. none of the SMSFs will hold a majority interest in the Company;
5. the ordinary shares will be acquired by the SMSFs on the same terms;
6. the assumption that the Company will only drive income from parties as a result of any scheme the parties to which were not dealing with each other at arm's length and the Company will not enter into any non-arm's length transactions that inflate the income of the Company that can be distributed to the SMSFs.

ATO reference *Private Binding Ruling* Authorisation No. 1052250823319
w https://www.ato.gov.au/law/view/document?docid=EV/1052250823319

6.5 CGT and restraint of trade payment

Facts

X entered into a fixed term employment agreement (the original employment contract) with X's employer in late 20XX (several years ago) in relation to a managerial position.

A specific clause of the original employment contract imposed various restraint terms on X for one year following the termination of X's employment. Another clause of the original employment contract stated that, subject to X being employed for at least a certain set period of time, upon termination of X's employment X will receive a restraint of trade payment.

In late 20XX (a couple of years after X commenced the employment), X signed an offer of permanent part time employment (subsequent employment contract) with the same employer.

The subsequent employment contract stipulated that many of the terms would be on the same terms as the original employment contract, including the restraint terms.

In late 20XX, X resigned from their employment, being several years after X commenced the employment, with their final day of employment being a few days later.

X's employer issued a severance letter to X which referred to the restraint of trade payment in accordance with the relevant clause of the original employment contract. In late 20XX, X signed an acknowledgement of the severance letter. A day later, X received the restraint of trade payment.

Questions

1. Is the lump sum payment received under the restraint of trade clause in X's original employment contract assessable as ordinary income under section 6-5 of the ITAA 1997?
2. Is the lump sum payment received under the restraint of trade clause in X's original employment contract an employment termination payment (ETP)?
3. Did CGT event C2 happen when X received the restraint of trade payment?
4. Is X eligible for the 50% CGT discount in relation to the assessable capital gain resulting from CGT event C2, which happened when X received the restraint of trade payment?

Ruling

<u>Question 1 – ordinary income</u>

The ATO ruled no.

The ATO confirmed that the lump sum payment received under the restraint of trade clause in the original employment contract was not assessable as ordinary income, as it was a one-off lump sum payment that is not income from rendering personal services, income from property or income from carrying on a business.

For this reason, the payment was considered to be capital in nature. Accordingly, the lump sum payment was not ordinary income and is therefore not assessable under section 6-5 of the ITAA 1997.

<u>Question 2 – ETP</u>

The ATO ruled no.

Section 82-135 of the ITAA 1997 specifically excludes from the definition of an employment termination payment a capital payment in respect of a legally enforceable contract in restraint of trade so far as the payment is reasonable having regard to the nature and extent of the restraint.

The ATO stated that the lump sum payment received under the restraint of trade clause in the original employment contract meets the criteria for being excluded from the definition of an ETP, as set out in paragraph 82-135(j) of the ITAA 1997. Where the Commissioner decides that an amount is not an employment termination payment, the payment (or part of it) may be assessable as a capital gain.

<u>Question 3 – CGT event C2</u>

The ATO ruled yes.

Section 104-25 of the ITAA 1997 states that CGT event C2 happens if a taxpayer's ownership of an intangible CGT asset ends because the asset expires or is redeemed, cancelled, released, discharged, satisfied, abandoned, surrendered, or forfeited.

CGT event C2 happened when X received the restraint of trade payment in late 20XX as this was when X's ownership of your intangible CGT asset ended. This intangible CGT asset was X's right to receive the payment, which X only obtained upon termination of their employment in late 20XX as per the relevant clause of the original employment contract.

The cost base in this instance would include any costs incurred in entering into the agreement, and the capital proceeds is the restraint of trade payment X received after X's employment was terminated.

The ATO stated that although CGT event D1 (creation of a right) may apply in relation to a restrictive covenant, section 102-25 of the ITAA 1997 provides that D1 will not apply if another CGT event happens. As C2 happened, D1 will not apply.

Question 4 – CGT discount

The ATO ruled no.

The ATO stated that the relevant CGT asset was the right to receive the payment, which X only obtained upon termination of X's employment. This is because under the relevant clause of the original employment agreement, the restraint of trade payment was only available to X upon termination of employment.

Therefore, the ATO concluded that given X only received the restraint of trade payment a short time (and less than 12 months) after X first held the right to demand that payment, X was not eligible for the CGT discount in relation to the assessable capital gain from CGT event C2.

The ATO further stated that a capital gain from CGT event D1 is not eligible for the 50% CGT discount. Therefore, even if CGT event D1 applied instead of C2, X would still not be eligible for the 50% CGT discount.

ATO reference *Private Binding Ruling* Authorisation No. 1052246900943
w https://www.ato.gov.au/law/view/document?docid=EV/1052246900943

6.6 CGT and deferral of payment on the sale of property

Facts

Trust A owns the Property. Company B is the Trustee for Trust A.

Individual C is the beneficiary of Trust A. Individual C is also the director of the sole Trustee.

A contract was signed to sell the Property by Individual C, as director of the Trustee, on XX June 20XX (the date of exchange).

The contract allowed for a deposit to be paid on signing and the balance of the deposit to be paid at the expiration of XX days from the date of exchange, being the conclusion of the due diligence period.

A final instalment, being the balance of the purchase price, was to be paid at the expiration of XX months from the date of exchange.

The Trustee made a resolution which stated Individual C's distribution was XX% of the net franked dividends, share of the net capital gain, and share of the distributable surplus of the trust. There are no other beneficiaries.

The Trustee has not made a choice and does not intend to seek approval from the Commissioner to make a choice for the Trustee to be assessed on the capital gains under section 115-230 of the ITAA 1997.

Questions

1. Can the trustee of Trust A and the beneficiary defer reporting the capital gain on the sale of a property in their income tax returns for the income year ending 30 June 20XX until settlement occurs?

2. Can all General Interest Charges (GIC) and/or penalties be waived or fully remitted, providing an amendment application is lodged within 30 days of the final settlement date when the bulk of the sale proceeds will be received?

Ruling

Question 1 – deferral of reporting

The ATO ruled yes.

The ATO stated that the Trustee of Trust A and the beneficiary can defer the capital gain on the sale of a Property in their income tax returns for the income year ending 30 June 20XX until settlement of the contract occurs.

Once settlement occurs and if the gain is not already included in their income tax assessment, the Trustee and the beneficiary will be required to amend their income tax assessments for the income year ending 30 June 20XX to include the capital gain made, as CGT event A1 happened to the Property when the sale contract was executed.

Question 2 - GIC

The ATO declined to rule on this question as it requires the ATO to rule based on assumptions about future events or other matters (section 357-110 of the TAA).

The ATO stated that it is unable to make any decision on the remission of interest charges and/or penalties until such a time as the liability for interest and/or penalties arise. the ATO indicated that if interest charges or penalties do arise, a taxpayer is able to request a remission of these by following the relevant process that is in place.

The ATO confirmed that TD 94/89 states where an assessment is amended to include a net capital gain, and a liability for interest arises under section 170AA(1), the remission of interest will be dealt with in each case on its own merits. Paragraph 5 of TD 94/89 states that this amendment must be made within a reasonable time after the date of settlement. The ATO stated that, in most cases, the ATO would consider a period of one month after settlement to be a reasonable period.

ATO reference *Private Binding Ruling* Authorisation No. 1052250117730
w https://www.ato.gov.au/law/view/document?docid=EV/1052250117730

6.7 Carrying on an enterprise and mere realisation of a capital asset

Facts

We assume person A and person B are spouses.

Person A had an interest in a property, zoned residential.

The property was transferred to a trust managed by Person A and Person B as directors of the trustee company. The intention of purchasing the property was the possibility of capital improvement, depending on the financial situation of person A and person B, and long-term financial support for lifestyle and retirement.

The property was tenanted until it was vacated by the tenants before the existing dwelling on the property was demolished.

An error during the property transfer resulted in the property being transferred to Person A and Person B's individual names. An objection was lodged to the Victorian State Revenue Office on the grounds that the trustee company decided the transfer was not to proceed and to be withdrawn. The objection was disallowed. The matter was referred to the VCAT and later settled. The settlement offer was that the stamp duty for the transfer was to be paid over 12 monthly instalments without accrual of interest. The transfer was held to be executed on DD/MM/YY.

Person A and person B wanted to improve the land but were having difficulties borrowing funds in the trust. As a result, two loans were obtained for construction and investment. One loan was in the trust's name and the other loan was in the personal names of person A and person B.

The trust was used to obtain permits and other requirements for the development of the property. A planning permit was issued and a building permit was issued for demolition works. Later, another permit was issued for the construction of units on the property. The intention was to fund person A and person B's retirement by renting out the units long-term.

Three residential units were constructed. An occupancy permit was issued for the completed units a couple of years later.

Both loans were refinanced into one loan in person A and person B's personal names.

The property was then legally transferred from the trustee to person A and person B in their personal names.

Due to quickly increasing interest rates putting financial stress on person A and person B, a decision was made to sell one of the units and reduce the loan.

Person A and person B subdivided the property and the properties were given a new address.

One of the units was sold to a third party and proceeds of the sale were used to decrease the loan amount.

The remaining units are being retained and rented out long-term.

The trust was incorrectly registered for GST and the registration was subsequently cancelled.

Person B works in hospitality. Person B does not have an ABN and is not registered for GST.

Person A is a tradesperson with an ABN but is not registered for GST.

Person A and person B were not actively involved in the subdivision and construction of the units. Professionals were used to complete the building works and drawings.

The trust has not been involved in any prior developments. Person A and person B were involved in one subdivision several years ago. This was treated as capital as the properties are used as their principal place of residence and a rental.

Questions

1. Are person A and person B carrying on an enterprise in relation to the subdivision of the property and, as a result, required to be registered for GST?
2. Are the proceeds from the sale of the unit on capital account as a mere realisation of a capital asset?

Ruling

<u>Did person A and person B carry on an enterprise in relation to the subdivision of the property?</u>

The ATO ruled no.

The activities of person A and person B did not display the relevant indicators of a business, which are transactions entered into on a continuous and repetitive basis. The subdivision was a 'one-off project' that was not considered to be carried out in a manner similar to other property development businesses. It did not have a commercial purpose or character. Additionally, having regard to *Miscellaneous Taxation Ruling* MT 2006/1, the ATO did not consider the activities of constructing three residential units and subsequently selling one of the units as being done in the form of an adventure or concern in the nature of trade.

While the rental of the residential units constitutes an 'enterprise' for GST purposes, paragraphs 188-15(1)(a) and 188-20(1)(a) of the GST Act provide that input taxed supplies of leasing residential premises are disregarded when determining whether an entity meets the GST registration turnover threshold. The proceeds from the sale of the unit will also be disregarded in calculations to determine whether person A and person B are required to register for GST as paragraphs 188-15(1)(c) and 188-20(1)(c) of the GST Act provide that supplies that are not made in connection with an enterprise that an entity carries on are disregarded.

Were the proceeds from the sale of the property a mere realisation of a capital asset?

The ATO ruled yes. The intention of the development of the three units was not making a profit by sale but to generate an income stream as a result of renting the three new dwellings. The ATO considered that the facts and circumstances of the case did not indicate the carrying on a business or an isolated commercial transaction with profit making intent. The project was not planned in an organised or business-like manner and the sale was due to external financial pressures, not the motivation of making a profit. The sale of the unit resulted in a capital gain on a mere realisation of a capital asset.

COMMENT – in considering whether Person A and Person B were carrying on an enterprise, the ATO appears to have confined its analysis to whether they were carrying on a business. The meaning of enterprise goes beyond carrying on a business. In this case, in circumstances where properties were lease, it unclear why the ATO did not consider that Person A and Person B engaging 'in an activity or series of activities, done...on a regular or continuous basis in the form of lease, licence or other grant of an interest in property'.

ATO reference *Private Binding Ruling* Authorisation No. 1052245869916
w https://www.ato.gov.au/law/view/document?docid=EV/1052245869916

7. ATO and other materials

7.1 CGT improvement threshold

The cost threshold to check if a capital improvement to a pre-CGT property is subject to CGT has increased to $182,000 for the 2025 income year.

Generally, capital improvements are considered to form part of the land and are not separate assets for CGT purposes. However, major capital improvements can be separately subject to CGT where:

1. the taxpayer acquired property before 20 September 1985;
2. the taxpayer made capital improvements to it on or after that date; and
3. the improvements are not exempt under the main residence exemption.

An addition or improvement, such as renovating a house, is a major capital improvement if its original cost is both:

1. more than 5% of the amount you receive when the asset is disposed of; and
2. more than the improvement threshold for the income year in which you dispose of the asset.

If the improvements were commenced before 21 September 1999, the original cost is indexed for inflation.

w https://www.ato.gov.au/individuals-and-families/investments-and-assets/capital-gains-tax/property-and-capital-gains-tax/property-improvements-and-additions

7.2 GIC and SIC rate update

The GIC and SIC rates for the 1 July to 30 September 2024 quarter have been published.

The GIC annual rate is 11.36% increased from 11.34%, with the daily rate being 0.03103825%.

The SIC annual rate is 7.36% increased from 7.34%, with the daily rate being 0.02010929%

7.3 Gazette notice – data-matching program

On 17 June 2024, Gazette published a notice regarding ATO's initiative to acquire Medicare Exemption Statement data from Services Australia for the 2024 to 2026 financial years. It is estimated that the record of 180,000 individuals will be collected for each financial year.

The data will be used for a variety of compliance and verification purposes, including to ensure individuals are correctly claiming exemption from payment of the Medicare levy and Medicare levy surcharge.

w https://www.legislation.gov.au/C2024G00310/asmade/text

7.4 South Australia – medical specialists and dentists

Payroll tax relief in respect of past non-declaration of wages of medical specialists and dentists providing services to clinics and practices under a contract arrangement will be available to medical specialists and dentists in South Australia on condition that they register for any future payroll tax liabilities by 30 June 2024.

This relief is separate to the amnesty provided to general practitioners which concluded on 30 November 2023. This relied only applies to medical specialists and dentists.

There is no need to separately register to qualify for the offer of relief. Registering for payroll tax through RevenueSA is sufficient to become eligible for the waiver of any previous payroll tax liabilities arising from non-declarations covered by the relief.

From 1 July 2024 there is no future relief afforded to practices and clinics engaging medical specialist or dentists.

w https://www.revenuesa.sa.gov.au/payrolltax/medical-specialists-and-dentists

7.5 Division 293 assessments

The ATO has published a reminder to SMSF trustees about the steps required before any payments can be released from super to pay the Division 293 liability.

Individuals may incur an additional tax on their super contributions, referred to as Division 293 tax, if their combined income and contributions exceed the threshold during a financial year. This threshold is currently $250,000.

The determination of a Division 293 liability occurs once the member has lodged their tax return and the SMSF has lodged its annual return.

If a member has a liability, a Division 293 notice of assessment will be issued to them. One of the options available to them is to pay the tax by electing to release some of their contributions from their super. Payment of this liability is the responsibility of the individual who received it and it must be paid by the due date specified on the assessment. Individuals have 60 days to elect to release money from super to pay the Division 293 liability; however, this does not alter the actual due date for payment.

The trustee cannot release any amounts until:

1. the member has made an election to release money from their super; and
2. the trustee has received a release authority from the relevant authority.

Once the member has made their election, a release authority will be sent to the trustee through the SMSF's messaging provider. If there is no messaging provider, a paper form will be received.

Upon actioning the release authority, the trustee is required to pay the amount to the ATO, which will then use this amount to settle the Division 293 liability. Any remaining amount will be offset against other debts before being paid to the member.

If funds are released prior to receiving a release authority, a contravention will occur, and the trustee may be liable for penalties. In this event, the ATO recommends that the trustee should consider submitting a voluntary disclosure form.

w https://www.ato.gov.au/individuals-and-families/super-for-individuals-and-families/self-managed-super-funds-smsf/smsf-newsroom/has-your-member-received-a-division-293-assessment

7.6 SMSF Annual Return common errors

The ATO has published the SMSF annual return and instructions for 2024.

The ATO is reminding tax professionals to avoid common errors by ensuring that the:

1. members' information and tax file number (TFN) is provided as per (Section F);
2. correct SMSF auditor number and auditor details are provided including the date the audit was completed (Section A Item 6); and
3. closing account balance equals the sum of accumulation and retirement phase account balance amounts. If the member's closing account balance is zero or a negative amount, write 0 (Section F Label S).

The ATO also reminds tax professionals and SMSF trustees to make sure that member benefits have been:

1. paid, if a condition of release has been satisfied; or
2. rolled over to an APRA account via SuperStream

before lodging a final return and winding up an SMSF. The ATO refers to its winding up checklist that can be found at the link below.

w https://www.ato.gov.au/individuals-and-families/super-for-individuals-and-families/self-managed-super-funds-smsf/smsf-newsroom/avoid-common-errors-when-lodging-your-2024-annual-return
w https://www.ato.gov.au/individuals-and-families/super-for-individuals-and-families/self-managed-super-funds-smsf/in-detail/smsf-resources/smsf-checklists#WindingupanSMSF

7.7 SMSFs acquiring assets from related parties

The ATO has updated its website guidance about SMSFs acquiring assets from related parties.

An SMSF cannot acquire an asset from a related party unless it is acquired at market value and falls into one of the following categories:

1. a listed security (such as shares, units, or bonds listed on an approved stock exchange);
2. business real property;
3. an in-house asset, provided the market value of the SMSF's in-house assets does not exceed 5% of the total market value of the SMSF's assets; or
4. an asset specifically excluded from being an in-house asset.

If the asset is acquired at less than market value (including any 'in specie' contribution value), the difference between the market value and the amount actually paid is not considered a contribution. Income generated by the asset will be non-arm's length and will be taxed at the highest marginal rate.

The ATO page also provides a link to the ATO's valuation guidelines for SMSFs.

w https://www.ato.gov.au/individuals-and-families/super-for-individuals-and-families/self-managed-super-funds-smsf/investing/restrictions-on-investments/acquiring-assets-from-related-parties w https://www.ato.gov.au/individuals-and-families/super-for-individuals-and-families/self-managed-super-funds-smsf/in-detail/smsf-resources/valuation-guidelines-for-self-managed-super-funds

7.8 Non-arm's length income

The ATO has updated its website guidance on how non-arm's length income (NALI) is taxed.

The page sets out a summarised definition of NALI and notes that there may be regulatory implications, as well as tax on any non-arm's length dealings between SMSFs and other parties.

Any NALI forms part of the non-arm's length component (NALC) of the SMSF's taxable income, which is taxed at the highest marginal tax rate. However, the SMSF's total NALC cannot exceed the SMSF's assessable income minus deductions, excluding assessable contributions and deductions against them

The ATO page also provides links to the following relevant ATO guidance:

1. Self-managed superannuation fund annual return instructions;
2. TR 2006/7 Special income (special income was the predecessor to non-arm's length income);
3. LCR 2021/2 Non-arm’s length income - expenditure incurred under a non-arm’s length arrangement; and
4. PCG 2020/5 Applying the non-arm's length income provisions to 'non arm's length expenditure.

w https://www.ato.gov.au/individuals-and-families/super-for-individuals-and-families/self-managed-super-funds-smsf/tax-on-income/non-arm-s-length-income

7.9 Detailed guide to exempt current pension income

The ATO has updated its website guidance on claiming a tax exemption for exempt current pension income when a small super fund pays retirement income streams.

The website has a multi-page guide that covers:

1. how to comply for small super funds with no more than 6 members;
2. methods for calculating ECPI;
3. actuarial certificate requirements;
4. completing labels in the SMSF annual return;
5. reduction of tax losses (not capital losses) by the net ECPI amount;
6. how expenses are treated when an SMSF has ECPI;
7. how capital gains and capital losses are treated when an SMSF has ECPI; and
8. treatment of non-arm's length income and assessable contributions when calculating ECPI.

w https://www.ato.gov.au/individuals-and-families/super-for-individuals-and-families/self-managed-super-funds-smsf/in-detail/smsf-resources/smsf-technical-pensions/exempt-current-pension-income

8. Tax Professionals

8.1 New obligations for Code of Professional Conduct

New obligations will come into effect from 1 August 2024 under the Tax Agent Services (Code of Professional Conduct) Determination 2024.

The new requirements are summarised below.

Integrity of profession

In addition to the existing general requirements relating to honesty and integrity under section 30-10 of the *Tax Agent Services Act 2009* (Cth) (**TASA**), section 10 of the Determination specifies that registered tax agents and BAS agents must not engage in conduct that they know, or ought reasonably to know may undermine public trust and confidence in the integrity of the tax profession or the tax system.

The Explanatory Statement to the Determination recommends that tax practices, in cooperation with individual tax practitioners within them, should institute measures such as:

1. providing training and resources on complying with the Code;
2. introducing and actively undertaking processes to manage underperformance in relation to breaches of the Code;
3. instituting mechanisms for staff to report and address concerns about conduct that may breach the Code;
4. providing appropriate and adequate protection for staff that report conduct that may breach the Code;
5. providing directions to staff not to engage in specific conduct where that conduct may result in a breach of the Code;
6. maintaining appropriate records relating to potential breaches of the Code;
7. processes for amending or correcting false or misleading statements in documents or conversations;
8. having recruitment processes that include police checks, checks of the Tax Practitioners Board's (**TPB**) register and checks to test whether someone is a disqualified entity;
9. encouraging compliance with the Code when considering remuneration, including promotions and bonuses, as well as in other human resource policies; and
10. developing a culture of transparency, accountability, ethical conduct, and compliance with the Code and with the tax laws.

The Explanatory Statement to the Determination also provides examples of conduct that would very likely be a breach of section 10 of the Determination:

1. not removing staff from a project or work area where there are reasonable concerns about potential unethical conduct relating to the project or work area;
2. asking not to be informed of, or for appropriate records to be made of, information relating to potential breaches of the Code;
3. destroying evidence relating to any potential breach of the Code;
4. taking or threatening any adverse action against an individual who raises concerns about potentially unethical conduct; or
5. rewarding an individual in relation to conduct that is unethical or otherwise encouraging (or not discouraging) such unethical behaviour.

False or misleading statements

Section 15 prohibits registered agents from making, preparing, permitting, or directing false or misleading statements to the TPB or Commissioner of Taxation. This obligation extends to statements made in a professional capacity or any other role, including personal tax affairs. The section covers direct statements, those prepared for clients, and those made by others under the practitioner's direction.

Registered agents must correct false statements as soon as they become aware of them, provided the statements were false at the time they were made. If the original maker of the statement refuses to correct it, the practitioner must notify the TPB or Commissioner. The obligations also apply to statements made to other Australian government agencies. If the statement was not made, prepared, permitted or directed by the registered agent, the registered agent is not obliged under section 15 to correct the statement.

According to the Explanatory Statement to the Determination, section 15 constitutes a legal duty to disclose, so that correcting false statements as required by Section 15 does not breach confidentiality obligations under the Code.

Dealings with government

<u>Conflicts of interest</u>

In relation to any activities undertaken by a registered agent in a professional capacity for an Australian government agency, section 20 of the Determination requires the registered agent to:

1. take reasonable steps to identify and document any material conflicts of interest (real or apparent) in connection with an activity undertaken for the agency; and
2. disclose the details of any material conflict of interest (real or apparent) that arises in connection with an activity undertaken for the agency to the agency as soon as you become aware of the conflict; and
3. take reasonable steps to manage, mitigate, and where appropriate and possible, avoid, any material conflict of interest (real or apparent) that arises in connection with an activity undertaken for the agency (except to the extent that the agency has expressly agreed otherwise).

The obligation to disclose a conflict of interest is not limited to a registered agent disclosing their own potential conflicts. It extends to any material conflict of interest they are aware of in connection with an activity undertaken for the agency. For instance, if a registered agent is performing an activity for an agency and becomes aware of another person's or entity's conflict of interest in the same or a different activity for the government, Section 20 requires the registered agent to disclose details of that conflict to the relevant government agency.

<u>Confidentiality</u>

Section 25(1) prohibits registered agents from disclosing any information received directly or indirectly from an Australian government agency unless it is reasonable to conclude that the agency authorised the disclosure. This would not prevent a registered agent from disclosing such information if they had a legal obligation to do so.

Section 25(1) applies to any information received in professional capacity. According to the Explanatory Statement to the Determination, this includes activities where a tax practitioner provides advice or services to a government agency, whether or not for a fee, but also activities where a tax practitioner is working together with a government agency outside of the provision of services, such as contributing views to consultation processes run by a government agency on potential legislative changes. The obligation applies to information received by a tax practitioner directly from the Australian government agency, or indirectly, such as through staff working with the agency on behalf of the tax practitioner.

Section 25(2) prohibits registered agents from using information received from an Australian government agency for personal advantage, unless that use is authorised by the agency. Section 25(2) also extends further than section 25(1) to capture associates, employees, employers or clients, in recognition that tax practitioners may use information for the personal advantage of others and potentially receive benefits indirectly through this unauthorised disclosure.

Client records

Section 30 of the Determination requires that records must be kept in relation to tax agent services provided to each client, including former clients. The records must:

1. be in English, or readily accessible and easily convertible into English; and
2. be retained for at least 5 years after the service has been provided; and
3. show the nature, scope and outcome of the tax agent service provided; and
4. include all relevant information considered in the provision of the tax agent service (including information exchanged with the client, advice provided to the client, and for more complex matters: the relevant facts, assumptions and reasoning underpinning any advice provided to the client).

The Explanatory statement to the Determination notes that relevant record keeping correct records includes making records, such as taking notes or writing a summary of advice provided orally to the client and information provided orally to the tax practitioner, and making notes of research that underpins the services provided. Keeping correct records also includes retaining records that already exist on the provision of tax agent services, such as client files, copies of written advice (including advice sent by email) and other documents that evidence the tax agent services provided to clients or the information on which advice is based.

These record-keeping obligations apply to tax agent services that are provided on or after 4 July 2024, when this Determination came into effect.

Competence

Section 35 of the Determination outlines critical obligations for registered agents regarding the competence and supervision of entities providing services on their behalf.

Section 35(1) mandates that registered agents ensure that each entity providing services on the registered agent's behalf, such as an employee, maintains adequate and relevant knowledge and skills appropriate to the specific services they are providing. This means that while employees do not need to possess comprehensive knowledge of all services offered by the registered agent, they must be proficient in the specific tasks they perform.

Section 35(2) requires registered agents to ensure that each entity providing tax agent services under their direction is appropriately supervised. The necessary level of supervision varies depending on the entity's knowledge and skills, the nature of the services provided, and the registered agent's quality management system. Therefore, supervision must be tailored to each individual and service type.

This section builds on the existing Code, which requires that all registered agents maintain the necessary knowledge and skills to competently provide tax agent services. Section 35 extends these requirements to include not only registered agents but also those providing services on their behalf. This includes ensuring that unregistered staff, such as interns, contractors, and associates, are competent and adequately supervised as well as being properly trained.

Quality management

Section 40 of the Determination requires registered agents to establish and maintain a system of quality management, including policies and procedures relating to governance and leadership, monitoring of performance, adherence to the Code of Professional Conduct, client engagement, proper keeping of records, protecting confidentiality of information, the management of conflicts of interest, and the recruitment, training and management of employees.

Disclosures to clients

Section 45 of the Determination imposes new obligations on registered agents to ensure transparency and informed decision-making by current and prospective clients.

Section 45(1) requires registered agents to inform all clients and prospective clients:

1. about any matter that could significantly influence a decision of a client to engage the registered agent, or to continue to engage registered agent, to provide a tax agent service;
2. that the TPB maintains a register of tax agents and BAS agents and how they can access and search the register;
3. how they can make a complaint about a tax agent service the registered agent has provided, including the complaints process of the TPB.

The Explanatory Statement to the Determination explains that this includes disclosing any prior or current material breaches, investigations, sanctions, conditions on registration, use of disqualified entities, charges or convictions related to fraud, dishonesty, or tax offenses, and promoter penalties under tax law.

The disclosure extends beyond the registered agent's individual non-compliance to include relevant matters pertaining to any company or partnership they operate under, ensuring comprehensive transparency within the profession.

Prospective clients will include individuals and entities that have contacted a tax practitioner in relation to the provision of services, which could include by email, phone or website.

Section 45(2) specifies that these disclosures must be provided in writing, clearly, prominently and unambiguously. Agents must give this information at the time of client inquiries or within 30 days of becoming aware of the matter if no inquiry is made. Information about the TPB's register and complaints process must be shared when clients engage or re-engage the agent, or upon relevant request.

According to the example in the note to section 45(2) and the Explanatory Statement to the Determination, registered agents can fulfill these obligations by publishing the required information on a publicly accessible website and including it in engagement and re-engagement letters, provided the information is clear, prominent, and unambiguous.

Section 45 will apply to matters that have arisen on or after 1 July 2022. For matters which arose between 1 July 2022 and commencement, disclosure to clients must be made by 30 October 2024.

All other obligations will take effect from 1 August 2024.

w https://www.legislation.gov.au/F2024L00849/asmade/text
w https://www.legislation.gov.au/F2024L00849/asmade/2024-07-02/es/original/pdf

8.2 TPB media release – new obligations

From 1 August 2024, tax practitioners must comply with the additional obligations set out in item 7.1 above, which will supplement the existing Code of Professional Conduct. These new obligations are designed to reinforce public trust and confidence in the tax profession.

Tax practitioners are encouraged to familiarise themselves with the new requirements and review their practices to ensure compliance. The TPB expects that many practitioners already meet these standards, but those who do not will need to implement appropriate controls and arrangements promptly.

The TPB will be consulting on draft guidance related to the new obligations. This consultation process will begin progressively in the coming weeks.

w https://www.tpb.gov.au/new-code-determination-lifts-professional-standards-tax-practitioners

8.3 Additional information to be published on TPB register

On 4 July 2024, the Tax Agent Services Amendment (Register Information) Regulations 2024 came into force.

Prior to these Regulations, the Tax Practitioner's Board (TPB) was required to maintain the following information on its register:

1. registered tax agents and BAS agents, and their names, contact details, relevant professional affiliations, duration of registration, any conditions of registration;
2. for registered tax and BAS agents, any sanction (other than a caution or termination) imposed by the TPB on the entity, for the longer of 12 months or the period during which the sanction has effect (for example, for a 3 year period if an entity had their registration suspended for 3 years); and
3. formerly registered tax agent or BAS agents whose registration was terminated within the past 12 months, including their name, contact details, the date of effect of the termination of the entity's registration and the reason for the termination of the entity's registration.

The Regulations expand the information that is to be maintained on the Tax Practitioner's Board register as follows:

1. past names and registration numbers during the previous 5 years for certain entities on the Register for misconduct;
2. the names and registration numbers of any registered individuals provided to the TPB as part of an entity's registration application to demonstrate that it has a sufficient number of individual tax practitioners to provide tax agent services to a competent standard and carry out supervisory arrangements;
3. an application to the TPB for renewal of registration;
4. details of registration applications rejected on integrity grounds, including for certain entities that have previously been registered or are already on the Register in relation to a Federal Court application or decision;
5. details of TPB orders, suspension and termination decisions for misconduct;
6. details of a TPB investigation finding that an entity breached the *Tax Agent Services Act 2009* (Cth) (**TASA**), if the TPB decides to publish those findings on the Register, and noting if registration lapsed during the investigation;
7. details or updates to Register information for any appeals by an entity against a reviewable decision of the TPB to the AAT or a court, including the fact that an application was made and updates for the outcomes, which could include removing an unregistered entity's record if they were exonerated by the appeal decision;
8. information linking breaches by companies or partnerships and breaches by the individuals representing them, in defined circumstances where the breaches relate to the same conduct or matter;
9. details of applications by the TPB to the Federal Court for a civil penalty or injunction under the TASA;
10. details of decisions if the Federal Court finds a breach of the TASA, orders a penalty, grants a non-interim injunction or makes a finding of contempt of court, and details of any appeals of those decisions; and
11. while the widely drafted, but functionally limited discretion for the TPB to include other relevant information has been removed, the Register will still include appropriate general information that is not about a specific entity, such as sub headings and explanations of terms used.

w https://www.legislation.gov.au/F2024L00856/latest/text

8.4 Update to SMSF independent auditor's report

The ATO has made an important change to the SMSF independent auditor's report.

The reference to Auditing Standard ASQC 1 has been removed from Part B of the report and replaced with reference to Auditing Standard ASQM 1. None of the sections or regulations at Appendix 1 of the report requiring compliance assurance have been changed.

The updated report is to be used for reporting periods starting on or after 1 July 2024.

When lodging the report, the auditor must give all SMSF trustees a signed copy of the report within 28 days after the trustee has provided all documents relevant in preparing the report. The auditor should then retain a copy of the report. The report should not be sent to the ATO.

A copy of the new report can be downloaded from the link below.

w https://www.ato.gov.au/individuals-and-families/super-for-individuals-and-families/self-managed-super-funds-smsf/smsf-newsroom/smsf-independent-auditors-report-updated
w https://www.ato.gov.au/api/public/content/4a685c6e458a4f76aeeb2a7c28dacb01?v=b72d412d