The Tax Institute

The Tax Summit

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Session 18.3: Providing definitive tax advice when the technical views are uncertain

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1. Introduction[1]

Tax professionals appreciate the challenge of providing definitive tax advice to their clients. After all, isn't this what clients are paying for?

However, the quest for certainty in tax is becoming increasingly unattainable. Advisors are substituting "should" or "would" with phrases like "it is the better view that," "it is not free from doubt," or "the views are finely balanced."

The economist and philosopher Adam Smith highlighted that one of the fundamental maxims of any well-functioning tax system is that it instils and champions certainty:

> "The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person…..The certainty of what each individual ought to pay is, in taxation, a matter of so great importance that a very considerable degree of inequality, it appears, I believe, from the experience of all nations, is not near so great an evil as a very small degree of uncertainty."[2]

Despite the challenges of providing definitive tax advice when the technical views are uncertain, our system of public and private rulings (albeit far from perfect) provides a framework for professional advisors to instil some assurances to taxpayers with respect to the ATO's interpretation of the tax laws.

Furthermore, even when the technical views are uncertain, professional advisors should not discount the utility of providing clients with a reasonably arguable position (having regard to legislation, the relevant explanatory memorandum, the case law, and ATO view), as well as highlighting the importance of contemporaneous evidence to substantiate taxpayer intentions and objectives.

Tax is complex, and as noted by The Honourable Tony Pagone AM KC writing extra-judicially, uncertainty in tax "may in part be an inevitable feature of language." However, in the same paper, it was also noted:

> "Some uncertainty may be inevitable, but some is not. Certainty and uncertainty each comes at a cost to the community and our focus should be on what we gain and what we lose when we enact laws with deliberate uncertainties. We should look hard at who gains, and how much may be lost, from the uncertainty of the application of taxing laws, and seriously question in whose interest uncertainty can be maintained."[3]

[1] The author thanks Kaitilin Lowdon, Principal Lawyer at Sladen Legal, for her time in reviewing this paper and for providing invaluable feedback.

[2] Adam Smith, *An Enquiry into the Nature and Causes of the Wealth of Nations* (William Strahan, 1778), p 454

[3] The Hon Tony Pagone AM KC, 'Tax Uncertainty' (Paper presented at the Melbourne Law School 2009 Annual Tax Lecture) p 28

2. When the ATO view may no longer be in accordance with the case law

A source of uncertainty in our tax system which makes it challenging for advisors to provide definitive advice to clients is inconsistencies between the ATO's published interpretation of the tax laws (such as in taxation rulings), and the interpretation of the tax laws by the courts.

As the examples in this section seek to highlight, some of these inconsistencies are curious when one considers that a core duty of the ATO is to administer and apply the law in accordance with the interpretation by the courts.

This principle was highlighted in the Full Federal Court decision of *Federal Commissioner of Taxation v Indooroopilly Children Services (Qld) Pty Ltd* (2007) 158 FCR 325 (**Indooroopilly**) which concerned whether an employer's contribution to a trust constituted a fringe benefit under the *Fringe Benefits Tax Assessment Act 1986*.

Previous single judge decisions in the Federal Court (including *Essenbourne Pty Ltd v FCT (2002) 51 ATR 629* (**Essenbourne**)) indicated that an employer contribution to a trust would constitute a fringe benefit only if it was paid to a particular employee. Despite this, the ATO did not appeal Essenbourne and continued to administer the law in accordance with TR 1999/5 (which was inconsistent with Essenbourne).

The Full Federal Court in Indooroopilly, in considering the above, found for the taxpayer and was critical of the ATO's administration of the tax laws in a way that was inconsistent with Federal Court decisions:

> … From the material that was put to the Full Court, **it was open to conclude that the appellant [ATO] was administering the relevant revenue statute in a way known to be contrary to how this Court had declared the meaning of that statute.** Thus, taxpayers appeared to be in the position of seeing a superior court of record in the exercise of federal jurisdiction declaring the meaning and proper content of a law of the Parliament, but the executive branch of the government, in the form of the Australian Taxation Office, administering the statute in a manner contrary to the meaning and content as declared by the Court; that is, seeing the executive branch of government ignoring the views of the judicial branch of government in the administration of a law of the Parliament by the former. **This should not have occurred**. **If the appellant [ATO] has the view that the courts have misunderstood the meaning of a statute, steps can be taken to vindicate the perceived correct interpretation on appeal or by prompt institution of other proceedings; or the executive can seek to move the legislative branch of government to change the statute. What should not occur is a course of conduct whereby it appears that the courts and their central function under Chapter III of the Constitution are being ignored by the executive in the carrying out of its function under Chapter II of the Constitution, in particular its function under s 61 of the Constitution of the execution and maintenance of the laws of the Commonwealth**.
>
> [Bold added]

To the ATO's credit, the ATO sought legal advice from the solicitor general following Indooroopilly to ascertain what process it should follow when there are inconsistencies between the ATO view and the view of the judiciary.[4] The advice revealed, among other things, that while the ATO should be permitted to refrain from following a single judge decision if such as position is supported by good legal arguments, it is also incumbent upon the ATO in such instances to take prompt action to seek clarity before the courts (as reflected in the decision impact statement). [5]

The ATO's website page titled "How we interpret and apply the law" also highlights the ATO's commitment to applying the law:

[4] Available here: https://www.ato.gov.au/law/view/pdf/psr/indooroopilly3.pdf

[5] https://www.ato.gov.au/law/view/document?docid=LIT/ICD/QUD253OF2006/00001&PiT=20110225000001

- "Interpreting and applying the law is central to our administration of the tax and super systems" and

- "We have a duty to apply the law."[6]

It may be arguable that some of the inconsistences between the ATO view and the view of the courts can be attributable to the challenge of deciphering if a judicial pronouncement constitutes *ratio decidendi* as opposed to *obiter dicta*.

Furthermore, it is acknowledged that many provisions of the tax laws have yet to receive judicial consideration (for example, the small business restructure rollover).[7] This enables the ATO, in exercising its general powers of administration (and combined with the complexities of our tax laws), to adopt an interpretation of the law which may not necessarily align with the views of taxpayers (or be perceived as being biased).

[6] https://www.ato.gov.au/businesses-and-organisations/corporate-tax-measures-and-assurance/privately-owned-and-wealthy-groups/what-you-should-know/the-right-services/how-we-interpret-and-apply-the-law

[7] And even when a tax issue is judicially considered, we may be left asking more questions (e.g. will we ever know what is meant by the expression "ordinary commercial or family dealing"?).

2.1 Absolute Entitlement

The legislative background

CGT event E5 happens if a beneficiary becomes **absolutely entitled** to a CGT asset of a trust as against the trustee. The time of the event is when the beneficiary becomes absolutely entitled to the asset.

Once a beneficiary becomes absolutely entitled to a CGT asset as against a trustee, any subsequent CGT event happening to the CGT asset is assessable to the beneficiary, not the trustee.[8]

ATO view

The ATO's views, albeit in a product that has remained in draft for 20 years, on what it means to be absolutely entitled are contained in Draft Taxation Ruling TR 2004/D25:

- To be absolutely entitled to an asset as against the trustee, the beneficiary must have both a **vested** and an **indefeasible** interest in the asset and be able to demand transfer of the asset by the trustee.
- A sole beneficiary in respect of a trust asset will be absolutely entitled to that asset as against the trustee if the beneficiary can (ignoring any legal disability) terminate the trust in respect of that asset by directing the trustee to transfer the asset to them or to transfer it at their direction.
- The requirement for absolute entitlement cannot be satisfied if there are multiple beneficiaries for a single asset, such as land. While each beneficiary may have an interest in, and therefore be entitled to, a share of the land, no beneficiary is entitled to the whole of it.
- When there is more than one beneficiary with interests in the trust asset, then it will be possible for those beneficiaries to be absolutely entitled to a specific trust asset provided:
    - the assets are fungible;
    - the beneficiary is entitled against the trustee to have their interest in those assets satisfied by a distribution or allocation in their favour of a specific number of them; and
    - there is a very clear understanding on the part of all the relevant parties that the beneficiary is entitled, to the exclusion of the other beneficiaries, to that specific number of the trust's assets.
- The existence of the trustee's right of indemnity does not prevent a beneficiary from being absolutely entitled.

The concept of absolute entitlement also arises in the context of trust vesting. In Taxation Ruling TR 2018/6, the ATO notes that vesting may cause CGT event E5 to happen for the beneficiaries whose interests in the trust's property vests, but no analysis as to why that is the case is provided. However, in the draft version of TR 2018/6 (TR 2017/D10), the ATO considered that its view was supported by Draft Taxation Ruling TR 2004/D25.

Judicial view

The view of the ATO in Draft Taxation Ruling TR 2004/D25 appears to be supported by the Federal Court decision of *Kafataris v Deputy Commissioner of Taxation* (2008) 172 FCR 242, in which the Court held that a sole beneficiary was absolutely entitled to an asset only if that beneficiary had a vested, indefeasible and absolute entitlement to the trust property and was further entitled to require the trustee to deal with the trust property at their direction.

[8] Section 16-50.

However, in *Oswal v Federal Commissioner of Taxation (2013)* 233 FCR 110, the Federal Court held that there are at least two impediments to a beneficiary becoming absolutely entitled to a trust asset.

Firstly, if the trustee has properly incurred liabilities in managing the trust property, it will have a right to be reimbursed for those liabilities and is entitled to a lien over the trust property to the extent of that right of reimbursement. This prevents any beneficiary from being absolutely entitled to the trust property.

> "I am of the view that the Trustee's lien in respect of its right of indemnity continues to attach to the shares in Burrup Holdings subsequent to the making of the 13 March 2007 resolution; for that reason Mr and Mrs Oswal did not become, in consequence of the resolution, absolutely entitled to those shares as against the Trustee; and therefore that CGT event E5 did not happen in the 2007 income year."[9]

Secondly if the trustee has a power of sale over a trust asset, that will prevent any beneficiary from being absolutely entitled to the trust asset. Under the Trustee Act in each Australian jurisdiction, a trustee would have a power of sale, unless that power were excluded by the terms of the trust.

> "There can be no doubt that the exercise by a trustee of a power of sale, either expressed in the instrument creating the trust or conferred by statute, of an asset vested in the trustee for the absolute benefit of a beneficiary would defeat that beneficiary's interest in the asset (albeit giving rise to an equivalent interest in the proceeds of sale). In that sense, the beneficiary's interest in the asset is defeasible, as referred to by his Honour by reference to what was said by Tamberlin and Hely JJ in Kent v SS "Maria Luisa" (No 2) at [71], even though, until the power is exercised, the beneficiary's entitlement to call for a transfer of, or a dealing with, the asset exists."[10]

Having regard to the Federal Court's pronouncements in Oswal, it would appear a beneficiary would rarely be absolutely entitled (as against a trustee) to a CGT asset (and therefore trigger CGT event E5).

What does this mean?

"Absolute entitlement" is an important concept in the income tax legislation to which there is a clear difference of interpretation between the ATO and the Federal Court.

While a draft ruling doesn't offer taxpayers the same protection from penalties and interest as compared to a finalised public ruling, it nevertheless represents the ATO's view of the law to which ATO officers must have regard. This is confirmed in PSLA 2003/3, where it is acknowledged that ATO precedential views are contained in draft public rulings (paragraph 3) and that, when making a decision, ATO officers need to:

> …apply the precedential ATO view if you believe the facts of the interpretative issue…are similar enough that the law will be applied correctly…

TR 2004/D25 is also still frequently referenced by the ATO in private rulings as reflecting its position in respect of the meaning of absolute entitlement (see, for example PBR 1052228994630 issued in April 2024).

Despite the above, the ATO has publicly acknowledged that TR 2004/D25 may need to be reviewed. For example. the headnote to the draft ruling provides:

> The Tax Office is consulting with Treasury in relation to absolute entitlement and in particular the problem areas of joint and multiple beneficiaries, and the trustee`s indemnity. TR 2004/D25 will not be finalised while this consultation is occurring. TR 2004/D25 will not be withdrawn and still represents the Tax Office view of the law.

The minutes to the ATO's National Tax Liaison Group meeting of 14 September 2011 also provides:

> "Taxation Ruling TR 2004/D25 (about CGT absolute entitlement) was discussed at the NTLG Rulings Steering Committee on 2 September 2011. The overwhelming view of the Committee members was that the finalisation of this Ruling should not be

[9] Oswal at [92].

[10] Oswal at [72].

> further delayed by the proposed review and rewrite of Division 6 (refer Assistant Treasurer's Media Release No. 025 on 16 December 2010). Members suggested that the draft Ruling be either withdrawn or finalised. We do not think it appropriate to simply withdraw the draft Ruling and leave no ATO view on this topic. We therefore intend to take steps to finalise the draft Ruling. It will be reviewed in light of relevant cases decided since it issued (including for example, CPT Custodian Pty Ltd v. Commissioner of State Revenue (Vic) [2005] HCA 53 and Kafataris v. Deputy Commissioner of Taxation [2008] FCA 1454). We will then reissue it in draft form so as to provide members and other practitioners an opportunity to comment."

Much has been written about the need for clarity on the concept of absolute entitlement.[11] The quest for clarity is not aided by the inconsistencies between the ATO's views in Draft TR 2004/D25 and the Federal Court's pronouncements in *Oswal*.

[11] See here for instance: https://taxboard.gov.au/sounding-board-plus/all-ideas/1506

2.2 CGT event A1 or CGT event E2?

The legislative background

Sometimes a transaction may trigger more than one CGT event. In such circumstances (and with limited exceptions) taxpayers need to identify and apply the "**most specific"** CGT event to their situation.[12] As not all CGT events happen at the same time, correctly identifying the most specific CGT event can have significant consequences to a taxpayer's capital gains tax exposure.

CGT event A1 happens when a taxpayer disposes of a CGT asset and there is a change of beneficial ownership. If there is a contract (as is often the case for CGT assets of significant value) the time of CGT event A1 is when the taxpayer enters into the contract for the disposal of the CGT asset.

CGT event E2 happens when a taxpayer transfers a CGT asset to an **existing trust**, and the time of CGT event E2 is when the CGT asset is transferred. Unlike CGT event A1, CGT event E2 does not require taxpayers to assess whether and when a contract has been formed.

CGT event E2 therefore requires an assessment of the transfer time, which would typically be on settlement (in the context of real property) or when a company's share registry is updated (in the context of shares, but this may also depend on the company's constitution).

ATO view

In ATO Interpretative Decision ATO ID 2003/559, the ATO consider that CGT event A1 (not CGT event E2) is the more specific event when a CGT asset is disposed of to an existing trust and the parties are **"completely unconnected and are dealing with each other at arm's length."**

> In this case, the vendor knew that the purchaser was acting in a trustee capacity. But that will not always be the case. For example, the purchaser may be a nominee company formed for the purpose of acquiring property on behalf of others who do not want their identity revealed. Clearly, CGT event A1 is the most specific event in that case. There can be no question of CGT event E2 being the most specific event if the vendor does not know that the asset has been disposed of to a person acting in a trustee capacity.
>
> Consistent with that outcome, CGT event A1 is considered the most specific event whenever the parties are unconnected. It would be inappropriate for a different CGT event to apply depending on whether the vendor knew the capacity in which the purchaser was acquiring the asset.
>
> On the other hand, CGT event E2 will be the most specific event if, for example, an asset is transferred to a trust of which the transferor or an associate is a beneficiary or object.
>
> The exception to CGT event E2 suggests that event is applicable when the parties are connected. That exception applies if the transferor is the sole beneficiary of the trust and is absolutely entitled to the transferred asset as against the trustee and the trust is not a unit trust (section 104-60(5) of the ITAA 1997). Accordingly, CGT event A1 is the most specific event that happens where an asset is sold to the trustee of a trust that has no connection with the vendor or the vendor's associates.

While the ATO position may be a practical one, does it accord with the case law?

Judicial view

In the Federal Court case of *Healey v Federal Commissioner of Taxation* [2012] FCA 269 (**Healey**), two companies executed a "Standard Transfer Form" to transfer shares in a company (JAH) to another company (Newcode) as trustee for a discretionary trust (Esteem Trust).

[12] Section 102-25(1) of the ITAA 97.

Although the "Standard Transfer Form" was signed on 1 May 2004, it was not until 9 December 2005 that another shareholder of JAH had waived its pre-emptive rights to acquire the shares and the share transfer to Newcode was recorded in JAH's shareholder register.

Was CGT event A1 the most specific CGT event (in which case, the capital gain occurred on 1 May 2004 when the Standard Transfer Form was signed) or CGT event E2 (in which case, the capital gain occurred when the transfer was recorded on 9 December 2005)?

Justice McKerracher of the Federal Court concluded that CGT event E2 was the more specific event as it was (unlike CGT event A1) specifically directed to trusts. His Honour also considered that the legislative provisions supported the view that "transfer" under CGT event E2 encompassed a conveyance by way of sale.

The consequence of the decision was that:

1) the two companies were required to account for and assess their capital gains tax exposure from the transfer of the shares in the 2006 income year, not the 2004 income year; and

2) Newcode acquired the shares in the 2006 income year, not the 2004 income year (and could not therefore avail of the CGT discount as the subsequent share disposal occurred within 12 months of acquisition).

What does this mean?

The decision in Healey arguably suggests that CGT event E2 (as opposed to CGT event A1) is the most specific CGT event when the purchaser/acquirer/transferee of a CGT asset is an existing trust. The relationship between the parties would not appear to be relevant consideration.

The Federal Court in Healey did not have regard to the relationship between the parties in reaching its conclusion that CGT event E2 (rather than CGT event A1) was the more specific CGT event. The identification of the more specific CGT event was based principally on an analysis of the statutory construction of the word "transfer."

Accordingly, and despite the ATO continuing to rely on ATO ID 2003/559 in recent private rulings (see for example PBR 1052129282146), it seems difficult to reconcile the ATO's views with the pronouncements in Healey.

Perhaps the telling factor was the unusual facts in Healey whereby the transfer was effected by way of a share transfer form rather than a typical sale contract?

2.3 Isolated Profit-Making Transactions

The legislative background

Advisors will no doubt be aware that profits made from isolated transactions can be assessable on revenue account when the intention or purpose of the taxpayer entering into the transaction was to make a profit.

As per the High Court in *FC of T v. The Myer Emporium Ltd* (1987) 163 CLR 199:

> ``... The authorities establish that a profit or gain so made will constitute income if the property generating the profit or gain was acquired in a business operation or commercial transaction for the purpose of profit-making **by the means** giving rise to the profit."
>
> [Bold added]

In *Westfield Limited v FC of T* 91 ATC 4234 (by **Westfield**), Hill J stated at 4243:

> Second, where a transaction falls outside the ordinary scope of the business, so as not to be a part of that business, **there must exist, in my opinion, a purpose of profit-making by the very means by which the profit was in fact made.** So much is implicit in the decision of the High Court in Myer.
>
> [Bold added]

And later:

> "While a profit-making scheme may lack specificity of detail, the mode of achieving that profit must be one contemplated by the taxpayer as at least one of the alternatives by which the profit could be realised."

The above led the Full Federal Court in Westfield to conclude that a company that was in the business of constructing and managing shopping centres disposed of land on capital account because the company had acquired the land with the intention of developing it as a shopping centre, not with the intention of selling it at a profit.

ATO view

Despite what Hill J said in Westfield, in Taxation Ruling TR 92/3 the ATO maintain that income from a profit-making transaction can still be assessable on revenue account even if the profit was not made by the very means that were originally contemplated:

> 57. We also consider that an assessable profit arises if a taxpayer enters into a transaction or operation with a purpose of making a profit by one particular means but actually obtains the profit by a different means. Thus, a taxpayer may contemplate making a profit by sale but may ultimately obtain it by other means (such as compulsory acquisition, through a company liquidation or a distribution in specie) that were not originally contemplated.
>
> 58. Dicta of Hill J in Westfield have been cited as being contrary to this view. However, our view follows from the earlier Full Federal Court decision in Moana Sand Pty Ltd v. FC of T. In a joint judgment the Court (Sheppard, Wilcox and Lee JJ) applied the Myer decision and held that a profit on the disposal of land by means of compulsory acquisition was income according to ordinary concepts. The Court reached this conclusion notwithstanding the finding of fact that the taxpayer acquired the land for 2 purposes. The purposes were working and/ or selling the sand and thereafter holding the land until it became 'ripe' for subdivision, when it would be sold either to another family company for the purpose of subdivision or to a third party subdivider, whichever gave the largest financial return to the taxpayer. In any event, the law on the issue raised in paragraph 57 above is not clear and, in our view, needs further judicial elucidation.

The ATO's position is curious particularly when one considers the sentiments by Deputy President Blow and Member Cunningham in the Administrative Appeals Tribunal decision of *Case 1/99* 99 ATC 101 at 105:

> 17. Mr. Loader submitted on behalf of the respondent that what Hill J said in the passages we have quoted was obiter, the views of only one judge, and wrong. He relied on a commentary in relation to His Honour's judgment in Taxation Ruling TR92/3 at paragraphs 51-58 which made those assertions. But those assertions are all wrong. What His Honour said was not obiter: the taxpayer succeeded in that case for the very reason that, whilst it acquired the relevant land for the purposes of profit-making, it did not then have a purpose of profit-making by the means that ultimately gave rise to the profit. In Westfield (at ATC 4235; FCR 334), Lockhart J and Gummow J each specifically agreed not only with the orders proposed by Hill J, but also with His Honour's reasons. **What His Honour said is consistent with the passage we have quoted from Myer Emporium in paragraph 15 above, and must therefore be taken to represent the law in this country. The relevant paragraphs in Taxation Ruling TR 92/3 are wrong and should be rewritten.**
>
> [Bold added]

Although the Commissioner successfully appealed the decision of *Case 1/99* 99 ATC 101 *(*in *Commissioner of Taxation v Haass* [1999] FCA 1088), this was on the basis of the Federal Court's view that the taxpayer did have the requisite profit-making purpose when the transaction was entered into:

> If a taxpayer were to acquire land intending to resell it at a profit in 10 years time, but as a result of unexpected circumstances resold after three years, profit from the resale would be assessable. What happened in the present case was essentially no different.

In reaching that conclusion, the Federal Court did not reject Hill J's statements in Westfield, nor expressly reject the views of the AAT above.

What does this mean?

All tax professionals will appreciate the challenge of providing definitive advice on whether a receipt is on income account or capital account.

The challenges are highlighted in the case law where distinguished judges frequently come to different conclusions (for example, the litigation leading up to the High Court hearing in *Federal Commissioner of Taxation v Sharpcan Pty Ltd* [2019] HCA 36, and in the Full Federal Court in *Greig v Commissioner of Taxation* [2020] FCAFC 25).

It is unfortunate that we are still awaiting "further judicial elucidation" on the precedential force of Justice Hill's comments in Westfield more than 30 years after the ATO published TR 92/3. It is also noteworthy that the ATO's request for special leave to the High Court in Westfield was denied (which perhaps lends further support to the precedential force of *Westfield* and the contention that the pronouncements in Westfield should not be readily discounted).

2.4 Division 7A

One of the most recent examples of the tension between the ATO and taxpayers on legislative interpretation is in the context of Division 7A.

Since December 2009, the ATO has maintained that a private company which does not call upon an unpaid present entitlement owing to it from a related trust constitutes the provision of "financial accommodation" from the private company to the trust, and therefore a "loan" within the meaning section 109D of Division 7A of the ITAA 36.

This view was reflected in TR 2010/3 and PSLA 2010/4 (which have since been withdrawn)[13] and represented a change in the Commissioner's practice prior to 2009. Despite many advisors disagreeing with the ATO's position (particularly as it was without explicit judicial support), many taxpayers structured their affairs to accord with the ATO's views to mitigate the risk of scrutiny.

Now (and perhaps finally), this long-standing ATO view was recently rejected by the Administrative Appeals Tribunal in *Bendel and Commissioner of Taxation* [2023] AATA 3074, and which is now on appeal to the Full Federal Court (it was heard in late August). Despite the issuing by the ATO of an interim decision impact statement, the state of play for advisors and their clients in this space is precarious:

- What do clients do if they have only recently discovered that they have not been placing unpaid present entitlements under sub-trust arrangements or under a complying 109N agreement?

- What if clients have acted in accordance with the ATO's views in (now withdrawn) TR 2010/3 and PSLA 2010/4 but the courts ultimately decide that the ATO was wrong?

- Should an application to seek the Commissioner's discretion under section 109RB of the *Income Tax Assessment Act 1936* be lodged now?

- Is it better to do nothing or act now?

The uncertainty is also amplified by the fact that the Australian Government has previously announced amendments to Division 7A so that the legislation would be amended to be consistent with the ATO view. So, even if the ATO losses Bendel, will it make a difference?

[13] TD 2022/11 now contains the ATO's views in respect of this.

3. When the ATO interpretation or views of the law evolves

Another source of uncertainty in our tax system which makes it challenging for advisors to provide definitive advice to clients is when the ATO's interpretation of the law evolves.

The case law amplifies the importance of the statutory text.

In *Federal Commissioner of Taxation v Consolidated Media Holdings Ltd* [2012] HCA 55, the High Court stated (having regard to the High Court decision of *Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue* [2009] HCA 41) at 39:

> "This Court has stated on many occasions that the task of statutory construction must begin with a consideration of the [statutory] text". So must the task of statutory construction end. The statutory text must be considered in its context. That context includes legislative history and extrinsic materials. Understanding context has utility if, and in so far as, it assists in fixing the meaning of the statutory text. **Legislative history and extrinsic materials cannot displace the meaning of the statutory text. Nor is their examination an end in itself**."
>
> [Bold added]

More recently in the Full Federal Court, Justice Hespe in *B&F Investments Pty Ltd as trustee for the Illuka Park Trust v FCT* [2023] FCAFC 89 stated at paragraph 35 (in the context of section 100A of the ITAA 36):

> From the outset, it needs to be recognised that it is the text of s 100A which must be construed. **Extraneous material cannot and must not be a substitute for the statutory text**. Where it applies, s 100A operates to "switch off" a beneficiary's present entitlement with the result that the trustee will be taxed on that share of the trust's net income.
>
> [Bold added]

Arguably the significance that the judiciary has placed on the legislative text when interpreting statute (particularly in the last 15 years) has facilitated the ATO's ability to apply certain legislative provisions more widely than in the past. This is despite the views expressed in PSLA 2009/4 where the Commissioner acknowledges the importance of purpose and object in interpreting statute:

> 8. Further, as a matter of statutory construction, the Commissioner must administer the taxation laws **consistent with their purpose or object**, whether express or implied, and their plain meaning. The Commissioner **must interpret and administer each Act to give effect to its intention** as discerned from it as a whole, not, for example, by interpreting a particular section in isolation from the rest of the Act. The provisions must be interpreted having regard to the **context** in which they appear.
>
> [Bold added]

The Hon Justice Susan Kenny has also written extra-judicially that context and purpose still has an important part to play in the statutory interpretation exercise, noting in particular the role of the *Acts Interpretations Act 1901*: [14]

> The statement, which appears in both Alcan and in Consolidated Media, to the effect that historical matters and extrinsic materials cannot displace the meaning of the statutory text, **should not be read out of context**. If read literally, it would be inconsistent with s 15AB(1)(b)(ii) of the Acts Interpretation Act, which permits reference to extrinsic material "to determine the meaning of [a] provision when …the ordinary meaning … leads to a result that is manifestly absurd or is unreasonable". **Most likely, the Court's non-displacement statement signals only that statements in extrinsic materials, such as an explanatory memoranda or second reading speeches, cannot be permitted to govern the meaning given to a statutory text that is not unclear and does not fall within s 15AB(1)(b)(ii).** If the Court was simply repudiating attempts to

[14] Seminar on *Current Issues in the Interpretation of Federal Legislation* National Commercial Law, 3 September 2013.

reformulate a statutory text in the terms of an explanatory memorandum or the like, it was doing no more than applying the traditional rules of construction to determine legislative intent, properly understood.

[Bold added]

3.1 Section 100A

Background

Section 100A was inserted into the law in 1979 as a specific anti-avoidance provision to counter trust stripping arrangements designed to enable trading profits and other income derived by trusts to escape tax completely.[15] It was not designed to apply to arrangements that are entered into in the course of ordinary family or commercial dealings.

Since that time (and perhaps with the exception of *Commissioner of Taxation v Guardian AIT Pty Ltd ATF Australian Investment Trust* [2023] FCAFC 3)[16], most of the cases that have considered section 100A concern complex fact scenarios involving egregious tax evasion behaviour:

1. In *East Finchley*, a family trust resolved to distribute $585.00 to 126 non-resident beneficiaries, where the expectation was that those beneficiaries would lend the relevant amounts back to the trustee.

2. In *Prestige Motors, a* complicated transaction involving the sale of the business to a unit trust was undertaken so that the profits from the business would be distributed to a unit holder with losses.

3. In *Idlecroft,* two entities—one of which had substantial losses—entered into a joint venture agreement with the intention any profits should be absorbed by the loss trust.

4. In *Raftland*, a substantial distribution was made to a "loss trust", where a fee was paid to the previous controllers of that trust.

Despite being an anti-avoidance provision, the Courts held in *Prestige Motors* and *Idlecroft* that a "reimbursement agreement" should not be interpreted narrowly and that the extrinsic materials are consistent with the legislation having been framed broadly enough to catch not merely trust stripping arrangements, but other arrangements having similar characteristics.

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

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

ATO view

Until recently, the policy underpinning the introduction of section 100A and the cases which considered section 100A naturally informed professional advisors about the types of behaviour that would be caught within its ambit (particularly given section 100A has an unlimited period of review).

There were further indications as to how the ATO interpreted section 100A per its website guidance which suggested that only specific types of schemes (such as the "washing machine" arrangement) would generate scrutiny.

[15] Explanatory Memorandum to ITAA Bill (No. 5) 1978

[16] It is acknowledged that the Full Federal Court in Guardian, despite rejecting the application of section 100A, ultimately held that Part IVA applied (but that this was in respect of the 2013 scheme, not the 2012 scheme). Unlike the 2012 scheme, "*the form of the 2013 related scheme was not the product of an evolving set of circumstances, but was the implementation of a strategy that had been developed with the evolution and implementation of the 2012 related scheme."*

Now, with the finalisation of Taxation Ruling TR 2022/4 and PCG 2022/2 (and the removal of the website guidance which had been in place since 2014), it is evidently clear that the ATO's views as to how section 100A applies requires professional advisors to be increasingly aware of the scope and reach of the provision.

Previously, it might have been considered low-risk for a beneficiary to forgive a UPE (particularly when there are no companies involved). The ATO's updated views on section 100A now mean that such practices should be very carefully considered.

So too must advisors be conscious of trust distributions and ensuring that the form of the distributions matches the substance (that is, the economic benefit of a trust entitlement is received by the presently entitled beneficiary).

3.2 Section 99B

Background

Section 99B, like section 100A, was inserted into the tax laws for a very specific purpose (specifically, in response to *Union Fidelity v FCT* (1969) 119 CLR 177 which held Division 6 did not capture foreign source income).

As the Explanatory Memorandum to the Income Tax Assessment Amendment Bill (No 5) 1978 which introduced section 99B said, section 99B "*will normally apply where accumulated foreign income of a non-resident trust estate (or of a resident trust estate that previously was not able to be taxed in Australia in the light of the Union Fidelity decision) is distributed to a resident beneficiary*".

So the context, purpose and object underpinning section 99B would appear to be to assess Australian resident beneficiaries on **foreign sourced income** derived in a trust (particularly a foreign trust).

Section 99B will not apply where one of the following carve outs under section 99B(2) applies:

1. corpus of the trust estate, but not an amount that is attributable to income derived by the trust that would have been included in the assessable income of a resident taxpayer had it been derived by that taxpayer;

2. an amount that would not have been included in the assessable income of a resident taxpayer had that taxpayer derived it;

3. an amount included in the assessable income of the beneficiary under section 97;

4. an amount assessed to the trustee of the trust or the trustee of another trust under section 98, 99, or 99A; or

5. an amount included in the assessable income of a taxpayer under section 102AAZD.

The difficulty this creates for taxpayers and their advisers is, once the elements of subsection 99B(1) are established, the taxpayer has the onus of establishing one of the carve outs in subsection 99B(2) applies in order to reduce (or eliminate) the amount included in assessable income under subsection 99B(1).[17]

In *Traknew Holdings Pty Ltd v FCT* (1991) 21 ATR 1478 [60], Justice Hill highlighted the potential scope of section 99B:

> The application of s. 99B also presents difficulty. Literally, the section is capable of applying in the circumstances of the present case. However, the section was not enacted to render assessable payments or applications to the benefit of discretionary beneficiaries. Such payments or applications were already made assessable income by force of s. 97 alone or in combination with s. 101, leaving aside a case where s. 98 applies but the presently entitled beneficiary is under a legal disability where the trustee is assessable.
>
> The provisions of s. 99B can only be understood in their historical context. The need for some such provision was discussed by the Taxation Review Committee (the Asprey Committee) in its report of 31 January 1975. The problem exposed by cases such as Union Fidelity Trustee Co. of Australia Ltd v FC of T 69 ATC 4084; 119 CLR 177 was that ss. 99 and 99A had no application where accumulated income was derived from a source outside Australia. If the trust income was accumulated and became capital, its subsequent receipt by a beneficiary was neither assessable income under ss. 25 or 26(b). Section 99B together with ss. 99C and 99D were introduced into the Act by the Income Tax Assessment Amendment Act No. 5 of 1978. As the Explanatory Memorandum circulated with that Act discloses to deal:

[17] See *Campbell v FCT* [2019] AATA 2043.

> ``... primarily with the receipt by resident beneficiaries of distributions from non resident trust estates of previously untaxed foreign sourced income."
>
> .....
>
> It is not necessary to decide for the purposes of the present case whether the extreme width of s. 99B and associated sections require it to be read down having regard to the obvious legislative purpose in enacting it.

ATO view

Taxpayers and their advisors are becoming increasingly attune to the breadth of section 99B and are conscious as to how widely the ATO may be willing to test its application.

The breadth of section 99B's scope is not only highlighted but what Justice Hill stated above, but also in the words of the legislative text itself. That is. there is nothing in the express words of section 99B to limit its operation to foreign trusts , as recognised in the *Modernising the taxation of trust income – options for reform* Consultation Paper in 2011:[18]

> One of the most significant concerns is about the extent to which it can apply to distributions from resident trusts.

Similarly, there is nothing in the express words of section 99B to limit its operation to foreign sourced income.

In short, any amount, being property of a trust estate, that is paid to (or applied for the benefit of) an Australian resident beneficiary is included in assessable income pursuant to subsection 99B(1) unless that amount is reduced by one of the items in subsection 99B(2).

The scope of section 99B has been highlighted in TD 2017/23 and TD 2017/24, as well as taxpayer alert 2021/2.

More recently, on 31 July 2024, the ATO released Draft Taxation Determination TD 2024/D2 and Draft Practical Compliance Guideline PCG 2024/D1.

While some guidance is welcomed, the draft TD and PCG do not address many other questions advisors have in applying section 99B, for example:

1. the application to Australian trusts (other than redomiciled trusts);
2. amounts distributed from the revaluation of assets;
3. non-assessable non-exempt amounts other than under section 802-17, for example non-assessable non-exempt amounts under Subdivisions 152-B, 152-C, and 152-D; and
4. capital gains and CGT discounts, including the small business concessions, not included in assessable income under section 97 due to the operation of Subdivision 6E or otherwise not assessed under sections 97, 98, 99 or 99A.

In the absence of legislative amendment, advisors need greater clarity on technical aspects. For example, what is corpus, and how do the other paragraphs in subsection 99B(2) apply given the ATO's interpretation of paragraphs 99B(2)(a) and 99B(2)(b) as set out in the in the Draft TD. And, importantly, how will the ATO apply its compliance resources to resident trusts.

[18] At page 18.

3.3 Section 109RB Discretion

Background

Since 2007, the Commissioner has had the power under section 109RB to disregard a deemed dividend under Division 7A if the deemed dividend arose because of an honest mistake or an inadvertent omission by the private company, the shareholder or the shareholder's associate or another person (including a tax agent).

The Explanatory Memorandum that introduced section 109RB[19] (**109RB EM**) confirms that whether or not there is an honest mistake or inadvertent omission is an objective question to be determined by reference to all the circumstances surrounding the failure to satisfy the requirements of Division 7A. Paragraph 1.36 of the 109RB EM adds:

> *1.36 ... There is a very wide range of possible mistakes or omissions that would result in Division 7A deeming there to be a dividend paid to a taxpayer. For example, there may be a complete failure to make any minimum yearly repayment over a long period of time, or there may be a simple miscalculation of the minimum yearly repayment in one year.*

ATO view

The Commissioner sets out his views regarding the application of the 109RB Discretion in TR 2010/8 and in PS LA 2011/29. Consistent with the 109RB EM, PS LA 2011/29 sets out a two-step process for the exercise of the Commissioner's discretion under section 109RB:

- Step 1: Establishing the Commissioner is empowered to exercise his discretion because the breach of Division 7A arose, on the balance of probabilities, because of either an honest mistake and/or inadvertent omission; and
- Step 2: If the Commissioner is empowered to exercise his discretion, deciding whether the discretion should be exercised having regard to those matters referred to at subsection 109RB(3).

Although the Commissioner has not changed his stated practice as contained above, the ATO has recently been proactively engaging with the community through education seminars on the application of Division 7A.[20]

Although not expressly stated, the implicit message from the Commissioner is that he will no longer exercise his discretion under 109RB for what he would consider are basic fundamental elements of Division 7A.

Division 7A has been the law for many years and taxpayers or their advisors arguing an honest mistake or inadvertent message on fundamental elements of Division 7A are likely to encounter greater resistance from the ATO.

[19] Explanatory Memorandum to the Tax Laws Amendment (2007 Measures No. 3) Bill 2007.

[20] https://tv.ato.gov.au/media/bi9or7orrp1x5m

3.4 Discretion to treat an objection lodged out of time as within time.

Background

The Commissioner has a discretion under subsection 14ZX(1) of the TAA to treat an objection as if it had been lodged within the statutory time limits.

In *Brown v FC of T* 99 ATC 4516, at 4527, Justice Hill stated (in respect of the Commissioner's exercise of the discretion):

> *The balancing process should be approached on the basis that while Parliament has stipulated a time in which objections are required to be lodged it has entrusted to the Commissioner a power to extend that time in appropriate circumstances. The decision maker should not lose sight of the fact that s 14ZW is an* ***ameliorating provision designed to avoid injustice****.*
>
> [Bold added]

ATO view

PSLA 2003/7 (**PSLA 2003/7**) details the Commissioner's practice in respect of administering how to treat a request to lodge a late objection.

Paragraph 1 of PSLA 2003/7 previously provided that *"As a general rule, requests for an extension of time are to be approached on the basis that extensions will be granted, unless there are exceptional circumstances."*

In July 2023, the passage above was removed from PSLA 2003/7.

It is not clear why the above passage was removed and why there wouldn't be a presumption that an application for an out-of-time objection would be approached favourably by the ATO, particularly in light of Justice Hill's comments in *Brown v FC of T* 99 ATC 4516.

Nevertheless, the change to PSLA 2003/7 perhaps reflects a change in the ATO's approach to the exercise of this discretion.

3.5 Administrative Penalties / Interest / Remission

Case law guidance

In the context of administrative decision making and discretions, Australian case law highlights the importance of administrators (like the ATO) exercising the discretions afforded to them under the statute fairly and consistently between taxpayers in similar circumstances.

In *Bellinz Pty Ltd & Ors v FC of T* 98 ATC 4634 (**Bellinz FFC**), the Court stated:

> There is little difficulty in accepting that, where a decision-maker, including the Commissioner of Taxation, has a discretion, a principle of **fairness** will require that that discretion be exercised in a way that does not **discriminate** against taxpayers…
>
> [Bold added]

In *Pickering & Ors v FC of T* (1997) 37 ATR 41, Justice Cooper cited the following passage in *Inland Revenue Commissioners v National Federation of Self Employed and Small Businesses Ltd [1982] AC 617* (which was subsequently approved by the Australian Federal Court in David Jones Finance and Investments Pty Ltd & Anor v FC of T 91 ATC 4315 at 4318):

> ``... I am persuaded that the modern case law recognises **a legal duty owed by the revenue to the general body of the taxpayers to treat taxpayers fairly; to use their discretionary powers so that, subject to the requirements of good management, discrimination between one group of taxpayers and another does not arise; to ensure that there are no favourites and no sacrificial victims**."
>
> [Bold added]

While the case law has highlighted some underlying principles of administrative decision making, the ATO has significant flexibility in respect of how to impose administrative penalties and consider remission applications. This flexibility does not assist in the quest for certainty.

General Interest Charge

Under section 8AAG of the *Taxation Administration Act 1953* (**TAA**) the Commissioner is empowered to remit GIC.

These powers of remission extend to occasions when the circumstances that contributed to the delay in payment were due to an act or omission of the person but the Commissioner considers it "fair and reasonable" to remit, there are "special circumstances," or is it "otherwise appropriate" to remit.

PS LA 2011/12 provides that when a taxpayer seeks remission of GIC, their request should be considered, in addition to the factors in section 8AAG of the TAA, having regard to the facts of the particular case.

During the Covid-19 pandemic, the ATO took a more lenient view as the remission of GIC, and this continues to be acknowledged on the ATO website.[21] However, now that the Covid-19 pandemic is over, taxpayers and their advisors will need to be conscious of framing a request for remission of GIC on the basis of Covid-19.

The statutory requirements underpinning the Commissioner's exercise of the power to remit GIC were recently highlighted by the Federal Court in *Hyder & Ors v Federal Commissioner of Taxation* [2024] FCA 464:

> 97. It was unlawful to decide the GIC remission request without addressing the central issue raised by EMHIV, it being an issue which was relevant to the decision (Hyder No 2 at [70]) and seriously advanced by EMHIV. The jurisdictional error can be characterised in a number of ways, including as an exercise of jurisdiction in breach of the implied statutory condition that it be exercised reasonably or as a breach of procedural fairness. **The power to remit GIC must be exercised reasonably (in**

[21] https://www.ato.gov.au/individuals-and-families/financial-difficulties-and-disasters/covid-19/support-for-tax-professionals

> **the legal sense) and in accordance with the rules of procedural fairness. Procedural fairness requires the affording of an opportunity to be heard,not just an opportunity to speak**: Khawaja v Attorney-General (Cth) [2022] FCA 334 at [93].
>
> **The rules of procedural fairness required the decision-maker to turn his mind to and address the central submission which had been made in circumstances where that submission was relevant to the exercise of the power and of substance**: National Disability Insurance Agency v KKTB [2022] FCAFC 181; 295 FCR 379 at [163(1)]. The failure to consider the central submission which had been put was a breach of the implied condition to exercise the power under s 8AAG of the TAA 1953 reasonably. Whilst EMH IV did not cast its case as one o fbreach of procedural fairness, it did contend that the decision was legally unreasonable and the underlying facts were sufficiently raised by the lengthy pleadings.
>
> [Bold added]

Administrative Penalties

There are a range of administrative penalties which apply to a taxpayer if they (or their advisor) make a false or misleading statement to the Commissioner which results in a tax shortfall. The extent of the shortfall penalty depends on the taxpayer's (or their agent's) conduct that triggered the shortfall.

- 25% for a failure to take reasonable care;
- 50% for recklessness; and
- 75% for intentionally disregarding the tax laws.

There is a safe harbour provision contained in ss 284-75(5) which effectively provides that an entity will not be subject to a penalty as a result of certain actions (or omissions) of their tax agent, as long as:

- they gave all the relevant tax information necessary for the statement to be correctly prepared to the agent
- the agent made the statement, and
- the agent did not act recklessly or with intentional disregard of the law.

Some tax professionals have observed a trend by the ATO to adopt a firmer view as to the application of administrative penalties and assessing a taxpayer's culpability at a standard that is higher than what is other appropriate. Recent case law suggests that there might be substance to these observations.

For example, in *Huang v Federal Commissioner of Taxation* [2024] AATA 397 (which is now on appeal) the AAT considered that the failure by the taxpayer to reconcile financial reports and income tax returns with source documents or ensure the transactions in the bank accounts were verified did not amount to recklessness (or a failure to take reasonable care):

> 90. …Even if there was a failure as described, I do not accept that it was reckless as that term is explained in paras 42-46 of the Objection Decision reasons,70 or MT 2008/1 which is referred to in that explanation.
>
> 91. Further, I am not satisfied that if there was a failure as described by the Commissioner, it would have even got the level of a failure to take reasonable care as that term is defined in paras 27-29 of MT 2008/1 forItem 3 of s 284-90 of Sch 1 to the TAA to apply.

Furthermore, in *Mitri v Federal Commissioner of Taxation* [2024] AATA 1268, administrative penalties of 75% and 50% for tax shortfalls arising from the taxpayers treating various property disposals on capital account rather than revenue account were considered by the AAT to be "excessive" and "unduly harsh."

> 52. We consider a penalty approaching $200,000 is **unduly harsh** in the circumstances in which the shortfall for the Beveridge property arose.

> 53. As indicated earlier, **the object of the penalty regime is to encourage compliance with taxation laws**. **This is not a case in which there was a lack of transparency which is implicit in the object of encouraging compliance**. The sale was not hidden from the Commissioner. The gain was disclosed, albeit in the return for the NMFT and with the 50% discount, rather than for Frontlink in its own right which would not have been entitled to the discount.

It is noteworthy that, even if a taxpayer's conduct is considered to constitute recklessness, the wide powers of remission provided to the ATO under s 298-20 (Sch 1 TAA 53) should not be forgotten. This was recently highlighted by the AAT in *DQTB v Federal Commissioner of Taxation* [2023] AATA 515 which cited the relevant principle from the Full Federal Court case of *Commissioner of Taxation v Complete Success Solutions Pty Ltd ATF Complete Success Solutions Trust* [2023] FCAFC 19.

> … The power in s 298-20 of Sch 1 to the Taxation Administration Act 1953 (Cth) to remit a penalty is constrained only by the purposes and object for which the power is conferred: Sanctuary Lakes Pty Ltd v Federal Commissioner of Taxation [2013] FCAFC 50; (2013) 212 FCR 483at 521 [193] (Greenwood J). **In determining whether to remit a penalty, the Tribunal is not confined only to considering the circumstances surrounding the failure on the part of the taxpayer or its agent to exercise reasonable care or to not act recklessly in making the statement to the Commissioner that might explain the conduct the subject of the penalty. It is also relevant to consider what circumstances on the evidence, ought to be taken into account in determining, as a matter of discretion, that, notwithstanding the imposition of a penalty on the taxpayer on the basis of a failure to take reasonable care or acting recklessly in making the statement, the penalty ought nevertheless be reduced either in whole or in part:** Sanctuary Lakes at 524
>
> [Bold added]

In the same decision Senior Member Olding referenced Logan J in *Melbourne Corporation of Australia Pty Ltd v Commissioner of Taxation* [2022] FCA 972, which was another case where the taxpayer's culpability was determined to be less than what the ATO had been maintained (in this case, recklessness rather an intentional disregard for the law). Here, Logan J highlighted that documentary informality between closely held small businesses (in this instance, a loan agreement) is commonplace:

> 46. A great disservice can be done to the Australian business community, especially the small business community, by a failure on the part of the Commissioner, in his administration of national taxation laws, to recognise, as the courts do in cases great and small and in circumstances extending across a wide range of controversies, these **ordinary features of Australian commercial life.**
>
> [Bold added]

Despite Senior Member Olding agreeing with the Commissioner that the taxpayer in DQTB was not carrying on a business of agistment,[22] he dismissed the Commissioner's contention that the absence of a formal written business plan was evidence that a business was not being carried on.

> 82. The Commissioner, as commonly occurs in cases where the existence of a business is in issue, also drew attention to the absence of a formal business plan for the agistment activities. The applicants maintained they did have a business plan, involving staged improvement of the property to increase its carrying capacity, just not one reduced to writing. The Commissioner suggested this was not a plan but a mainly a recitation, after the events, of work the applicants had carried out or caused to be carried out.
>
> 83. In the context of an alleged small agricultural business, I would give little weight to the absence of a formal written business plan. There would be countless small businesses in Australia that do not have a written business plan…

The decisions above suggest that the ATO's assessment of a taxpayer's level of culpability can often be misplaced. Furthermore, while taxpayers must continue to battle the evidential burden imposed on them in tax disputes, there appears to be a growing acknowledgement by the Federal Court and the AAT that informality

[22] Perhaps unsurprisingly given that this is not the first time a taxpayer has failed to persuade the Tribunal that agistment constituted a business.

and unsophisticated record keeping is commonplace for many small businesses and that the Commissioner should take this into account when exercising his statutory discretions.

4. When legislative amendments are announced but unenacted

Another impediment to a professional advisor's ability to provide clients with definitive tax advice is the uncertainty generated from successive Australian governments announcing proposed reforms to legislation which never eventuate.

4.1 Individual Tax Residency

The Australian individual tax residency laws have remained largely unchanged since the 1930s.

In the 2021-22 Budget, the former Government announced that it would replace the individual tax residency rules with a "new, modernised framework", based on the model recommended by the Board of Taxation in its 2019 report "Individual Tax Residency Rules – a model for modernisation."

In July 2023, Treasury released a Consultation Paper on a new, modernised individual tax residency framework. While that consultation has finished, the framework outlined in the Consultation Paper has not received Government approval and is not yet law and may not become law. It is still to be seen whether the Government will prioritise making changes to individual residency in 2024.

Consequently, the Consultation Paper is merely a guide as to how the framework might work.

Furthermore, the ATO has had to adopt careful language in its public guidance products to manage uncertainty in the context of the individual tax residency rules. For instance, in Taxation Ruling TR 2023/1 (concerning individual tax residency), provides:

> 7. Each residency decision turns on its facts. While Court and Tribunal decisions provide illustrations of how the Court or Tribunal has considered and weighted facts, an outcome in one case does not govern the outcome in a different case, even where the facts are similar.

The above calls into question to what extent taxpayers can gain any confidence by relying on TR 2023/1.

4.2 Corporate Tax Residency

The ATO previously held the view (as contained in TR 2004/15) that a distinction could be drawn between where a company was centrally managed and controlled, and where it carried on a business.

However, this view no longer became sustainable as a result of the High Court decision in *Bywater Investments Ltd v Federal Commissioner of Taxation*. The implication of the High Court decision is that very many foreign incorporated companies may in fact be Australian tax residents under Australian domestic law.

As part of the 2020-21 Australian Federal Budget, the former Government announced plans to legislate a change based on the Board of Taxation's key recommendation from its 2020 report, "Review of Corporate Tax Residency."

This change aims to ensure that a company incorporated offshore will be treated as an Australian tax resident if it has a 'significant economic connection to Australia.' This connection is defined as the company conducting its core commercial activities in Australia and having its central management and control in Australia.

The changes were set to take effect from the first income year following the Royal Assent of the amending legislation. A transitional rule would allow taxpayers to apply the new law retroactively from 15 March 2017, the

date when the ATO withdrew its previous taxation ruling (TR 2004/15) on the residency of foreign-incorporated companies.

It is currently unclear whether the present Government intends to proceed with this proposal.

In the meantime, the ATO has had to frequently update PCG 2018/9 to address the continued delay with the government's proposed legislative reform. The most recent update provides a risk assessment framework given the transitional compliance approach ended on 30 June 2023.

4.3 Division 7A

It almost goes without saying that Division 7A continues to be a topic of significant uncertainty as a result of numerous announced but unenacted measures.

Since 2012, there have been a wide range of sources championing impending legislative reform on Division 7A (from self-initiated board of taxation reports, treasury consultation products, and government announcements in at least two federal budgets).

Despite these indications that Division 7A will be reformed, there appear to be no recent signs that the Australian Government considers Division 7A reform to be a sufficient priority.

5. Options to assist in the quest for certainty

5.1 Know how ATO advice and guidance protects your client

Much has been written about the distinction between the "law" (that is, the case law as decided by the judiciary) and the "lore" (that is, the ATO view of the law).

As noted above, some of the ATO's public guidance products reflect an interpretation of the law that may be inconsistent with binding case law. This creates uncertainty and confusion for taxpayers and their advisors.

Furthermore, the question as to whether ATO public and private rulings are "quasi-law" and whether, as a matter of policy, this is desirable (or reflects a blurring of the separation of powers principle) is also not free from doubt.

However, in practice it is generally the case that taxpayers will want to structure their tax affairs to accord with the ATO view of the law. Adopting a position that is contrary to the ATO view requires time, resources, and money which is, more often than not, the last thing a taxpayer wants to endure:

> A key element of the Australian self-assessment regime is the system of public and private rulings which was introduced to improve certainty of the law in a self-assessment environment. Although rulings are not binding on taxpayers, it has long been recognised that there is a general perception in the community that rulings are 'quasi-law' as taxpayers commonly follow rulings in order to avoid penalties.[23]

So, while professional advisors may struggle to provide clients with certainty as to how the tax law applies (particularly given the complexity of the tax legislation), professional advisors may nevertheless be able to provide their clients with some level of certainty as to how the ATO applies the tax laws having regard to the ATO's advice and guidance products. This can instil confidence in the client that they can pursue a course of action which is unlikely to trigger ATO scrutiny.

However, given the diversity of the ATO's advice and guidance products (from taxation rulings, interpretative decisions, and law companion rulings), becoming acquainted with the extent to which these products can be relied upon by taxpayers to bind the ATO (from tax shortfalls to penalties) is an important tool which a tax professional can use to their advantage.

Appendix B of PSLA 2008/3 provides a useful summary

[23] Sunita Jogarajan, 'Regulating the Regulator: Assessing the Effectiveness of the ATO's External Scrutiny Arrangements' (2016) 18(1) Journal of Australian Tax 23, at 33.

CATEGORIES	LEVELS OF PROTECTION			
	Protection from tax shortfall?	Protection from false or misleading statement penalty? [1]	Protection from interest charges?	Related practice statement paragraph numbers
Legally binding advice				
• Public Ruling - Division 358	YES	YES	YES [2]	29 - 45
• Product Ruling	YES	YES	YES [2]	51 - 59
• Class Ruling	YES	YES	YES [2]	60 - 65
• Private Ruling - Division 359	YES	YES	YES [2]	80 - 123
• Oral Ruling - Division 360	YES	YES	YES [2]	145 - 182
Administratively binding advice	^ Level of protection is subject to conditions set out in paragraph 199 of this practice statement			
• Administratively binding advice	YES^	YES	YES [2]	190 - 204
Guidance	* Statement penalty and interest charges may be remitted in individual cases for reasons unrelated to the guidance relied on			
• Published speeches and minutes of consultative forums	NO	YES	YES [2]	218 - 220
• Decision impact statements	NO	YES	YES [2]	224 - 225
• Media releases	NO	YES	YES [2]	221 - 223
• Internal publications:				
- ATO interpretative decisions	NO	YES	YES [2]	226 - 230
- Law administration practice statements	NO	YES	YES [2]	231 - 236
- Technical skilling material	NO	YES	YES [2]	237 - 240
• ATO communications not intended to be relied on	NO	NO*	NO*	241 - 244
• Edited versions	NO	NO*	NO*	245 - 246
• Technical discussion papers	NO	NO*	NO*	247 - 248
• Oral guidance	NO	YES [3]	YES [3]	249 - 262

The ATO website[24] also provides summarises the above but also takes into account subsequent products issued by the ATO since the publication of PSLA 2008/3, including Law Companion Rulings (being public rulings) and Practical Compliance Guidelines (these are similar to a practice statements).

The ATO website also highlights that ATO website guidance does provide protection from penalties and interest.

[24] https://www.ato.gov.au/about-ato/ato-advice-and-guidance/how-our-advice-and-guidance-protects-you

5.2 Public Rulings

The framework

A public ruling is an expression of the Commissioner's opinion of the way in which a relevant provision applies, or would apply, to entities generally or a class of entities. The most common form of public rulings are:

- Taxation Rulings
- Taxation Determinations; and
- Law Companion Rulings

Importantly a public ruling **binds** the Commissioner in relation to a taxpayer if:

- the ruling applies to the taxpayer; and
- the taxpayer relies on the ruling by acting (or omitting to act) in accordance with the ruling.[25]

Accordingly, professional advisors can provide some degree of definitive tax advice to their clients by alerting them to any public rulings which are applicable to their circumstances.

Benefits

The legislative force of a public ruling was recently highlighted in the Administrative Appeal Tribunal decision of *Bowerman and Commissioner of Taxation* [2023] AATA 3547. In that case, Mrs Bowerman successful argued that she could claim a loss on her main residence under the *Myer Emporium* principle.

One of the issues for consideration was whether Mrs Bowerman "incurred" the loss of her main residence in the 2020 income year (when the contract of sale was signed) or in the 2021 income year (when the contract of sale was settled)?

The AAT concluded that, because Mrs Bowerman relied on Taxation Ruling TR 97/7 and the view in TR 97/7 on when a loss is incurred, Mrs Bowerman incurred the loss in the income year when the contract of sale of her main residence was signed.

The AAT conceded that, absent Mrs Bowerman's reliance on TR 97/7, it would have decided that Mrs Bowerman incurred the loss at settlement. This was consistent with the Commissioner's argument that, in the income context, income is derived on settlement as this is when a debt accrues (per *Gasparin v Commissioner of Taxation* (1994) 50 FCR 73).

However, because TR 97/7 is a public ruling which Mrs Bowerman relied and acted upon, it bound the Commissioner. The Commissioner was therefore precluded from applying the law inconsistently with the public ruling (despite the AAT conceding that aspects of the ruling are "vague.")

> Clearly, Mrs Bowerman relied on TR 97/7 because she had acted in accordance with it in the lodgement of her Objection by claiming to be entitled to the deduction for the loss on the sale of the Dune Walk Unit. The effect of a public ruling binding the Commissioner is that the Commissioner will not apply the provision in a way that is inconsistent with the public ruling.
>
> …
>
> Absent the reliance on TR 97/7 by Mrs Bowerman, I would have decided that she had not "incurred" the loss on the sale of the Dune Walk Unit until settlement, which took place in the 2021 income year … However, due to the ruling applying to Mrs Bowerman, and Mrs Bowerman's reliance on TR 97/7, s 357-60 of Schedule 1 to the TAA binds the Commissioner.

As noted by the AAT:

[25] 357-60(1) of Schedule 1 to the *Taxation Administration Act 1953*.

> "It is obviously a matter for the Commissioner as to whether to update his public ruling to record his views as to the relevant authorities, or to withdraw it."

Bowerman therefore provides a pertinent example as to how taxpayers can achieve certainty in their tax affairs by relying on a public ruling (despite the ruling being inconsistent with the case law).

Limitations

Like so many things in the world of tax, there are qualifiers.

The limitations of binding the Commissioner to a public ruling were highlighted by the Full Federal Court in Bellinz FFC.

In Bellinz FFC, the taxpayers received an unfavourable private ruling and appealed to the courts arguing, among other things, that the Commissioner could not issue an unfavourable private ruling because it was inconsistent with other public rulings which the Commissioner has issued at the time.

The taxpayers were ultimately unsuccessful in the Full Federal Court. In particular, the Full Federal Court endorsed Merkel J's pronouncements in the Federal Court judgement (*Bellinz v FC of T* 98 ATC 4399) (**Belinz FC**) that:

- the arrangement under consideration was distinguishable from the subject-matter of the public rulings which the taxpayers sought to rely on ; and

- if there was uncertainty about how a public ruling applies, the taxpayer should then obtain a private ruling:

Relevantly:

> **The Commissioner's administrative practices and his rulings must be viewed in the context of the changed statutory regime brought about by the binding public and private ruling system. The very essence of that system is that taxpayers are entitled to rely on the public rulings as being binding on the Commissioner in the manner provided by the Act but, when there is doubt, they may apply for a binding private ruling to resolve the doubt.** That is precisely what has occurred in the present case. **For the reasons set out above the various rulings, when viewed cumulatively, did not entitle the Lessor Partners to conclude that their leveraged financing and leasing arrangements necessarily fell within the rulings or practice or otherwise bound the Commissioner to treat them as owners of the plant under s 54(1).** [26]
>
> [Bold added]

The Court also rejected the taxpayer's contentions that the Commissioner's refusal to issue a favourable private ruling (having regard to other public rulings like IT 28 and IT 4219) was unfair and represented an abuse of power, particularly in light of the Commissioner's duty to administer the law:

> But where the question arises as to the inclusion of an amount in assessable income or the allowance of an amount as a deduction, **where no question of discretion arises and where the Commissioner is charged to administer the law** (cf s 8 of the Act), and one might say bound so to do in accordance with the language used in the statute as passed by Parliament, **it is difficult to see how the Commissioner can properly be said to have acted unfairly, even if there is an element of discrimination, where he has acted in accordance with the law itself**.[27]
>
> [Bold added]

[26] Bellinz FC, at 4418.

[27] Bellinz FFC, at 4645.

More generally, the Court in Bellinz FFC noted the following in respect of the public ruling system:

> Despite a submission to the contrary, the issue of a public ruling is to be made in accordance with the Act as interpreted by the Commissioner and not in accordance with some practice which the Commissioner may have adopted, to the extent that that is inconsistent with the Assessment Act. What is to be ruled upon is the way in which, inter alia, the Act under which the extent of a liability for income tax of the appellants is to be worked out would apply.
>
> …
>
> **The binding quality which the legislation gives to a public ruling applies to the tax consequences of the arrangement or class of arrangements to which the ruling relates, and not, as the appellants contend, to the underlying philosophy behind the ruling**. That this is so follows inexorably from the language of s 14ZAAE to which reference has already been made.[28]
>
> [Bold added]

In IT 1, the Commissioner states:

> In using Taxation Rulings it should be recognised that **they cannot supplant the terms of the law**. It is now well established that statements or declarations by the Commissioner of Taxation or his officers do not have the effect of an estoppel against the operation of the taxation law. **While Taxation Rulings are compiled with care and are intended to assist in the interpretation of taxation law in given circumstances, they must be overruled by legislative amendment to the law or by decisions of appellate tribunals**. Furthermore, where a Ruling is given in respect of a particular fact situation. Taxation Rulings are issued subject to these necessary reservations.
>
> [Bold added]

Accordingly, as Bellinz FFC, Bellinz FC, and IT 1 highlight, if a taxpayer if seeking to rely on a public ruling to bind the Commissioner, they should be very careful to ensure that their circumstances fall within the ambit of the public ruling (and, if in doubt, seek a private ruling):

> For the reasons already set out I am satisfied that the leveraged financing and sub-leasing arrangements in the present case **differ in significant respects** from the lease with a purchase option arrangement the subject of the Commissioner's practice and described in some of the rulings….
>
> …
>
> The applicants may have had a justifiable expectation that the Commissioner was likely to apply the principles he relied upon in his rulings and practice but prudence and common sense dictated the application for the private ruling that was made. **It was for the Commissioner to determine how the tax law would apply to the arrangement and whether it was distinguishable from the arrangements the subject of his rulings and practice. If he erred in doing so the applicants were entitled to have the matter reviewed by the AAT or the Court**. They did so. There was no substantive or procedural unfairness in that process.[29]
>
> [Bold added]

<u>What about draft public rulings?</u>

While a draft ruling doesn't offer taxpayers the same protection from penalties and interest as compared to a finalised public ruling, it nevertheless represents the ATO's view of the law to which ATO officers must have regard (and follow) in relation to making a decision on an interpretative issue (e.g. a private ruling application).

[28] Bellinz FFC, at 4646.

[29] Bellinz FC, at 4418.

This is confirmed in PSLA 2003/3, where is acknowledged that ATO precedential views are contained in draft public rulings (paragraph 3) and that, when making a decision, ATO officers need to:

> …apply the precedential ATO view if you believe the facts of the interpretative issue…are similar enough that the law will be applied correctly…

Accordingly, professional advisors should not be discouraged from alerting clients to draft public rulings in the quest to provide some level of certainty.

5.3 Private Rulings

The framework

A private ruling is a written ruling from the ATO on the way in which the ATO considers a relevant provision of the tax laws applies or would apply to a taxpayer in relation to a specified scheme.

Like a public ruling, a private ruling is binding on the Commissioner if the ruling applies to the taxpayer and the taxpayer relies on the ruling by acting (or omitting to act) in accordance with the ruling.[30]

This means if a taxpayer adheres to the advice in their private ruling, the ATO cannot impose additional income tax, penalties, or interest even if the advice proves to be incorrect.

In the second reading speech to the *Taxation Laws Amendment (Self Assessment) Bill 1992,* Peter Baldwin MP said

> "The new system of binding and reviewable rulings will promote certainty for taxpayers, and thereby reduce their risks and opportunity costs"[31]

The benefits

A private ruling is a useful way for taxpayers to achieve certainty regarding how the ATO will interpret the tax laws to a specific scenario. It enables taxpayers to implement a transaction with confidence, even if the relevant legislation to which the ruling pertains is re-enacted (provided it deals with the same ideas).[32]

A private ruling also only binds the Commissioner to the scheme. It does not compel the taxpayer to implement the scheme, and so a taxpayer who receives an unfavourable private ruling is not penalised. Rather, the taxpayer can then make a more informed decision to object to the private ruling, reconsider other options to achieve their commercially objectives, or perhaps implement the transaction the subject of the private ruling but lodge an objection.

It might be arguably that the receipt of an unfavourable private ruling may trigger an ATO investigation of dispute. However, this may also be seen as an opportunity to further engage with the ATO to resolve the issues and reduce the risk of interest and penalties.

Furthermore, although it is frequently suggested that taxpayers should carefully consider the merits of objecting to a private ruling, there are also some success stories. Indeed, while a private ruling may place limits on what a taxpayer can object to (it is limited to the scheme in the private ruling), this also places limits on what the Commissioner can fulsomely scrutinise.

In *Eichmann v Federal Commissioner of Taxation* [2020] FCAFC 155, the Full Federal Court concluded that the land in question was an active asset for the purposes of the small business CGT concessions. The litigation arose from an objection to a private ruling.

At paragraph 48, the Full Federal Court suggested that the taxpayer's private ruling might be deficient and that the Commissioner ought to have sought further information about the use of the land in respect of the taxpayer's business before deciding to rule (particularly in respect of paragraphs 6 and 12 of the private ruling).

> 48. Paragraphs 12-14 of the ruled facts well identify the use of the asset here, being the appellant's property. In contrast, para. 6 of the ruled facts does not very well describe the parameters of the course of the carrying on of the business here, being the business of building, bricklaying and paving. On one view, the ruling is, in this respect, perhaps deficient. In applying

[30] 357-60(1) of Schedule 1 to the *Taxation Administration Act 1953*.
[31] Commonwealth, Parliamentary Debates, House of Representatives, 26 May 1992, 2774 (Peter Baldwin)
[32] 357-80 of Schedule 1 to the *Taxation Administration Act 1953*.

> s. 152-40(1)(a), in our view, the drafter of the ruling could have made clearer findings of fact about how the business was carried on. If necessary, the drafter could have made further inquiries about that issue: s. 357-105 of Sch. 1 of the T.A.A.

This sentiment was further amplified at paragraph 9 of the Full Federal Court's judgment:

> 9. As is sometimes the case with private binding rulings, ruled facts can, with the benefit of hindsight, be found to be not as fulsome as might be desired to decide the question of law before the Court. That is not meant as a criticism of the Commissioner's staff. They cannot be expected to predict all of the legal arguments that might subsequently be made in relation to the facts they identify in a ruling. But it does suggest that the rulings system contained in Div. 359 of Sch. 1 to the Taxation Administration Act 1953 (Cth.) (the "T.A.A.") will not always be an apt mechanism to address disputes concerning facts, and even issues of characterisation of those facts.

The Commissioner's decision impact statement also noted:

> A challenge to a private ruling proceeds within the confines of the scheme specified in the ruling. The importance of this point is underscored by the Eichmann litigation in that, both at first instance and on appeal, the Courts identified deficiencies in the description of the scheme which in turn made the task of deliberating on the Commissioner's views on the application of the law to those facts more difficult.
>
> In ruling on whether the active asset test is met in a particular case, the Commissioner will take care to ensure the description of the scheme is, so as far as possible, sufficiently detailed as to reveal all the facts relevant to the statutory enquiry.

Another example is in *Rosgoe Pty Ltd v Federal Commissioner of Taxation* [2015] FCA 1231. In that case, the taxpayer successfully appealed an AAT decision which had incorrectly redefined the arrangement the subject of the private ruling in dispute.

As a result of the limitations placed on the description of the private ruling as described by the Commissioner, the taxpayer was able to successfully maintain that it was not carrying on a business and that, based on other Federal Court authority, could treat the disposal of land on capital account. Relevantly:

> 25. On the Commissioner's description of the facts which constituted the arrangement, the present was a case where property was acquired not for sale at a profit but rather for the carrying out of a profit-making scheme which later came to be abandoned. When, later, the property was sold, "the profit here arose not from the purchase but from the sale and because the sale was not part of the profit-making scheme the profit did not arise 'from the carrying on or carrying out' of that scheme. Indeed the profit did not arise until the scheme had been abandoned: Kratzmann v Commissioner of Taxation (1970) 44 ALJR 293 at 294.

Accordingly while a private ruling can limit what a taxpayer can object against, so too does can it limit the ATO's ability to fulsomely critique and scrutinise the issue in dispute.

<u>The limitations</u>

The private rulings system is far from perfect, and there are some limitations.

Firstly, a private ruling is only binding on the Commissioner to the extent of the facts in the scheme. So, if there are deviations from the scheme, the binding nature of the private ruling may be lost. This means it is important when preparing a private ruling application that the facts of the scheme are fulsomely outlined (rather than conveniently censored). This could sometimes arise in situations where a taxpayer is seeking to obtain the ATO's view as to whether a business is being carried on.

Secondly, taxpayers who choose to object to an unfavourable private ruling may be at risk of significantly limiting their ability to fulsomely contest the issues in dispute. As noted by Emmett J in Commissioner of Taxation v McMahon (1997) 79 FCR 12 at 149 -150:

> Once it is accepted that the scheme of the private ruling provisions is to enable a Taxpayer to obtain a binding ruling on a question of law, it follows that, on the hearing of an application to the Tribunal for review of an objection decision, **the only**

> **function which the Tribunal is to perform is to review the opinion of the Commissioner, as stated in the ruling, as to the way in which the relevant tax law applies to the arrangement which is the subject of the ruling. There is simply no cause for the Tribunal to investigate whether the facts and circumstances which are the subject of the ruling accord with the true facts or not.** Indeed, that would be an impossibility where the ruling was sought in relation to an arrangement consolidated by facts and circumstances which had not yet occurred.
>
> [Bold added]

These limitations where also outlined by Gilmour J in *Cooperative Bulk Handling Ltd v Commissioner of Taxation (2010)79 ATR 582*:

> **Neither the Commissioner nor the applicant can make good any deficiency in the scheme description**. The court is unable to consider a different scheme; it cannot investigate the facts on which the Commissioner's opinion was formed and make its own findings of fact, make assumptions, re-define the scheme or create its own description of the scheme.
>
> [Bold added]

Thirdly, the Commissioner may decline to rule on a private ruling, particularly when the facts concern future events which are uncertain. The Commissioner will often generally decline to rule on Part IVA, the limitations of which were highlighted in Bellinz FFC:

> While there is nothing to suggest that in an appropriate case a ruling could not issue on Pt IVA of the Act, **both the Commissioner and the taxpayer must be aware of the difficulty which a private ruling on a Pt IVA issue will create**. Section 177D(b) sets out the various matters to which the Commissioner shall have regard in reaching the conclusion that a person … entered into or carried out the scheme … for the purpose of enabling the relevant taxpayer to obtain a tax benefit in connection with it. One of those matters is 'the manner in which the scheme was entered into or carried out'. **Where the arrangement in respect of which a private ruling is sought has not yet been carried out, it is difficult to see how there could be adequate facts upon which to base a private ruling. Even where the scheme has been carried out, there may in many cases be difficulty in obtaining all relevant facts, particularly those relating to the manner in which the scheme was entered into or carried out. In the present circumstances there is no need to consider these difficulties.**[33]
>
> [Bold added]

The Commissioner's power to decline to make a private ruling in the context of Part IVA was also judicially tested in the Full Federal Court in *Commissioner of Taxation v Hacon Pty Ltd* [2017] FCAFC 181. Although the taxpayer was successful in the Federal Court, he ultimately lost in the Full Federal Court.

As noted in the ATO's decision impact statement, the decision confirms the Commissioner's view that he is entitled to decline to make a private ruling where the correctness of the ruling would depend on assumptions about future events or other matters, and that the Commissioner is not obligated to first request that information from the taxpayer in those circumstances.

The ATO also states:

> The ATO considers that, where possible, taxpayers should be provided with certainty in respect of prospective arrangements. However, in some circumstances, such as where the application of the law is particularly dependent on assumptions about future events or matters (for example, section 177D of the ITAA 1936) a private ruling may not be an appropriate way for the Commissioner to provide the taxpayer with certainty.

[33] Bellinz FFC, at 4647.

The private ruling database

Private rulings are available in an edited form in a public register on the ATO's website, and the ATO have consistently cautioned professional advisors and taxpayers from relying on the private ruling database or using it as a research tool.

Edited private rulings are not legally binding on the ATO. As per PSLA 2008/4 at paragraph 2:

> We are not bound by an EV (Edited Versions of written binding advice), in relation to any taxpayer. Importantly, an EV:
>
> • is not intended to provide a taxpayer with advice or guidance
>
> • is not a publication approved in writing by the Commissioner
>
> • does not set out a general administrative practice of the ATO.
>
> Therefore, a taxpayer who relies on information contained in an EV which is incorrect or misleading is not protected from:
>
> • tax that would otherwise be payable or repaying an otherwise overpaid entitlement
>
> • interest
>
> • penalty.
>
> It is only the written binding advice that is provided to the taxpayer (from which the EV is created) that is binding on the Commissioner, and only in relation to the taxpayer to whom it applies.

In 2010, the Inspector General of Taxation prepared a report to the Assistant Treasurer titled "Review of aspects of the Australian Taxation Office's administration of private binding rulings" and concluded that, on balance, the ATO should continue its practice of publishing edited and searchable versions of binding private rulings (despite reservations by the ATO).

Some of the benefits of the edited private ruling database that were noted were:

- a detailed register helps tax practitioners and their clients to determine whether or not to apply for a private ruling on a topic, and if they do decide to apply for a private ruling it gives them guidance on what points they should include in their application;

- a detailed register assists tax compliance. Sometimes publication of a particular edited private ruling has deterred taxpayers from entering into particular arrangements. On other occasions a detailed edited private ruling has alerted tax practitioners to aspects of a tax issue that they had not yet considered;

- a detailed register assists the self assessment process because it provides some types of assistance to taxpayers and tax practitioners which is not available from other ATO sources. For example, private rulings are often about matters which involve an application of the law to particular facts rather than about an interpretation of the law. In these circumstances no ATO product (such as an ATO Interpretative decision (ATOID)) will exist to help guide taxpayers as ATOIDs and similar products only deal with interpretative issues;

Accordingly, it appears that the database of edited private rulings is unlikely to be removed anytime soon!

Indeed, the register of edited private rulings is a useful resource which provides insights as to how the ATO is likely to interpret the laws based on a particular fact pattern. An edited private ruling will often refer to cases, as well as various ATO advice and guidance products, to support contentions. This may in turn enable tax professionals to more fulsomely consider the issues likely to generate ATO attention.

However, the limited authoritative value of an edited private ruling should not be forgotten. Indeed, this was highlighted in the Administrative Appeals Tribunal case of *Gupta v Commissioner of Taxation* [2016] AATA 914 at 11, where Mr Gupta sought to substantiate his argument that the compensation he received was for loss of earning capacity (and therefore on capital account) on the basis of a private rulings he found on the database:

> 11. The various Private Rulings to which Mr Gupta referred can be read as lending some support to his arguments. But the reality is that those rulings provide no sound basis from which to make a determinative characterisation of his particular payment entitlement under the 19 May 2015 consent determination. There are two main reasons why that is the case. The first reason is that the Private Rulings typically do not reveal the full circumstances of the claims, agreements and payments involved. (A potentially critical lack of information, in many cases, is the absence of reference to the specific legislative compensation provisions that applied to the taxpayer.) The second is that the Private Rulings are in no sense authoritative (other than for the parties to which the rulings "apply" for the purposes of the Taxation Administration Act 1953). **They are useful in illustrating the way in which the Commissioner has applied the relevant legislation and authoritative case law. But that illustration itself points to the need to pay primary regard to the legislation and case law, and to avoid findings being made in reliance on beguiling analogies and apparent (but typically not verifiable) similarities.**
>
> [Bold added[

5.4 Practice Statements / Practical Compliance Guidelines

The framework

As noted in PSLA 1998/1, Law Administration Practice Statements (**LAPS**) are corporate policy documents, which provide instructions to ATO staff on the way they should perform certain duties involving the application of the laws administered by the Commissioner. LAPS are not intended to provide interpretative advice.

In 2016, the ATO ceased to issue LAPS and commenced issuing Practical Compliance Guidelines. The rationale for this appears to be that the intended audience of LAPS are ATO officers, whereas the intended audience for PCGs are taxpayers.

The ATO provides in PCG 2016/1:

> 8. The provision of compliance guidance can be seen as consistent with the duty of good management stemming from the Commissioner's general powers of administration of the taxation laws. Balanced against the duty to assess and collect the revenue properly payable under the law, the duty of good management involves efficient resource allocation decisions to achieve optimal, though not necessarily maximum, revenue collection. **Practical compliance guidelines will transparently communicate the ATO's assessment of risk in relation to tax law compliance issues and consequential resource allocation intentions.**
>
> 9. Practical compliance guidelines are the identifiable, coherent, principal source of the type of broad compliance guidance described above in respect of significant law administration issues.
>
> [Bold added]

The benefits

As LAPS provide instructions to ATO staff in relation to how to administer the law, they can be useful documents to which professional advisors can refer when advising clients. This is particularly the case in the context of administrative discretions and determining whether a client's circumstances may fall inside or outside the confines of the ATO's interpretation.

For instance, many of the ATO's protocols with respect to the application and/or remission of administrative penalties/interest are containing in LAPS.[34] Accordingly, if a submission is to be drafted on behalf of a client to request the remission of GIC (and noting the limited rights to appeal an unfavourable GIC decision), professional advisors would be wise to carefully consider and have regard to the ATO's views in PSLA 2011/12.

In certain contexts, PCGs can also provide administrative safe harbours to which taxpayers can avail so as to ensure that they have certainty in respect of likely ATO compliance activity. For instance, PCG 2016/16 provides an administrative safe harbour as to when a trust is a fixed trust for the purposes of Schedule 2F, and PCG 2019/5 provides an administrative safe harbour in the context of the 2-year rule for deceased estate dwellings under section 118-195.

PCGs are also useful to have regard to when assessing a client's risk of ATO scrutiny in certain contexts, and the extent to which behaviours/actions fall inside or outside the ATO's radar. This is amplified in PCG 2022/2 and the various colour-coded risk zones concerning section 100A compliance, as well as PCG 2021/4 concerning professional firm profits.

[34] For example, PSLA 2012/4, PSLA 2012/5, PSLA 2011/12, PSLA 2011/19, PSLA 2006/8.

Arguably, and provided the ATO is operating within the confines of the law, the ATO is unlikely to deviate from the processes in a practice statement or PCG if it enlivens reputational risks. This is highlighted at paragraph 26 and 27 of PCG 2016/1:

> 26. **If a practical compliance guideline outlines an approach (for example, an administrative safe harbour) that has clear consequences for determining tax liabilities of taxpayers who rely on that approach in good faith, and the ATO subsequently changes its view and/or the practical compliance guideline is withdrawn or altered, the principles under PS LA 2011/27 will be relevant and the ATO will not take action to apply any changed view of the law to prior years.** In these circumstances, any action in terms of applying the ATO view of the law will only occur on a prospective basis. The law will also provide protection from general and shortfall interest charges where a taxpayer has reasonably relied in good faith on an approach set out in a Guideline
>
> 27. **The ATO has good reason to stand by approaches outlined in practical compliance guidelines**. These guidelines are intended to guide the behaviour of taxpayers who wish to operate in a low tax risk environment, as well as to signal when the ATO considers certain behaviour to be of a higher risk of non-compliance with the law. **These objectives would be undermined if the guidelines were not applied consistently by the ATO.**
>
> [Bold added]

This is also highlighted in PSLA 2008/3 (which provides an explanation of the different forms of advice and guidance the ATO provides about the application of laws administered by the Commissioner):

> 234. **ATO personnel are required to follow law administration practice statements** unless they consider that the application of a particular practice statement would have unintended consequences or is otherwise incorrect. Where this occurs ATO personnel must follow their business line's escalation process.
>
> [Bold added]

<u>The limitations</u>

The limitations of LAPS were highlighted by the Full Federal Court in *Macquarie Bank Ltd v Federal Commissioner of Taxation* [2013] FCAFC 119 (**Macquarie**).

Macquire concerned particular provisions of the income tax laws relating to the allocation of expenses for Macquarie's Offshore Banking Units. Following an unfavourable audit decision, Macquarie brought proceedings in the Federal Court submitting that the Commissioner was proposing to apply, and to administer, the relevant statutory provisions in a way that was contrary to his statements in PSLA 2011/27 (which concerns matters which ATO officers should take into account in deciding whether to apply the ATO view of the law prospectively only).

In rejecting Macquarie's contentions, the judges (Middleton, Pagone, Davies JJ) highlighted the following at paragraph 11:

- The power of the general administration of tax legislation given to the Commissioner…does not permit the Commissioner to dispense with the operation of the law.

- The power of general administration in such provisions is not a discretion to modify, or which modifies, the liability to tax imposed by the statute: the power in such provision for general administration (coupled with whatever discretion they may contain) affects the administration of the Acts and not the Commissioner's duty to act according to law and to assess taxpayers to the correct amount of liability imposed by the legislation.

- … the practice statement could not fetter the Commissioner's duty of assessment or re-assessment where the law operated to impose liability nor could it fetter the lawful process of making an assessment to that end.

- The practice statement may set out the Commissioner's position about the circumstances in which he will apply retrospectively a different view about the operation of the law, but any failure by the Commissioner to comply with his view in the practice statement will not alter the taxpayer's liability upon an assessment or the Commissioner's duty to assess upon the correct view of the law…

- Whatever the sanction may be for the Commissioner not complying with the practice statement, it is not to relieve the taxpayer of the liability correctly imposed by the Act, and by its correct application, and it will not prevent the Commissioner from raising an assessment or a re-assessment of that liability in accordance with his duty to apply the law.

What does this mean?

While Macquarie highlights the risks of taxpayers relying on a practice statement, the Court also noted the "limited scope of operation" of PSLA 2011/27, particularly in the context of offshore banking units.

Accordingly, there may be many other LAPS and PCGs where the ATO may be less inclined to depart from its stated practice, especially if those LAPS and PCGs have wider application and scope (e.g. administrative penalties, or PSLA 2015/2 concerning original trustee assessments).

Indeed, and despite the pronouncements in Macquarie, it might be queried whether the ATO would be prepared to litigate a matter that is contrary to their own stated practice in LAPS or PCG in light of the associated reputational risks (as well as the underlying guiding principles of LAPS and PCGs to guide taxpayer behaviour…)

As noted in PSLA 2008/3 (which provides an explanation of the different forms of advice and guidance the ATO provides about the application of laws administered by the Commissioner):

> 234. **ATO personnel are required to follow law administration practice statements** unless they consider that the application of a particular practice statement would have unintended consequences or is otherwise incorrect. Where this occurs ATO personnel must follow their business line's escalation process.

5.5 ATO Interpretative Decisions

ATO Interpretative Decisions do not provide taxpayers with protection from tax shortfalls, but do protect taxpayers from shortfall penalties and interest.

While ATO ID's do not have the same binding affect as a public or private ruling, they can provide a degree of certainty as to how the ATO may interpret a specific tax technical issue.

In particular, PSLA 2001/8 highlights that an ATO ID represents a "precedential ATO view" and provides instructions to ATO officers to consider (and follow) an ATO ID under certain circumstances:

> ATO IDs set out a precedential ATO view. The precedential ATO view system is explained in PS LA 2003/3 *Precedential ATO view*. Precedential ATO views are produced to ensure we provide consistent interpretative decision making and you are required to search for existing precedential ATO views and those being prepared as part of your resolution of interpretative issues.
>
> You must follow an ATO ID where:
>
> • in your judgment, there is no material difference between the facts of the issue you are making a decision on and the facts of an existing ATO ID, and
>
> • you are satisfied that the application of the precedential ATO view set out in the ATO ID will result in a correct decision.[2]
>
> An interpretative issue is one where the application of the law is not straightforward. An exercise of a discretion, a conclusion of fact or the determination of a value for example, would not be an interpretative issue.

Accordingly, ATOIDs should not be discounted and may in fact be a sufficient basis for a professional advisor to provide their client with a level of assurance as to how the ATO is likely to interpret the law. For example, there are numerous ATOIDs in respect of the CGT Main Residence Exemption and these continue to be referenced by the ATO in private rulings as representing their interpretation of the law.

5.6 Website guidance

Some commentators have observed a trend by tax professionals to form views based exclusively on ATO website guidance (rather than the case law or a more formally published ATO guidance product, such as a tax ruling or practice statement).

However, ATO website guidance does provide taxpayers with some level of protection (i.e. shortfall interest) and should not be entirely discounted. Indeed, website guidance may assist taxpayers to substantiate a reasonably arguably position or to support a contention in a private ruling application.

In particular, there remain some areas of the tax laws that have little to no guidance, either in the explanatory memorandum which introduced the provision, the case law, or in ATO published products. In such circumstances, identifying relevant website guidance can be "better than nothing."

One example is the meaning of "in connection with retirement" in the context of the 15-year exemption under subdivision 152-B of the *Income Tax Assessment Act 1997*. There have been no cases which have considered the meaning of this phrase and the explanatory memorandum is brief (and somewhat vague) as to its application and scope.

The ATO website previously provided a very fulsome overview as to how it the ATO interpreted this condition, with examples which amplified a flexible interpretation to when a CGT event is in connection with retirement. This provided taxpayers with some degree of guidance and was a source that taxpayers could use to support their position in a private ruling application.[35]

A further example (also in the context of the small business CGT concessions) relates to the active asset test for land. A question often arises as to what proportion of the land must be used for business purposes in order for the land (as a distinct CGT asset) to be an active asset. While some cases have considered the issues somewhat (*Eichmann* and *Rus*), these cases arose from schemes in a private ruling and arguably have limited application.

Previously the ATO had the following example on their website,[36] which suggested that a parcel of land could be an active asset even though only 20% of the land was used in a business.

Example

Tom acquired 10 hectares of land as a single parcel in 1988. There are three distinct areas of the land which have different uses. Approximately 20% of the land is used in his business and 20% of the land is used for domestic purposes and contains Tom's main residence. The remaining 60% (rear of property) is vacant. The vacant part of the property has not been used or held ready for use for any purpose. Tom will subdivide the land into residential blocks. The subdivided blocks will not be trading stock because Tom is not carrying on a business of land development. After the subdivision is completed, Tom will sell all of the new subdivided blocks including those created out of the vacant part of the land.

Land is a CGT asset. Tom owns the land and used it in his business. Although only 20% of the land area has been used in the business, it is considered the conditions of an active asset are satisfied.

[35] Curiously this website guidance has been recently revised and no longer contains a fulsome description of the ATO's views. So, when considering website guidance to support a position, it is recommended that a screenshot is saved on file rather than relying on a website URL!

[36] https://www.ato.gov.au/Business/Small-business-entity-concessions/Concessions/CGT-concessions/Active-asset-test/Land-subdivision-and-active-asset-test/

Prior to its removal on the ATO website, this example could have provided a basis for a taxpayer to substantiate a position that their land is an active asset such as in a private ruling application.

Other examples of website guidance that may prove to be a useful resource are:

- The ATO's website on the impact on Covid-19 on an individual's tax residency status.

- The ATO's website FAQs on Division 7A (since withdrawn).

- The ATO's draft website guidance on property development agreements and the revenue/capital distinctions. (since withdrawn).

- The ATO's Value Shifting Guide.

5.7 Declaratory Relief

For the vast majority of disputes, obtaining certainty on a technical position to which the ATO is in disagreement generally results in engaging in the taxation objection (and potentially AAT/Federal Court) process under Part IVC of the *Taxation Administration Act 1953*.

However, for clients who have not been issued an assessment by the Commissioner and who do wish to obtain a private ruling, an alternative mechanism to which certainty could be achieved is through obtaining an order for declaratory relief under section 39B of the *Judiciary Act 1903* and sections 21 and 22 of the *Federal Court of Australia Act 1976*.

There are numerous technicalities underpinning the process of seeking an order from the Court (for one, it is a discretionary remedy) and less sophisticated taxpayers (without sufficient resources) may not be inclined to engage in the court processes to obtain clarity. Nevertheless, it is an option that should not be forgotten or discounted.

Gareth Radenbach of the Victoria Bar in his paper *Declaratory Relief – finally an alternative to Part IVA* from 2022 notes some practical examples when declaratory relief may have merit:

1) Where there is a new law of uncertain application

2) Where no assessment has issued, or no assessment will issue, on a particular set of facts to the taxpayer seeking certainty. Examples include not just the wrong taxpayer being assessed, but also facts leading up to an assessment such as the date on which a CGT asset was acquired which would inform its cost base but not ultimately the assessment of taxable income until a later year (although this may be more practically dealt with via the ruling process absent other factors).

3) Where a private binding ruling has been received in respect of facts that are sufficiently certain, but due to deficiencies in how the Commissioner has recorded the facts or that the transaction did not occur in the year subject to the ruling, no objection is possible or useful.

6. Conclusion

Certainty as to the interpretation and operation of various provisions of the tax laws is hard to achieve in the absence of clear and unequivocally guidance from the High Court.

While there are many areas of the tax laws where the technical views are uncertain, the protection afforded to taxpayers under the public and private ruling system does provide an avenue for professional advisors to give their clients some level of certainty as to how the Commissioner interprets and applies the tax laws.

Indeed, as the case of *Bowerman* highlights, sometimes reliance on the legislative force of a public ruling can be a better avenue to exploit to achieve certainty rather than deciphering complex legislation or case law where the *ratio decidendi* is unclear.

Nevertheless, as draft TR 2004/D25 and the concept of absolute entitlement highlights, some public rulings are easier to rely upon than others. In addition, as the ATO's views in TR 2023/1 concerning individual tax residency indicate[37], some areas of the tax laws are so innately uncertain that, in the absence of legislative reform, the burden falls on tax professionals to provide their clients with prudent and reasonable advice.

Perhaps the uncertainty of the statutory language which pervades some important areas of tax practice (e.g. "an ordinary family or commercial dealing"[38] or "corpus"[39]) instils an obligation on the ATO (in the interests of administering the tax laws) to more pro-actively encourage Treasury to consider law reform[40], or otherwise promote test-case funding in order to obtain judicial clarification.

Finally, advisors shouldn't forget the importance of evidence to discount ATO contentions and satisfy the burden of proof. Many of the provisions in the tax laws depend on ascertaining a taxpayer's intention and purpose objectively (e.g. isolated profit-making transaction, or Part IVA). So, regardless as to whether a reasonably arguable position can be developed having regard to legislation and case law, this may be futile if contemporaneous evidence is lacking.

[37] "7. Each residency decision turns on its facts.[4] While Court and Tribunal decisions provide illustrations of how the Court or Tribunal has considered and weighted facts, an outcome in one case does not govern the outcome in a different case, even where the facts are similar.".

[38] Section 100A.

[39] Section 99B.

[40] "Where the ATO identifies that enacted law is not operating consistently with the policy intent, and when this cannot be addressed administratively, the ATO will advise the Treasury. The Treasury will consider the issues raised by the ATO and advise the ATO of its views within a reasonable timeframe." (https://www.ato.gov.au/about-ato/new-legislation/in-detail/ato-treasury-protocols/ato-treasury-protocol)