THE TAX INSTITUTE

Tax Update
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1 Cases

1.1 Hill and Zuda – binding death benefit nominations

Facts

Alec Sodhy died on 22 November 2016.

Prior to his death, Alec was in a de facto relationship with Jennifer Murray. Jennifer was the executor of Alec's estate, and also a beneficiary of Alec's estate.

Alec had one child, Claire Hill. Claire made a family provision claim on the estate.

Alec was a member of the Holly Superannuation Fund. The trustee of the fund is Zuda Pty Ltd, of which Jennifer is the sole director (and sole member). Jennifer and Alec were the only members of the Holly Superannuation Fund prior to the death of Alec.

The Holly Superannuation Fund was created by trust deed on 14 June 2000. The original trust deed was amended on 13 December 2011 replacing the original rules.

Clause 5 and 6 of the amended deed provided as follows:

> *5. Despite anything else in the trust deed or Rules, if either of Alec Kumar Sodhy or Jennifer Patricia Murray dies, then the Trustee must distribute the whole of the deceased Member's Account Balance to the other Member and may pay any part of the benefit as a lump sum or as a pension as the Trustee considers appropriate.*
>
> *6. Clause 5 is a Binding Death Benefit Nomination for the purpose of the Rules.*

Rule 5 of the amended trust deed relevantly provided:

> *5.2 A Member may give the Trustee a Binding Death Benefit Nomination.*
> *5.3 The Trustee may refuse to accept any Binding Death Benefit Nomination without giving any reason. When the Trustee accepts a Binding Death Benefit Nomination, any previous Binding Death Benefit Nomination from the Member is taken to have been revoked.*
> *5.4 If a Member dies the Trustee must pay a benefit equal to the Member's Account Balance.*
> *5.5 If, in relation to any part of the benefit:*
> *a) the Trustee accepted a Binding Death Benefit Nomination;*
> *b) it has not been revoked; and*
> *c) it can be followed under Government Requirements*
> *then the Trustee must follow the Binding Death Benefit Nomination in relation to that part of the benefit.*
> *5.6 If in relation to any part of the benefit:*
> *a) the Trustee does not hold a current Binding Death Benefit Nomination; or*
> *b) the nomination cannot be followed for any reason*
> *the Trustee must pay that part of the benefit to any or all of the Member's Dependants and legal personal representative in the proportions that the Trustee decides.*

'Dependant of a Member' includes a spouse and child of the Member. Therefore, both Jennifer and Claire are dependants of Alec.

Zuda Pty Ltd had paid the balance of Alec's member account to Jennifer. Claire submitted to the Court that the binding death benefit nomination contained in the amending deed did not actually constitute a valid binding death benefit nomination. Claire submitted that the nomination was invalid on the basis that it had not been signed in the presence of two independent adult witnesses as required by regulation 6.17A of the *Superannuation Industry (Supervision) Regulations 1994* (Cth) (**SIS Regulations**). Regulation 6.17A relevantly provides as follows:

> *(1) For subsections 31(1) and 32(1) of the Act, the standard set out in subregulation (4) is applicable to the operation of regulated superannuation funds and approved deposit funds.*

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(2) For subsection 59(1A) of the Act, the governing rules of a fund may permit a member of the fund to require the trustee to provide any benefits in respect of the member, on or after the death of the member, to the legal personal representative or a dependant of the member if the trustee gives to the member information under subregulation (3).

(3) The trustee must give to the member information that the trustee reasonably believes the member reasonably needs for the purpose of understanding the right of that member to require the trustee to provide the benefits.

(4) Subject to subregulation (4A), and regulations 6.17B, 7A.17 and 7A.18, if the governing rules of a fund permit a member of the fund to require the trustee to provide any benefits in accordance with subregulation (2), the trustee must pay a benefit in respect of the member, on or after the death of the member, to the person or persons mentioned in a notice given to the trustee by the member if:

- *(a) the person, or each of the persons, mentioned in the notice is the legal personal representative or a dependant of the member; and*
- *(b) the proportion of the benefit that will be paid to that person, or to each of those persons, is certain or readily ascertainable from the notice; and*
- *(c) the notice is in accordance with subregulation (6); and*
- *(d) the notice is in effect.*

Subregulation (6) then sets out the requirement for the BDBN to be witnessed by 2 witnesses who are not nominated beneficiaries. Section 59 of the SIS Act effectively prohibits a trustee from allowing someone other than a trustee to exercise a discretion given to a trustee, unless the exception in section 59(1A) applies. The above regulation sets out when 59(1A) may allow someone to exercise a discretion of the trustee, and allows for binding death benefit nominations (BDBNs). Section 59(1) is stated not to apply to self-managed superannuation funds.

The question for the Court was whether regulation 6.17A(4) of the SIS Regulations applies to self-managed superannuation funds.

Claire contended that regulation 6.17A does apply to self-managed superannuation funds as section 31 and section 32 of the SIS Act apply to self-managed superannuation funds.

Jennifer submitted that regulation 6.17A does not apply to self-managed superannuation funds in accordance with the decision in *Cantor Management v Booth* [2017] SASCFC 122 which considered whether a BDBN needed to be given to a trustee in the way set out in subregulation 6.17A(4) if the fund is a self-managed superannuation fund. The reasoning in that case was that section 59(1) of the SIS Act expressly excludes self-managed superannuation funds so that the proviso found in section 59(1A) (which requires that the superannuation fund complies with the regulations) does not apply to self-managed superannuation funds and subregulation 6.17A(4) is not an exception that must be complied with (following *Munro v Munro* [2015] QSC 61).

Issue

Whether the requirements provided by regulation 6.17A(4) apply to a binding death benefit nomination made by a self-managed superannuation fund?

Decision

The Court considered that there was force to the contention of Claire that the requirements of subregulation 6.17A(4) apply to self-managed superannuation funds but also considered that the opposite view, which has been adopted in *Cantor Management* was reasonably open, though there was some doubt expressed as to whether the point about the operability of the subregulation may be considered *obiter*.

The Court decided to adopt the approach in *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* [2007] HCA 22, namely that an intermediate appellate court should not depart from decisions of another intermediate appellate court in another jurisdiction, unless the preceding decision is plainly wrong. They therefore followed *Cantor,* determined that the regulation did not apply to the SMSF, so that the rules regarding BDBNs did not need to be followed, with the effect that the payments under the deed were correctly made.

Citation *Hill v Zuda Pty Ltd* [2021] WASCA 59 (Buss P, Murphy JA and Mitchell JA, Perth)
w http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/wa/WASCA/2021/59.html

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1.2 Baba v Sheehan – fraud on the power

Facts

In 2006, Mustafa Baba, Steven Carney and Paul Sheehan decided to commence an optometry practice.

On 2 September 2006, Mustafa, Steven and Paul entered into a partnership agreement setting out the terms of their arrangement. Under the partnership agreement, Mustafa and Steven would be paid salary as specified, and any increase in salaries paid to Mustafa and Steven would result in an equivalent increase in payment paid to an related entity of Paul as a consultancy fee.

Despite the partnership agreement, Smart Street Optical Trust was established by deed dated 15 December 2006, from which the optometry practice was conducted.

Under the trust deed of the Optical Trust, the original unitholders were Anna Baba (Mustafa's wife), Sedarni Pty Limited (a company controlled by Steven) and Rijalu Pty Limited (a company controlled by Paul).

Smart Street Optical Pty Limited, a company controlled by Mustafa, Steven and Paul, was appointed as trustee of the Optical Trust.

Paul was named as the Appointor of the Optical Trust. Under clause 2 of the trust deed, the Appointor had the power to appoint and remove trustees of the Optical Trust.

Between 2006 and 2016, Mustafa oversaw the accounting of the Optical Trust and instructed Darren Tappouras to carry out the accounting work.

In early 2016, Mustafa, Steven and Paul contemplated the sale of the optometry practice to an entity controlled by Paul.

Paul enquired into the accounts of the optometry practice carried on by the Optical Trust and became concerned with the way in which the optometry practice was managed. Notably, there was an apparent discrepancy in the financial figures of the Optical Trust and by the fact that there was no money in the Optical Trust's bank account for distribution to the unitholders of the Optical Trust. After several correspondences with Mustafa and Steven, Paul became concerned that he was kept out of the affairs of the Optical Trust.

In May 2016, Paul contacted the Trust's accountant, Darren, requesting information about an increase of 'beneficiary loans' from the Optical Trust to Mustafa and Steven shown in the financial statements of Trust for the year ended 30 June 2015.

In early August 2016, Paul was provided with draft accounts for the Optical Trust for the year ended 30 June 2016. Paul formed that the view that there were some discrepancies and discussed them with Mustafa and Steven, who advised Paul and that they would follow up with the accountant.

Subsequently, Paul received a copy of an email from Mustafa and Steven to Darren stating that some of the distributions had 'gone through salary sacrifice' and that that accounted for the discrepancy. The 'salary sacrifice arrangement' appeared to be that payments of consultants' fees were made to Mustafa and Steven, who were employed in the optometry practice. The distributions made to Anna and to Sedarni, as 'Unitholders', were reduced by the amounts of the consultants' fees.

Paul expressed concerns that he did not approve the salary sacrifice arrangement.

On 23 October 2016, Paul sought copies from Darren of the Optical Trust's bank account statements, tax returns of the Optical Trust for the past 10 years, plus breakdowns of salaries and other payments made to Mustafa and Steven. He also tried to telephone Darren but received no response.

Paul spoke with Mustafa and Steven expressing his concerns that he was not being provided with information, that Mustafa and Steven did not appear to understand their responsibilities as directors of a corporate trustee, and that it appeared to him that distributions from Optical Trust were not being made in proportion to the unit holdings.

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On 26 October 2006, Paul sent a notice via email and registered post to Mustafa and Steven addressed 'Dear Anna, Steve and Mustafa', informing them that Paul had exercised his power as the appointor of the Optical Trust to remove Smart Street as trustee and replace it with Silktote Pty Ltd, the directors of which were Paul and his wife, Dianne Sheehan.

Anna commenced proceedings in the Corporations List of the Equity Division of the Supreme Court seeking, relevantly, a declaration that the appointment of Silktote as trustee of the Trust was void and of no force or effect.

Silktote filed a cross-claim seeking a declaration that it is now the trustee of the Trust and that certain payments that had been made by the former trustee, Smart Street, were made in breach of trust.

Anna submitted that the exercise of the power by Paul conferred by clause 2 of the trust deed was a fraud on that power because it was exercised for the purpose of enabling Paul to acquire control of the Trust and the Trust Business, for the purpose of facilitating the sale of the Trust Business to Better Eyecare.

Paul contended that he had genuine concerns about the way in which the affairs of the Trust were being conducted and exercised his power to appoint a new trustee so as to protect the interests of his company, Rijalu, as unit holder of the Optical Trust.

The primary judge in the Equity Division dismissed Anna's claim.

The primary judge did not find Paul's evidence entirely satisfactory and considered that the emails relied on by Paul as evidence did not reflect a concern about the way in which the trust accounts were being prepared or the way in which the affairs of the Optical Trust were being managed. However, the primary judge considered that Paul's concerns as to the salary sacrifice arrangements were genuine and that Paul's motives and purpose in exercising the power conferred by clause 2 of the trust deed was not exercised for an improper purpose of obtaining control of the Trust.

On 24 December 2019, Anna and Mustafa appealed to the New South Wales Court of Appeal.

At the time of the hearing of the appeal, the only ground of appeal relied by Anna and Mustafa was that the primary judge had erred in failing to hold that the purported removal of Smart Street and appointment of Silktote as trustee of the Trust by Mr Sheehan was void as a fraud on the power of appointment conferred by the Trust Deed on Paul.

Issue

Was exercising the power conferred by clause 2 of the trust deed a fraud on the power?

Decision

The Court of Appeal dismissed the appeal.

The Court of Appeal distinguished the power of appointment to appoint a new trustee, from a power to appoint trust property to a discretionary beneficiary, about which most of the law on the nature of a trustee's powers is concerned. The latter power conferred on a trustee is fiduciary in character.

The Court of Appeal considered that the exercise of a power of appointment to appoint a new trustee is controlled by a doctrine of the 'fraud on a power', and may be fraudulent if the exercise of the power was not bona fide. Such as, if the exercise of the power was made for purposes foreign to, or beyond the scope of the power, or for a corrupt purpose.

The Court of Appeal considered the exercise of a power of appointment for the purpose of transferring control to the appointee, absent any intention that the appointee act other than properly in accordance with its responsibilities as trustee, was not of itself improper.

As there was no specific challenge as to the findings of facts and no basis to justify a conclusion that the primary judge erred in assessing Paul's credibility, the Court of Appeal held that it was open for the primary judge to make a finding of fact that Paul was not motivated by an improper purpose.

COMMENT – this case demonstrates that where there are disputes between parties, that the courts will have oversight of the efforts to wrest control of a trust and its assets from one or more of the parties involved in the dispute.

Citation *Baba v Sheehan* [2021] NSWCA 58 (Brereton JA, Emmett AJA and Simpson AJA, Sydney)
w http://classic.austlii.edu.au/au/cases/nsw/NSWCA/2021/58.html

1.3 Re McGowan & Valentini Trusts – trustee not in existence and vesting

Facts

Giuseppe Valentini and Iris Norma Valentini (who later remarried and became Iris Norman Fletcher) had two children, Anna Valentini (later known as Anna McGowan) and Peter Valentini.

By two separate deeds dated 14 February 1977, Giuseppe and Norma created two discretionary trusts – one for each of their children. The settlor of each of trust was Norma's sister, Doris Searle.

The trust deeds for the two trusts appointed I.N. & G. Nominees Pty Ltd (**ING**) as the trustee. ING appeared to execute the trust deeds applying the company seal and signature of Giuseppe and Norma as the directors of ING.

The trust deeds included a term which provided that the trusts were to vest absolutely in Anna and Peter when they each turned 30 years old. Anna turned 30 on 7 January 1988. Peter turned 30 on 14 February 1991.

Clause 8 of the trust deeds provided as follows:

> *Either the Trustee or the person or persons who for the time being have power to appoint new or additional trustees hereof may at any time or times alter vary rescind or add to in any way all or any of the trusts provisions or conditions herein contained and in particular and without derogating from the generality of the foregoing provisions by declaring in favour of any other issue of the said Giuseppe Valentini in addition to or in substitution for the Original Beneficiary any other trusts of the Trust Fund and the income thereof.*
>
> *PROVIDED that every such alteration variation rescission or addition shall be by deed executed by the person or persons making the same and if not made by the Trustee shall be delivered to the Trustee before it shall take effect.*
>
> *AND PROVIDED FURTHER that no such alteration variation rescission or addition shall have any force or effect if it would have the result of vesting in the Settlor or the Trustee or either of them any beneficial interest in the Trust Fund or the income therefrom.*

Giuseppe died on 26 November 1989 after which Norma married Bruce Fletcher. Norma died on 5 March 2020. Norma left a will appointing her children, Anna and Peter, as executors and trustees of her estate. Probate of Norma's will was granted to Anna and Peter on 12 June 2020.

ING was registered on 25 September 1978, being about 19 months after the execution of the trust deeds for the two trusts at incorporation, Giuseppe was appointed sole director of ING. Norma was appointed secretary.

On 23 June 1991, Doris and ING executed further deeds of settlement purporting to amend the trust deeds for the two trusts by relying on the variation power contained in the original trusts. The amendments included widening the class of discretionary beneficiaries, amending the trustee powers and extending the vesting dates of the trusts.

ING continued to manage the property of the trusts on the terms as amended by the 1991 deeds.

Over time, the Trusts (in equal shares) owned a number of assets and the accounts of the trusts indicated that they also owned land at 122 Victoria Street, North Geelong.

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The Victoria Street property was initially purchased in the joint names of Norma and Giuseppe. Norma later became the sole registered proprietor by right of survivorship after Giuseppe's death. However, Victoria Street had always been treated as an asset of the trusts.

ING applied to the Supreme Court of Victoria seeking judicial advice in relation to a number of problems arising from the factual circumstances surrounding the trusts, including the following:

1. the validity of the trusts and the identity of the trustee given that the original trust deeds were executed by ING about 19 months before ING was incorporated;
2. the fact that the Victoria Street property was purchased by Giuseppe and Norma jointly (and later was registered in Norma's sole name) even though Victoria Street was always treated as a trust asset;
3. although the other properties (excluding Victoria Street) were registered in the name of ING, there was no express signed declarations of trust by ING over the properties;
4. that ING continued to deal with trust property as if the trusts continued and the property had remained the subject of the original trust deeds despite their apparent vesting at earlier points in time;
5. after the 1977 deeds were amended by the 1991 deeds, the Trusts were administered on the terms of the 1991 deeds (e.g. distributions were made to beneficiaries that were not initially included in the class of beneficiaries under 1977 deeds).

Issues

1. What is the effect of the non-existence of ING at the creation of the trusts?
2. What is the effect of Victoria Street having been purchased by Norma and Giuseppe?
3. What is the effect of there being no declarations of trust by ING for the various other properties?
4. What is the effect of the trust assets vesting in 1988 and 1991?
5. What is the effect of the trusts being amended in 1991?

Decision

<u>Issue 1: What is the effect of the non-existence of ING at the creation of the Trusts?</u>

The Court noted that in order to create an express trust, there must be present three certainties:

1. certainty of intention;
2. certainty of subject matter of the trust; and
3. certainty of the identity of the beneficiaries of the trust.

In relation to the trusts, the original trust deeds were executed by Norma's sister Doris as settlor. Doris also settled an amount of $10 on each of the trusts. The original trust deeds also purportedly signed by ING with the signatures of Norma and Giuseppe.

The Court found that the trusts were executed on 14 February 1977 by Doris, Giuseppe and Norma.

It was held that the original trust deeds met the requirements of the three certainties for a trust relationship because:

1. there was certainty of intention as Doris (as settlor) expressly declared two trusts, being the Anna McGowan Trust and the Peter Valentini Trust;
2. there was certainty as to the identity of the beneficiaries, being Anna McGowan (and after the death of Anna, her children) under the Anna McGowan Trust and Peter Valentini (and after the death of Peter, his children) under the Peter Valentini Trust; and
3. there was certainty in relation to the trust property, being the $10 settled on the Trusts respectively.

The critical issue was whether the validity of the creation of the trusts was impacted by the fact that ING had not been incorporated at the time the 1977 deeds were executed.

The Court noted that equity will not allow a trust to fail for want of a trustee, because, generally, this would be contrary to the settlor's intention.

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It was held that the trusts did not fail and did not lack a trustee during the period of creation until ING was incorporated. By signing the original trust deeds as the natural persons who were to take responsibility for administering the trusts, although thinking they were doing so as directors of ING rather than individuals, Giuseppe and Norma sufficiently signified their agreement to accept, in absence of ING as trustee, the liabilities of the trustee and to hold the settled property on trust for the original beneficiaries of the Trusts.

The Court further held that having regard to the conduct of the trusts after 1978, ING became trustee of the Trusts by its conduct in administering the trusts and taking on the liabilities of the trustee. This is because:

1. the settlor intended ING to be the trustee;
2. ING's soon to be director, Giuseppe, and company secretary, Norma, executed the 1977 Deeds by which ING was appointed trustee;
3. Giuseppe and Norma undertook the role of trustee only because ING was not incorporated, yet proceeded to incorporate ING with one of the objects of ING being to undertake the office of a trustee;
4. ING appeared to have acted as trustee of the Trusts in the years following its incorporation.

Issue 2: What is the effect of Victoria Street having been purchased by Norma and Giuseppe?

Although Victoria Street was purchased by Giuseppe and Norma jointly, the property had always been treated as an asset of the Trusts.

Relevantly, section 53(1)(b) of the *Property Law Act 1958 (VIC)* provides that …*"a declaration of trust respecting any land or any interest therein must be manifested and proved by some writing signed by some person who is able to declare such trust or by his will…"*

The Court found that, for an equitable interest to be enforceable and have effect in relation to Victoria Street, the formalities of section 53(1)(b) of the Property Law Act must be complied with.

The Court held that the evidence submitted to the Court and referred to under Issue 1 above supported the inference that Giuseppe and Norma had an intention to hold Victoria Street for the Trusts expressed in the 1977 deeds. Furthermore, Victorian State Revenue Office had been treating Victoria Street as an asset of ING as trustee.

The Court further found that there was compliance with the formalities under section 53(1)(b) of the Property Law Act. This was supported by affidavit evidence of Norma where she deposed that it was her intention and the intention of Giuseppe to purchase Victoria Street for the Trusts.

Issue 3: What is the effect of there being no declarations of trust by ING?

It was noted that there was no express declaration of trust in favour of ING as trustee by ING in respect of the other properties it acquired or purchased.

Notwithstanding this, the court found that the evidence before the court supported the finding that ING declared the other properties to be held on the Trusts. It was held that there was writing signed by ING which manifested and proved those declarations of trusts, including:

1. the 1977 deeds and the 1991 deeds;
2. the income tax returns for the Trusts;
3. the fact that the income of the other properties were distributed in accordance with the terms of the Trusts created by the 1977 Deeds;
4. the affidavit of Norma.

This was sufficient evidence for compliance also with the formalities of section 53(1)(b) of the Property Law Act.

Issue 4: What is the effect of the trust assets vesting in 1988 and 1991?

The Court found that there was nothing in the language of the 1977 deeds that would prevent the continuation of the trusts beyond the vesting pending the winding up of the trusts. Relying on analogy of previous case law, it was held that the vesting of trust property upon Anna on 7 January 1988 and on Peter in 14 January 1991,

neither brought their respective trusts to an end nor brought into existence any new trusts upon which the property was held. The beneficiaries of the trusts were of full age and consented to the continuation of the Trusts (and to their subsequent amendment).

The Court held that the power of amendment contained in the 1977 deeds was broad enough to survive vesting of the trusts. The power should be construed as permitting a variation to the class of beneficiaries and vary the vesting date after vesting so long as it was for the benefit of and with the consent of the then entitled beneficiaries. The settlor, the trustee and the original beneficiaries of the trusts had all executed the 1991 deeds which signified their consent.

Issue 5: What is the effect of the trusts being amended by the 1991 deeds?

In accepting that trustee retained the power to vary or amend the 1977 deeds, the Court considered whether the amendments actually made by the trustees in the form of the 1991 deeds resulted in the continuation of the trusts or created new trusts altogether.

The power of amendment in the 1977 deeds was broad and, on its proper construction, permitted the variations (including to the class of beneficiaries) contained in the 1991 deeds. The amendment was made in conformity with and promoted the purposes of the trusts. The substratum of the trusts was not destroyed but, rather, the 1991 deeds expanded upon and varied elements which already existed in the trusts. There is sufficient continuity in the trust assets, beneficiaries and constitution of the trusts such that the trusts under the 1991 deeds should properly be seen as the continuation of the trusts.

Citation *Re McGowan & Valentini Trusts* [2021] VSC 154 (Macaulay J, Melbourne)
w http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/vic/VSC/2021/154.html

COMMENT – amending the vesting date after vesting would seemingly result in CGT event C2 for the beneficiaries then entitled to the trust property as a result of the vesting as their interest in the property would come to an end as result of the amendments.

1.4 Raissis – Land tax and principal place of residence

Facts

Emanuel Raissis and his brother Spiro Raissis jointly acquired land at Paddington on 26 October 2015 in equal shares as tenants in common.

Construction commenced on the residence of the Paddington property.

A certificate of structural adequacy was issued on 5 November 2019.

Emanuel asserted that he moved into the Paddington property on or about 23 December 2019. His wife and children continued to live with his mother at a separate house in Dillon Street, Paddington. At the hearing, Emanuel gave evidence that after he moved in to the property, he spent Christmas at his mother's home and, between Christmas and New Year, Emanuel and did not spend much time in the property.

Emanuel changed his address records on the electoral roll and his drivers licence to the Paddington property during the 2020 calendar year.

An Origin electricity bill indicated that the electricity ‘supply start date’ was 12 January 2020. An electrical compliance certificate was issued on 18 February 2020.

Inspection of the building prior to covering waterproofing occurred on 5 March 2020.

The plumbing and drainage certificate of compliance was issued on 28 May 2020.

An occupation certificate was issued on 12 August 2020, by which time Emanuel had left the property.

Spiro and Emanuel had also acquired land at Bondi in October 2015. In June 2019, Emanuel successfully brought proceedings seeking a review of the Chief Commissioner's assessment of land tax on the Bondi property for the 2018 land tax year on the basis that the Bondi property was the principal place of residence of Emanuel in the 2018 land tax year.

Spiro and Emanuel sought the principal place of residence exemption for the Paddington property on the basis of the concession at clause 6 of Schedule 1A of the LTM Act. That concession provides a concession to the owner of unoccupied land which the owner intends to use and occupy solely as his or her principal place of residence. That exemption is available if:

1. the land is unoccupied because the owner intends to carry out, or is carrying out, building or other works necessary to facilitate his or her intended use and occupation of the land as a principal place of residence;
2. those building works have physically commenced, no income has been derived from its use or occupation; and
3. the intended use and occupation is not unlawful.

Unoccupied land cannot be treated as a person's principal place of residence if other land is being treated as such.

In addition, as relevant to Emanuel and Spiro, the concession only applies for 4 years immediately following the year in which the Emanuel and Spiro became the owner of the property. Therefore, in order for the concession at clause 6 to apply, Emanuel and Spiro needed to show that the Paddington Property was used and occupied by one of them as his principal place of residence as at 31 December 2019.

The Chief Commissioner assessed Spiro and Emanuel for land tax for the 2016 to 2020 land tax years and denied them the benefit of the principal place of residence exemption for the Paddington property.

Spiro and Emanuel appealed the Chief Commissioner's decision to the NSW Civil and Administrative Tribunal on principal place of residence exemption, and the decision to impose market rate and premium interest on the land tax liability.

Issue

Was the Paddington property used and occupied by Emanuel as his principal place of residence as at 31 December 2019?

Decision

The Tribunal affirmed the Chief Commissioner's assessments of land tax covering the land tax years 2016 to 2020.

It was clear that the land tax liability for the 2018 tax year was not in issue as Emanuel could not claim the concession for the principal place of residence where the Bondi property was recognised as his principal place of residence for the 2018 land tax year.

As for the 2016, 2017 and 2019 land tax years, the evidence together suggested that Emanuel's connection to the Paddington property was temporary and transient.

The Tribunal considered that 'principal place of residence' is not a defined expression and has its ordinary meaning. Older cases considered the principal place of residence as the place where a person 'eats, drinks and sleeps' but the Tribunal noted that the concept required a consideration of a number of matters. In totality, it must be established that the occupation of the property has a degree of permanence to it, and that a connection to a place that was transient, temporary, contingent or passing in nature was not sufficient.

The Tribunal considered that the electricity supply date of 12 January 2020 would appear to indicate that, prior to that date, Emanuel must have been using the property without a main line, including using it for sleeping and eating without the use of electricity.

The Tribunal also considered it reasonable to impute that internal tiling may not have been in place in December 2019 or January 2020 having regard to the date of the plumbing and drainage certificate.

Even if Emanuel's sleeping arrangements had been simple and temporary, there was insufficient evidence before the Tribunal to demonstrate that Emanuel regularly cooked or heated his meals at the Paddington property. There was also no evidence of furniture and fittings which Emanuel had available at the property.

The change of details for the electoral roll and drivers licence post-dated the taxing date of 31 December 2019, and did not substantiate actual residence by Emanuel.

On a reasonable objective assessment, the building work and construction of the Paddington Property could not be regarded as being so well developed so as to facilitate the use and occupation of the property by Emanuel as a settled or usual abode.

The Tribunal also affirmed the Chief Commissioner's decision to impose interest consisting of both the market component and the premium component on the total land tax liability of Emanuel for the 2016 to 202 land tax years.

TRAP – as is demonstrated here, in determining where a person's principal place of residence (land tax) or main residence (CGT) is, use of utilities such as electricity and water will be considered.

Citation *Raissis v Chief Commissioner of State Revenue* [2021] NSWCATAD 99 (J S Currie, Senior Member, Sydney)
w http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/nsw/NSWCATAD//2021/99.html

1.5 Todd v Todd – Construction of will and latent CGT liability

Facts

Joan Todd died on 2 April 2018, leaving a will dated 11 September 2006.

The Will appointed Joan's four children Alexander, Wendy, Bronwyn and Yvonne as her executors.

Probate of the Will was granted on 7 November 2018.

Joan's estate included four properties: a property at Clarence Gardens, a property at Hawthorn, a property at Goolwa Beach and a property at Millswood.

Pursuant to respective clauses 5, 6 and 7 of the Will:

1. the Clarence Gardens property was gifted to Wendy;
2. the Hawthorn property was gifted to Yvonne; and
3. the Goolwa property was gifted to Bronwyn and Alexander as tenants in common.

Clause 8 of the Will gifted the Millswood property to the four children, subject to the following adjustment mechanism:

> *'[I give the Millswood property to my children]… to be divided between them in such a manner so as to ensure that as at the finalisation of the administration of my estate all of my said children have received an equal value of bequests under this my Will'*

Further, clause 11(1) of the Will relevantly provided:

> *'... that all benefits given by this my Will and any Codicil shall be paid delivered or retained free from all duties whatsoever which (whether presently or presumptively or prospectively payable) shall be paid out of my estate in the same manner as my funeral and testamentary expenses and debts shall be payable so that there shall be no subsequent adjustment or apportionment thereof as between any of the beneficiaries of this my Will.'*

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In light of the wording of clause 8 and clause 11, a question arose between the children as to whether the latent capital gains tax liability in relation to each property should influence the calculation of the gift of the Millswood property in accordance with clause 8 of the Will.

Specifically, Wendy and Bronwyn were of the view that the references to 'duties' in clause 11 should be construed as incorporating future potential CGT liabilities payable by each beneficiary. In contrast, Yvonne argued that taking CGT liabilities into account under clause 11 would be misguided, and would result in the finalisation of the estate being delayed, potentially indefinitely.

In light of the differing interpretations, the executors made an application for judicial advice regarding the correct construction of clause 8 and clause 11 of the Will.

Issue

Whether the accumulated capital gains tax liability attached to each of the properties referred to in clauses 5 to 8 of the Will should be apportioned to each of the parties in their capacity as beneficiaries in light of clause 8, or alternatively under clause 11 of the Will.

Decision

Bampton J held that the latent capital gains tax liability in respect of the properties should **not** be taken into account in determining the value of the individual bequests under clause 8 of the will.

Her Honour disagreed with Wendy and Bronwyn's argument that family law cases and commercial cases favoured a CGT inclusive interpretation of 'value received'.

In respect to the case law in the family law and commercial jurisdictions, Bampton J accepted or noted the following:

1. there were many instances where the Family Court declined to make an allowance for CGT, as there was no evidence that the CGT asset in question was to be sold immediately and no evidence of what the potential CGT payable may equate to. This was analogous to the matter at hand as there was no evidence that any of Joan's beneficiaries intended to dispose of the property gifted to them under the Will;
2. the nature of family law proceedings means there is necessarily more evidence presented as to whether an asset would be realised or not, whether a party intends to retain or sell an asset, or whether the court will in fact order that an asset be sold. This was contrasted to the current proceedings.
3. the Family Court's role in the division of property is different to the task in construing clause 8 of the Will (which requires a discovery of Joan's intentions and the scheme she conceived for her Will). The mere possibility that Joan's beneficiaries may dispose of their gift in the future giving rise to a CGT event cannot be taken into account in ascribing the equal value of bequests under clause 8 of Joan's will; and
4. Wendy and Bronwyn's interpretation of the commercial case law presented to the Court was incorrect. Bampton J noted the decision of *Commissioner of Taxes (Tas) v Perpetual Trustees Executors & Agency Company of Tasmania Ltd* (1969) 118 CLR 325 provided that, in the context of an inquiry as to notional 'value received' where no disposal of property has taken place, it would be incorrect to account for any liability (as to taxation or otherwise) that may have arisen had an actual disposal taken place or that may arise on a future disposal.

In addition to the above analysis of case law, Bampton J did not accept the inclusion of the CGT liability for the following key reasons:

1. the methodology proposed by the executors to estimate the latent CGT liability by assuming the properties were sold at the date of Joan's death, and seeking the cooperation of the beneficiaries in disclosing their personal taxation return for that year was problematic;
2. the taxation returns of the children for the year in which Joan died were irrelevant to the enquiry of value as at the finalisation of the administration of Joan's estate. It also would be inappropriate to require any of the children to reveal their taxation affairs in the circumstances;
3. the value of the three properties bequeathed under Joan's will should not depend on the tax affairs of the person to whom they are gifted, and there is no taxing event that arises upon such a gift. It is incorrect to say that a property gifted to a person in the highest bracket of income tax would have a higher value had it

been gifted to a person who had no taxable income. Such proposition ignores the fact that a CGT liability in respect of a property only arises when *and if* that property is disposed of.

Bampton J considered that valuing property on the basis proposed by Wendy and Bronwyn would present a nearly impossible task, as it would involve hypothesising the implications of an event which involves too many variables.

COMMENT – it is not uncommon for a will to be drafted to direct executors to take into account the effects of CGT when distributing assets. This case calls into question whether such clauses can be effective without specific principles being included in the drafting, such as what assumptions to make when calculating CGT.

Citation *Todd v Todd & Ors* [2021] SASC 36 (Bampton J, Adelaide)
w http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/sa/SASC/2021/36.html

1.6 SPIC Pacific Hydro – landholder duty and meaning of 'fixtures'

Facts

On 8 March 2016, SPIC Pacific Hydro Pty Ltd, as purchaser, entered into a Sale Securities agreement (**Agreement**) with Inversiones Capital Global, S.A and BlueNRGY Group Ltd, as vendors. Completion of the Agreement occurred on 12 May 2016.

Under the Agreement, SPIC acquired 100% of the units in various unit trusts, including the Taralga Holding Land Trust (**Holdco Land Trust**).

As at 12 May 2016, the Holdco Land Trust indirectly through 'linked entities' held freehold and leasehold interests in land. The leasehold interests were long-term leases with a remaining term of 25.78 years as at 12 May 2016.

The combined registered value of the freehold properties as at 12 May 2016 was $454,900, and the combined market value of the freehold properties (not including any TWF construction costs of property related to the land) was $750,000.

As at 12 May 2016, the leased landholdings were used to operate the Taralga wind farm by SPIC and its related entities (the **Wind Farm**). The leases provided that the equipment on the land were chattels and were to be removed at the end of the lease. The rent charged under the leases was set without reference to the value added by the plant and equipment i.e. the rent was based on the unimproved land value. The valuation evidence indicated that this resulted in a rental discount of approximately $21,500,000 each year.

The relevant features of the Wind Farm were as follows:

1. 51 wind turbine generators (**WTG**) are located at the Wind Farm;
2. each WTG comprises a concrete foundation, the tower sections, the nacelle and the hub and blades;
3. the tower sections of each WTG were custom designed and built for each project. The towers were typically 80 metres in height. The tower must be firmly fastened to the foundations because the hub and blade components weigh about 42 tonnes. Without this fastening the whole tower would fall forwards;
4. each WTG had a design life of 20 years. That design life is specified in the turbine design contracts;
5. the WTGs were connected to electrical cables which were predominantly underground and connect back to a switchroom located in a switchyard. There was 28 kilometres of underground cabling at the site. If the cables were removed they would be damaged, therefore the cables only had a scrap value;
6. none of the component parts of a WTG or the underground electrical cables were used by the landowners;
7. the switchyard consisted of components which had individual concrete footings;
8. the electricity generated at the Wind Farm connected to the national electricity grid via an overhead transmission line from the Wind Farm's substation to the Marulan substation. The transmission line, including land-related assets, was gifted to Essential Energy on 17 December 2014 and did not form part of the acquisition by SPIC;
9. there was a control building at the Wind Farm (**Control Building**) with facilities for operations and maintenance staff;
10. there were 23 kilometres of access roads across the site which provided vehicle access to the WTGs; and

11. there were eight meteorological or monitoring masts and a television re-transmitter on the site. None of these were used by the landowners.

As at 12 May 2016, the total of the unencumbered value of the plant and equipment assets situated at the Wind Farm was $227,182,500. The wind turbines were valued at $136,834,500, accounting for more than half of the total unencumbered value of the assets.

On 21 July 2017, the Chief Commissioner assessed SPIC as being liable for landholder duty under the *Duties Act 1997* (NSW). A Duties Notice of Assessment was issued to SPIC in the amount of $12,394,573.37 plus interest.

The Chief Commissioner contended that the Holdco Land Trust was a 'landholder' for the purposes of section 146(1) of the Duties Act with the consequence being that the acquisition of the units in the Holdco Land Trust by SPIC triggered a liability for landholder duty.

Whether Holdco Land Trust was a landholder depended upon whether the valued of the landholdings of the HoldCo Land Trust, including the deemed landholdings through the linked entities, were at least $2 million. At the time, value of an estate in fee simple for calculating the value of the landholdings was the registered value of the land but, for the other interests in land, the value to be included was the unencumbered of the interest. Leaseholds are an interest in land and the value of such interests need to be included in determining if a company or unit trust is a landholder.

In coming to the conclusion that Holdco Land Trust was a landholder, the Chief Commissioner considered that the plant and equipment installed on the leasehold land were 'fixtures'. If the plant and equipment were 'fixtures', they were required to be taken into account in valuing the leasehold interests. Adopting this approach, the value of the leasehold interests were, in the view of the Commissioner, $223.6 million.

SPIC contended that the Holdco Land Trust was not a 'landholder' and, if it was, the valuation of its land holdings of $223.6 million relied upon by the Chief Commissioner in the calculation of duty was incorrect.

Alternatively, SPIC sought an exercise of the power in section 163G of the Duties Act to disregard the value of goods in determining the duty payable. Section 163 of the Duties Act provides as follows:

> *163G SIGNIFICANT HOLDINGS IN GOODS*
>
> *If the Chief Commissioner is satisfied that the unencumbered value of all goods in New South Wales of a landholder comprises not less than 90% of the total unencumbered value of all land holdings and goods in New South Wales of a landholder, the Chief Commissioner may disregard the value of the goods in determining the duty chargeable under this Chapter.*

The Chief Commissioner and SPIC each obtained expert reports regarding the valuation of the plant and equipment assets and the value of the relevant interests in land. The valuation evidence depended upon whether the plant and equipment were fixtures. If the plant and equipment were not fixtures, the value of the land was nil. If the plant and equipment were fixtures, then the land of the leasehold interests was between $103 million and $201 million, depending on the discount rate applied in determining the benefit of the rent discount of the life of the lease. One valuer considered that a 20% discount rate was appropriate as he considered that the valuation methodology should reflect that the assets would not be sold as a going concern. The other valuer considered that an appropriate discount rate would be between 6.5% to 9.5%.

During the proceedings, the Chief Commissioner argued that landholder duty is payable on the basis that a tenant who has installed fixtures on leased premises has two relevant 'land holdings' as follows:

1. a legal interest, comprising the leasehold interest in the land; and
2. a separate equitable interest in the land arising from the tenant's right to sever and remove fixtures installed by it on the premises, exercisable during or at the end of the lease.

Issues

The Supreme Court considered the following five issues:

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1. What, if any, of the plant and equipment installed on the leased land was a 'fixture'?
2. To the extent that any plant and equipment installed on the leased land was a fixture, what (if any) interest in land did this give rise on the part of the Holdco Land Trust (through its linked entities)?
3. Was the Holdco Land Trust a 'landholder' under the Duties Act?
4. How are any interests in land on account of fixtures to be valued?
5. Is the power under section 163G of the Duties Act available and, if so, should it be exercised?

Decision

Question 1: Was the plant and equipment which was installed on the land a fixture?

The Court referred to various authorities regarding the law of tenant's fixtures. The most recent decision of the NSW Court of Appeal dealing with this issue was *Power Rental Op Co Australia, LLC v Forge Group Power Pty Ltd (in liq)* [2017] NSWCA 8 where Ward JA, with whom Bathurst CJ and Beazley P agreed, emphasised that whether an item has become a fixture depends upon the objective intention of putting the item in place, having regard to the degree of annexation and the object of that annexation.

In relation to the degree of annexation, the Court concluded that the turbines, the switchroom building, components of the switchyard, emergency generator, control building and masts were 'very strongly affixed to the land' based on:

1. their concrete foundations (consisting of 300-400 cubic metres and 35-50 tonnes of steel reinforcement);
2. the tower sections with the concrete foundations, each custom built and 80 metres high accessible by a ladder and lift inside the tower;
3. the foundations for the switchyard and Control Building were concrete;
4. there was widespread fastening of the items to the concrete by bolts, bracing and fasteners;
5. removal of the concrete foundations and cabling by digging and excavation will cause damage to the land;
6. whilst there was capacity to remove the turbines without destroying them, there was no evidence before the Court that any items will be removed until decommissioning of the Wind Farm or the end of their working life; and
7. the plant and equipment was part of an integrated electricity generation facility the subject of a long term supply agreement which pointed to the unlikelihood of early removal.

In relation to the purpose of annexation, the Court found that every item was fixed in place on the land for the objective purpose of better enjoyment of the land as an integrated wind farm operated. The Court had regard to the following characteristics:

1. the Wind Farm was purpose-built after an extensive (18-year) wind study of the area establishing its suitability as a wind farm;
2. the design working life of the wind turbines was between 20 and 25 years, the Court found that the items were fixes with the intention they remain in that position for a substantial period until the Wind Farm was decommissioned or the end of the useful life of the equipment;
3. the fact that the leases contemplate that the plant and equipment will be affixed to the leased land and removed at the conclusion of the lease was consistent with the Court's conclusion that the objective intention of the affixation was that the items would only be removed when the relevant plant and equipment had exhausted its useful life;
4. the 51 WTGs and their concrete foundations need to be considered as a whole. They were connected by underground electrical cabling, specifically placed on the land to capture the wind;
5. the different components of the Wind Farm and the 28 kilometres of underground cabling were essential and interconnected parts for use of the land as a wind farm and essential for the purpose of generating and selling electricity.

The Court concluded that the WTGs and masts, together with the infrastructure affixed to the land necessary to generate and send electricity and the roads and tracks on the land, were fixtures at the time of the Agreement. However, the development costs, construction-related costs, furniture and fittings, spare parts, and parts of the control system not affixed to the land were not fixtures.

Question 2: What interest in land did Holdco Land Trust hold?

Having found that the plant and equipment were fixtures, the next question the Court considered was whether the right of a tenant to remove tenant's fixtures gives rise to an equitable interest in land.

The Court concluded as follows:

1. a tenant's interest in unsevered leasehold improvements is a purely legal interest in land which arises from and is governed by the terms of the particular lease and rights under the common law; and
2. legal title to a tenant's fixture is in the landlord until the tenant chooses to exercise the power to sever it; and
3. the tenant's fixtures do not give rise to a separate equitable interest in land held by the tenant. This is on the basis that the tenant has exclusive possession of the land, and holds the leasehold interests legally and beneficially. The Court found no basis for equity to intervene in these circumstances.

Question 3: Was the Holdco Land Trust a landholder?

Despite the Court finding that the tenant's fixtures did not gave rise to an equitable interest in land, as they were fixtures regard was to be had to them when valuing the leasehold interests and, as such, the valuation of the leasehold interests were at least $100 million, over the $2,000,000 threshold in the Duties Act. Accordingly, Holdco Land Trust was a landholder for the purposes of the Duties Act.

Question 4: How are interests in land on account of fixtures to be valued?

The Court considered that the starting point in answering this question is to have regard to the provisions of the Duties Act. At the time of the Agreement, the definition of 'land' in the Duties Act defined land as including a stratum. Recently, the definition of land has been amended to be more expansive, and includes any estate or interest in land, and anything fixed to the land.

The Court determined that in valuing the 'landholdings' of the landholder identified by section 147, an interest in land is to be valued in the context of a hypothetical sale of a going concern where the hypothetical purchaser will also have access to and receive the benefit of other assets of the landholder which affect land value.

The Court identified that the relevant task is to ascertain the value of the Holdco Land Trust's land holdings upon the event of their sale. In valuing the Holdco Land Trust's landholding, the hypothetical willing but not anxious vendor is the tenant. The Court found that the Holdco Land Trust's landholding interest in land comprised its rights under the leases including the right to remove, during or at the end of the leases, and the plant and equipment affixed to the land as it was part of the long-term use of the site as a commercial or industrial plant operated as an integrated whole.

For this reason, the Court preferred a discount rate where the assets would be sold as a going concern. Accordingly, the Court applied a discount rate of 9.5%, the effect being that value of the Holdco Land Trust's interests in land was $201,621,227. This amount was approximately $22 million less than the Chief Commissioner's valuation amount through valuing the leasehold interests and fixtures separately.

Question 5: Is section 163G of the Duties Act enlivened?

As the plant and equipment were fixtures and not goods, the Court found that section 163G did not have any application to this case.

The Court ordered that the assessment be revoked and that the Chief Commissioner issue an assessment to SPIC on the basis of a valuation of $201,621,227 of the interests in land.

TRAP – in NSW, any dealing in shares or units, consideration needs to be given to duty. Even if there is no direct or indirect land ownership, a lease is considered to be an interest land for then tenant for duty purposes.

COMMENT – from June 2020 plant and equipment does not need to be a fixture in order for it to be treated as land under the landholder duty provisions. Any things that are 'fixed' to the land are now treated as land whether or not they are 'fixtures' at law.

Citation *SPIC Pacific Hydro Pty Ltd v Chief Commissioner of State Revenue* [2021] NSWSC 395 (Payne J, Sydney)
w http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/nsw/NSWSC/2021/395.html

1.7 Dessent – assessment recoupment

Facts

Matthew Dessent purchased a propery in Maitland, which he leased out for use as a cafe. Matthew received rent of $24,000 each year.

Matthew took out an insurance policy that covered damage to the property, interruption to business, glass and broadform liability.

In April 2015 the property was damaged by a storm and flood.

Matthew received an insurance payment of about $24,000 for lost rental income.

In November 2016 Matthew received a further payment of $250,000 pursuant to a deed with the insurer. The deed stated that the payment was for loss of rent and any other benefits under the policy of insurance. Under the deed, Matthew released the insurer from all liability past, present and future under the insurance policy

On 28 September 2018 Matthew lodged his income tax returns for the income tax years 2017 and 2018. He did not include the amount of $250,000 as income in his tax returns. Matthew claimed $62,308 for repairs to the property in the 2017 income tax year and $69,809 for repairs to the property in the 2018 income tax year.

In early 2019 the Commissioner commenced an audit of Matthew's tax affairs and, on 13 June 2019, the Commissioner issued Notices of Amended Assessment for the amounts that Matthew claimed as expenses in respect of the property for the 2017 and 2018 years. The Commissioner considered the insurance payments in both years to be an 'assessable recoupment' under section 20-20 of the ITAA 1997. Section 20-20 provides as follows:

> *(1) An amount is not an assessable recoupment to the extent that it is *ordinary income, or it is *statutory income because of a provision outside this Subdivision.*
>
> *Insurance or indemnity*
>
> *(2) An amount you have received as *recoupment of a loss or outgoing is an assessable recoupment if:*
> *(a) you received the amount by way of insurance or indemnity; and*
> *(b) you can deduct an amount for the loss or outgoing for the *current year, or you have deducted or can deduct an amount for it for an earlier income year, under any provision of this Act.*
>
> *Other recoupment*
>
> *(3) An amount you have received as * recoupment of a loss or outgoing (except by way of insurance or indemnity) is an assessable recoupment if:*
> *(a) you can deduct an amount for the loss or outgoing for the * current year; or*
> *(b) you have deducted or can deduct an amount for the loss or outgoing for an earlier income year;*

On 18 October 2019 Matthew objected to the amended assessments.

Matthew contended that the $250,000 payment made in the 2018 year was not income or rent and was not used to enable him to repair his property.

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On 13 July 2020 the Commissioner disallowed the objections.

Matthew applied to the AAT for review of the objection decision.

Issue

Whether the $250,000 received by Matthew is an assessable recoupment under s 20-20(2) of the ITAA 1997?

Decision

The AAT considered that determining whether a receipt is an assessable recoupment involves considering two points:

1. whether the amount was paid by way of insurance; and
2. whether the taxpayer can or could deduct and amount under the ITAA 1997 for a loss or outgoing for the current year or could deduct an amount for an earlier year.

Paid by way of insurance?

The AAT noted that the amount was paid by an insurer as a result of an insurance policy and, therefore, was paid by way of insurance.

The AAT considered that the payment was made under a settlement deed did not change it being a payment in relation to the policy of insurance. The payment was in respect of loss or damage that was covered by the insurance policy.

Loss deducted or deductible?

The AAT considered that it did not matter whether the payment received was actually used for the purpose of the repairs. The only question was whether it was a payment for a loss that was deductible.

The AAT noted that the repairs had been deducted by Matthew and that repairs in future years would also be deductible. For this reason, the AAT considered that the payment was for a loss that was deductible.

The AAT also noted that the policy intent of section 20-20 was to ensure that a person does not benefit twice for the same loss i.e. they should not get compensation that is tax free and a deduction for the loss.

Accordingly, the AAT considered that the amount was an assessable recoupment.

COMMENT – if the amount was not income, the CGT provisions would need to be considered. Note however that the ATO in TR 95/35 on compensation receipts, in some situations consider that compensation receipts can reduce cost base rather than causing capital gains. As well, if there is a capital gain, a rollover may be available where the relevant CGT event was loss or destruction of an asset.

Citation *Dessent and Commissioner of Taxation* [2021] AATA 1206 (Member Reitano, Sydney)
w http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/AATA/2021/1206.html

2 Budget 2021 – 2022

On 11 May 2021 the 2021 – 2022 Budget was released. There are a number of tax and superannuation measures in the budget, most of which require legislative change to be implemented. Some of the relevant tax and superannuation changes, and their proposed starting times, are set out below:

Measure	Relevant to	Start date
Medicare levy low-income thresholds	Individuals	1 July 2020
Removing $250 self-education rule	Individuals	1 July following Royal Assent
Remove work test for persons aged 67 – 74 for superannuation contributions	Individuals	1 July following Royal Assent (Government notes expected before 1 July 2022)
Downsizer superannuation contributions age reduced to 60	Individuals	1 July following Royal Assent (Government notes expected before 1 July 2022)
First home super saver scheme increase from $30,000 to $50,000	Individuals	1 July following Royal Assent (Government notes expected before 1 July 2022)
Individual residency rule changes	Individuals	1 July following Royal Assent
Self-assess useful life for intangibles otherwise depreciable	Individuals and businesses	1 July 2023 for assets acquired on or after that date
Superannuation guarantee remove $450 rule	Employers	1 July following Royal Assent (Government notes expected before 1 July 2022)
Removing cessation of employment as taxing point for ESS interests	Employees/employers	1 July following Royal Assent
AAT having ability to pause ATO debt recovery	Small business	On or after Royal Assent
Instant asset write off extended to 30 June 2023	SBEs, businesses with aggregated turnover up to $5 billion	Budget night
Loss carry back extended from 2022 to 2023	Companies	Budget night
New digital games tax offset	Digital game producers	1 July 2022
SMSF residency changes to 5 years and remove active member test	SMSFs	1 July following Royal Assent (Government notes expected before 1 July 2022)
Introduce a patent box concept	Medical and bio-technology businesses	1 July 2022

Broaden corporate residency changes to CLPs and trusts	CLPs and trusts	Unclear
Early engagement service for overseas businesses	Overseas businesses	1 July 2021

COMMENT – it is noteworthy that the proposed increase in superannuation guarantee charge on 1 July 2021 from 9.5% to 10% was not delayed in the budget.

2.1 Budget measures

2.1.1 Medicare levy

As is common in Federal Budgets, the changes to the medicare levy thresholds will be retrospectively increased from 1 July 2020 so that they are increased for singles from $22,801 to $23,226. The family threshold will be increased from $38,474 to $39,167. For single seniors and pensioners, the threshold will be increased from $36,056 to $36,705. The family threshold for seniors and pensioners will be increased from $50,191 to $51,094. For each dependent child or student, the family income thresholds increase by a further $3,597 instead of the previous amount of $3,533.

2.1.2 Low and middle income tax offset

Government will retain the low and middle income tax offset (LMITO) for the 2021-22 income year.

The LMITO provides a reduction in tax of up to $1,080:

- Taxpayers with a taxable income of $37,000 or less benefit by up to $255 in reduced tax.
- Between taxable incomes of $37,000 and $48,000, the value of the offset increases at a rate of 7.5 cents per dollar to the maximum offset of $1,080.
- Taxpayers with taxable incomes between $48,000 and $90,000 are eligible for the maximum offset of $1,080.
- For taxable incomes of $90,000 to $126,000, the offset phases out at a rate of 3 cents per dollar.

2.1.3 $250 self-education amount

Government intends to reduce the $250 threshold that must be exceeded for certain self-education expenses to be claimed from 1 July following Royal Assent to legislation to effect the change.

COMMENT – given that costs that are not deductible under section 8-1 (such as depreciation) or non-deductible are considered to 'use up' this cap amount, this threshold does not often apply in practice. Refer particularly to paragraph 142 – 144 of TR 98/9.

2.1.4 Residency tests for individuals

Government will replace the individual tax residency rules. The primary test will be a simple 'bright line' test – a person who is physically present in Australia for 183 days or more in any income year will be an Australian tax resident. Individuals who do not meet the primary test will be subject to secondary tests that depend on a combination of physical presence and measurable, objective criteria. The new framework will be based on recommendations by the Board of Taxation. The measure will have effect from 1 July after the date of Royal Assent of the enabling legislation.

2.1.5 Superannuation guarantee $450 rule

Currently employees earning less than $450 per month are not required to receive superannuation support from their employer to prevent their employer being subject to the superannuation guarantee charge. Government intend that from the 1 July following Royal Assent of amending legislation this threshold will be removed. Government expect that the amending legislation will pass before 1 July 2022.

The budget papers noted that this changes is estimated to impact around 300,000 individuals, 63% if whom are women.

2.1.6 Work test for persons aged 67 – 74

Currently, individuals aged 67 to 74 years can only make voluntary contributions (both concessional and non-concessional) to superannuation, or receive contributions from their spouse, if they are working at least 40 hours over a 30 day period in the relevant financial year (referred to as the work test).

Government will remove the work test for individuals aged 67 to 74 years (inclusive) for non-concessional (including under the bring forward rule) or salary sacrifice superannuation contributions, subject to existing contribution caps. Individuals aged 67 to 74 years will still have to meet the work test to make personal deductible contributions. The measure will have effect from 1 July after Royal Assent of the amending legislation, which Government expects to pass prior to 1 July 2022.

2.1.7 Downsizer contributions

Downsizer contributions allow a one-off, post-tax contribution to superannuation of up to $300,000 per person from the proceeds of selling their home subject to certain timing rules and eligibility criteria being met.

Currently the eligibility age is 65 or over. Government will reduce the age requirement from 65 to 60 years of age. The measure will have effect from 1 July after Royal Assent of the amending legislation, which Government expects to pass prior to 1 July 2022.

2.1.8 First home Super Saver Scheme

Government will increase the maximum releasable amount of voluntary concessional and non-concessional contributions under the First Home Super Saver Scheme (FHSSS) from $30,000 to $50,000.

Voluntary contributions made from 1 July 2017 up to the existing limit of $15,000 per year will count towards the total amount able to be released.

The measure will have effect from 1 July after Royal Assent of the amending legislation, which Government expects to pass prior to 1 July 2022.

Government have also proposed technical changes to the FHSS regime to be made retrospectively applicable from 1 July 2018:

- increasing the discretion of the Commissioner of Taxation to amend and revoke FHSSS applications
- allowing individuals to withdraw or amend their applications prior to them receiving a FHSSS amount, and allow those who withdraw to re-apply for FHSSS releases in the future
- allowing the Commissioner of Taxation to return any released FHSSS money to superannuation funds, provided that the money has not yet been released to the individual
- clarifying that the money returned by the Commissioner of Taxation to superannuation funds is treated as funds' non-assessable non-exempt income and does not count towards the individual's contribution caps.

2.1.9 SMSF residency rules

Government will relax residency requirements for self-managed superannuation funds (SMSFs) and small APRA-regulated funds (SAFs) by extending the central control and management test safe harbour (for temporary absences) from two to five years for SMSFs, and removing the active member test for both fund types.

The measure will have effect from 1 July after Royal Assent of the amending legislation, which Government expects to pass prior to 1 July 2022.

Government notes that these changes will bring into line the ability of large APRA-regulated funds to receive contributions for members temporarily travelling overseas.

COMMENT – the change to the temporary absence rules from 2 years to 5 years will still pose an issue for someone intending to be outside Australia during that period for more than the period of time allowed. It is not clear why the absence needs to be temporary (subjective intention) when an objective criteria (the time period) is able to be met with more certainty.

2.1.10 Taxing point for ESS interests

Government will remove cessation of employment as a taxing point for the tax-deferred Employee Share Schemes (ESS) rules. This change will apply to ESS interests issued from 1 July after the date of Royal Assent of the amending legislation.

The Budget announcements also included that Government intends to reduce red tape for ESS by:

- removing disclosure requirements, and exempting the offer from licensing, anti-hawking and advertising prohibitions for ESS, where employers do not charge or lend to the employees to whom they offer ESS; and
- where employers do charge or lend, streamlining requirements for unlisted companies making ESS offers that are valued at up to $30,000 per employee per year (currently a $5,000 cap).

These regulatory changes are intended to apply three months after Royal Assent of the amending legislation.

COMMENT – the cessation of employment taxing point can lead to unforeseen tax consequences for employees who are not aware of the taxing point, who are allowed to keep their ESS interests post termination. ESS interests forfeited on termination are not taxable.

2.1.11 Instant asset write off (temporary full expensing)

Temporary full expensing will be extended to allow eligible businesses with aggregated annual turnover or total income of less than $5 billion to deduct the full cost of eligible depreciable assets of any value, acquired from 7:30pm AEDT on 6 October 2020 and first used or installed ready for use by 30 June 2023.

The Budget papers note that from 1 July 2023, normal depreciation arrangements will apply.

2.1.12 Loss carry-back

The loss carry-back rules will be amended to allow eligible companies to carry-back tax losses from the 2022-23 income year to offset previously taxed profits as far back as the 2018-19 income year when they lodge their 2022-23 tax return.

Companies with aggregated turnover of less than $5 billion are eligible for temporary loss carry-back. The tax refund is limited by requiring that the amount carried back is not more than the earlier taxed profits and that the carry-back does not generate a franking account deficit.

The Budget papers note that companies that do not elect to carry back losses under this measure can still carry losses forward as normal.

2.1.13 Digital games tax offset

Government intends that from 2021-22 a Digital Games Tax Offset will be available to provide a 30 per cent refundable tax offset for qualifying Australian digital games expenditure ongoing from 1 July 2022, with the criteria and definition of qualifying expenditure to be determined through industry consultation. The maximum claimable amount is proposed to be $20 million each year. At present it is proposed that the game must not have gambling elements and that a minimum of $500,000 qualifying expenditure be spent on the game.

2.1.14 Self-assessing useful life of intangibles

Government will allow self-assessment of the tax effective lives of certain intangible depreciating assets that currently have statutory effectively lives, such as patents, registered designs, copyrights and in-house software. This measure will apply to assets acquired from 1 July 2023.

The Budget papers note that the option will still be available of applying the existing statutory effective life to depreciate the intangible assets.

2.1.15 Income tax exemption – Operation Paladin

Government will provide a full income tax exemption for the pay and allowances of Australian Defence Force (ADF) personnel deployed to Operation Paladin from 1 July 2020.

Operation Paladin is the Australian contribution to the United Nations Truce Supervision Organisation, with ADF personnel deployed in Israel, Jordan, Syria, Lebanon and Egypt.

2.1.16 Introducing patent box concept

Government will introduce a patent box tax regime by taxing corporate income derived from patents at a concessional effective corporate tax rate of 17 per cent, with the concession applying from income years starting on or after 1 July 2022.

The patent box concept is to apply to income derived from Australian medical and biotechnology patents. The Government also intends to consult on whether a patent box would be an effective way of supporting the clean energy sector.

Only granted patents applied for after the Budget announcement will be eligible.

Government intends to consult with industry before settling the detailed design of the patent box.

2.1.17 Broadening corporate tax residency rules

In the 2020-21 Budget Government announced it would reform the rules that determine corporate tax residency. Draft legislation to give effect to the changes has not yet been released. In the current Budget Government announced it will consult on broadening the amendment to corporate limited partnerships and trusts.

2.1.18 TOFA and hedging changes

Government will make technical amendments to the Taxation of Financial Arrangements rules which will include facilitating access to hedging rules on a portfolio hedging basis. The amendments are also intended to reduce compliance costs and correct unintended outcomes, so that taxpayers are not subject to unrealised taxation on foreign exchange gains and losses unless this is elected. These changes will take effect for relevant transactions entered into on or after 1 July 2022.

2.1.19 Corporate Collective Investment Vehicles (CCIVs)

Government will finalise the corporate collective investment vehicles (CCIV) component of the measure titled *Ten Year Enterprise Tax Plan — implementing a new suite of collective investment vehicles* announced in the 2016-17 Budget, with a revised commencement date of 1 July 2022.

A CCIV is an investment vehicle with a corporate structure that provides flow-through tax treatment.

2.1.20 Update exchange of information countries list

Government will update the list of jurisdictions that have an effective information sharing agreement with Australia. This is important as residents of listed jurisdictions are eligible to access the reduced Managed Investment Trust (MIT) withholding tax rate of 15 per cent on certain distributions, instead of the default rate of 30 per cent. The updated list will be effective from 1 January 2022.

This measure will add Armenia, Cabo Verde, Kenya, Mongolia, Montenegro and Oman to the information exchange countries list. These new jurisdictions have entered into effective information sharing agreements as assessed by the ATO as of 1 January 2021.

2.1.21 Remove 10% offshore banking unit rules

Government will remove the concessional 10 per cent effective tax rate that applies to income derived from eligible offshore banking activities. Existing Offshore Banking Units (OBUs) can continue to access the concessional 10 per cent effective tax rate until the end of their 2022-23 income year. The Government will also close the OBU regime to new entrants, effective from 26 October 2018.

As part of these changes, from 1 January 2024 Government will remove the current exemption from withholding tax that applies to interest and gold fees paid by OBUs on certain offshore borrowings.

Legislation giving effect to this measure was introduced into Parliament on 17 March 2021.

2.1.22 AAT power to pause debt recovery

Government will extend the power of the Administrative Appeals Tribunal (AAT) to allow it to pause or modify ATO debt recovery action in relation to disputed debts that are being reviewed by the Small Business Taxation Division (SBTD) of the AAT.

This measure will take effect from the date of Royal Assent of the enabling legislation.

The Budget papers note that when considering applications, the AAT will be required to consider the potential effect on the integrity of the tax system and ensure that applications are in relation to genuine disputes.

2.1.23 ATO early engagement for overseas business

The Budget papers announced that the ATO will introduce a new early engagement service to encourage and support new business investments into Australia by:

- Providing upfront confidence about how tax laws will apply;
- Offer support in relation to any or all federal tax obligations; and
- Integrate with the tax aspects of the FIRB approval process (if applicable),

The service is intended to be available from 1 July 2021.

2.1.24 Increase excise refund cap for small brewers and distillers

Government will increase the support available to brewers and distillers by aligning the excise refund scheme for alcohol manufacturers with the WET producer rebate. From 1 July 2021, under the revised scheme, eligible brewers and distillers will be able to receive a full remission (up from 60 per cent) of any excise they pay, up to a cap of $350,000 (increased from $100,000) per financial year.

2.1.25 Not-for-profit reporting

From 1 July 2023, the ATO will require income tax exempt not-for-profit entities with an active Australian Business Number to submit online annual self-review forms with the information they ordinarily use to self-assess their eligibility for the exemption. This measure is intended to ensure that only eligible NFPs are accessing income tax exemptions.

2.1.26 NZ Sporting team rules

Government will ensure New Zealand maintains its primary taxing right over members of its sporting teams and support staff in respect of Australian income tax and fringe benefits tax liabilities that arise from exceeding the 183-day test in the Australia/NZ DTA as a result of being in Australia for league competitions because of COVID-19. The measure will apply to the 2020-21 and 2021-22 income and fringe benefits tax years.

2.1.27 Early release of super for family and domestic violence victims

Government have decided not to proceed with a measure which would have allowed for the early release of superannuation benefits for victims of family and domestic violence.

2.1.28 Insolvency changes

Government announced they will continue to examine ways to improve Australia's insolvency laws, including consulting on options to:

- clarify the treatment of trusts with corporate trustees under Australia's insolvency law
- improve schemes of arrangement processes to better support businesses, including by introducing a moratorium on creditor enforcement while schemes are being negotiated.

The Government will also:

- increase the minimum threshold at which creditors can issue a statutory demand on a company from $2,000 to $4,000
- commence an independent review of the insolvent trading safe harbour.

Dates for these changes to occur were not included in the Budget papers.

3 Legislation

3.1 Progress of legislation

Title	Introduced House	Passed House	Introduced Senate	Passed Senate	Assented
Treasury Laws Amendment (Reuniting More Superannuation) Bill 2020	6/2	11/2	12/2		
Treasury Laws Amendment (More Flexible Superannuation) Bill 2020	13/5	31/8	31/8		
Treasury Laws Amendment (2020 Measures No. 4) 2020	28/10	25/3	11/5		
Treasury Laws Amendment (2021 Measures No. 1) 2021	17/2	17/3	18/3		
Treasury Laws Amendment (2021 Measures No. 2) 2021	17/3				
Treasury Laws Amendment (Your Future, Your Super) 2021	17/2				

3.2 Exposure draft – miscellaneous amendments to Treasury portfolio laws

Treasury has released an exposure draft *Treasury Laws Amendment (Measures for Consultation) Bill 2021* and *Treasury Laws Amendment (Miscellaneous and Technical Amendments) Regulations 2021*.

The purpose of the bill and regulations is to make minor and technical amendments to regulations in the Treasury portfolio, including to tax laws, corporations laws, foreign investment laws and laws relating to consumer protections.

Treasury Laws Amendment (Measures for Consultation) Bill

Loss carry-back choice

Section 160-16 is inserted into Division 160 of ITAA 1997 to clarify the mechanism through which an entity may change its loss carry-back choice. A change of a loss carry-back choice must be given to the Commissioner in the approved form within the limited amendment period (as defined in section 170 of ITAA 1936) for an assessment for an income year.

Franking account balance

Sections 205-15(1) and 219-15(2) of the *Income Tax Assessment Act 1997* are amended to ensure that a franking credit arises in circumstances where:

- a franking debit arises because the entity or company receives a tax offset refund;
- the entity or company's tax offset refund is subsequently reduced and the entity or company is liable to pay the Commonwealth the amount of the excess mentioned in section 172A(2) of the ITAA 1936; and
- the entity or company pays the amount of the excess.

The changes ensure an entity or company's franking account balance is restored to appropriately reflect the actual amount of the entity or company's tax offset refund.

Finance leases

Section 705-56(1) of ITAA 1997 modifies the operation of the consolidation tax cost setting rules when an entity that is the lessor or lessee under a lease of a depreciating asset joins a consolidated group, and the entity treats the lease as a finance lease under the accounting standards. Section 711-45(2A) of ITAA 1997 makes a corresponding modification if the entity subsequently leaves the consolidated group.

From 1 January 2019, the new Accounting Standard for Leases (AASB 16) applies to introduce a single accounting model for lessees. The new standard requires a lessee to recognise assets and liabilities for all leases

with a term of more than 12 months, unless the underlying asset is of low value. A lessee no longer classifies leased assets or liabilities as an operating lease or a finance lease.

Amendments have been made to section 705-56(1) of ITAA 1997 to expand the operation of the modified tax cost setting rule so that it is not limited to finance leases but applies to all leases where the joining entity is the lessor or lessee under a lease of a depreciating asset to which Divisions 40 applies.

Consultation on the Bill and Regulation will close on 25 May 2021.

w https://treasury.gov.au/consultation/c2021-167053

3.3 Exposure draft - exempting granny flat arrangements from CGT

The Government previously announced, in accordance with a recommendation of the Board of Taxation, its intention to introduce measures to exempt granny flat arrangements from CGT due to concerns that the incidence of CGT on such arrangements could lead to elder abuse.

Treasury has now released Exposure Draft legislation for these measures. The exposure draft legislation proposes to insert a new Division 137 into the ITAA 1997.

Requirements for exemption

The key requirements of the exemption are that a person has a 'granny flat interest in a dwelling' and the person is an individual who is 'eligible for a granny flat interest' at the relevant time (this depends upon the particular exemption sought to be claimed).

A 'granny flat interest in a dwelling' is an interest in a dwelling under an arrangement where individual has a right to occupy the dwelling for life that has been conferred by the arrangement.

An individual is 'eligible for a granny flat interest' at a particular time if:

1. the individual reached pension age at or before that time; or
2. the individual:
   (a) needs, because of a disability, assistance to carry out most day-to-day activities; and
   (b) is likely to continue to need that assistance, because of that disability, for at least 12 months after that time.

Exemptions

Entering into a granny flat arrangement

Proposed section 137-15 of the ITAA 1997 would provide that a CGT event does not happen if a granny flat interest is created in a person eligible for a granny flat interest (the start time) where the following requirements are met:

1. at the time the arrangement is entered into (the **start time**) another person
   (a) holds an ownership interest in the dwelling at the time; or
   (b) agrees, under the arrangement, to acquire an ownership interest in a dwelling that is to be the dwelling in which the first-mentioned individual is to hold the granny flat interest;
2. at the start time, both individuals are parties to the arrangement; and
3. the arrangement:
   (a) is in writing; and
   (b) indicates an intention for the parties to the arrangement to be legally bound by it; and
   (c) not of a commercial nature.

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Varying a granny flat arrangement

Proposed section 137-20 of the ITAA 1997 would provide that a CGT event will be disregarded to the extent that it relates to creating or varying a granny flat interest in a dwelling under an arrangement by varying an arrangement at a particular time (the **variation time**) where the following requirements are met:

1. at the variation time another person
   - (a) holds an ownership interest in the dwelling at the time; or
   - (b) agrees, under the arrangement, to acquire an ownership interest in a dwelling that is to be the dwelling in which the first-mentioned individual is to hold the granny flat interest;
2. at the variation time, both individuals are parties to the arrangement; and
3. the arrangement:
   - (a) is in writing; and
   - (b) indicates an intention for the parties to the arrangement to be legally bound by it; and
   - (c) not of a commercial nature.

Ending a granny flat arrangement

A CGT event does not happen to terminating a granny flat arrangement if:

1. proposed section 137-15 of the ITAA 1997 applied so that a CGT event did not happen when the arrangement was entered into; or
2. proposed section 137-120 of the ITAA 1997 applied so that a CGT event did not happen when the arrangement was varied.

Submissions have closed on the draft legislation. The legislation is expected to commence from 1 July following Royal Assent.

w https://treasury.gov.au/consultation/c2021-161601

3.4 FBT exemption for employer-provided retraining and reskilling benefits

On 2 October 2020, the Government announced that it would introduce an exemption from FBT for retraining and reskilling benefits provided by employers for redundant (or soon to be redundant) employees, for the purpose of assisting that employee to gain new employment.

Draft legislation was released on 16 April 2021.

Under the proposed laws, a benefit is exempt from FBT if all of the following conditions are satisfied:

- the benefit is provided in the tax year in respect of education or training undertaken by an employee of an employer;
- the employee is redundant, or where the employer reasonably expects the employee to be redundant, but has not yet made the employee redundant;
- the employer has complied with any obligations under the *Fair Work Act 2009* that apply in relation to the redundancy (such as any requirements to consult about the redundancy or, if the employee has been dismissed, any obligations regarding the dismissal);
- the education or training is for the primary purpose of enabling the employee to gain or produce salary or wages in respect of any employment to which the education or training relates.

The exemption will not extend to retraining acquired by way of a salary packaging arrangement, benefits to relatives of certain employers, or benefits that involve a primary course or secondary course (as defined by the GST Act).

The consultation period closed on 29 April 2021.

w https://treasury.gov.au/consultation/c2021-161627

3.5 HomeBuilder amendments

The Government has announced that it is extending the construction commencement requirement for the HomeBuilder program from 6 months to 18 months.

The extension will only apply to *existing* applicants and will provide an additional 12 months to commence construction from the date that the building contract was signed.

All applicants who signed contracts during the HomeBuilder eligibility period between 4 June 2020 and 31 March 2021 will have this extension applied to them.

w https://ministers.treasury.gov.au/ministers/josh-frydenberg-2018/media-releases/homebuilder-extended-support-more-jobs

3.6 JobMaker administrative adjustments

On 20 April 2021, the *JobMaker Hiring Credit Reporting Obligations Amendment Instrument 2021* was made.

JHCR 2021/1 contains changes to the *JobMaker Hiring Credit Reporting Obligations Instrument 2020* to enable employers using a software solution that does not support the reporting of all required information through STP, due to STP software constraints, to claim JobMaker Hiring Credit payments by providing information through an alternative mechanism on ATO Online.

w https://www.ato.gov.au/law/view/view.htm?docid=%22OPS%2FJHCR20211%2F00001%22

3.7 Draft superannuation regulations

On 17 February 2021 *Treasury Laws Amendment (Your Future, Your Super) Bill 2021* (Cth) was introduced into Federal Parliament, which provided for changes to the choice of fund requirements and the regulation of trustees of APRA regulated funds. Treasury has now also released draft regulations concerning the changes proposed to be made by the Bill.

Submissions for the consultation to be made at superannuation@treasury.gov.au. Responses can be submitted to the consultation up until 25 May 2021.

w https://treasury.gov.au/consultation/c2021-162375

3.8 Extended timeframe for applying for DIN

The director identification number (**DIN**) legislation regime commences on 22 June 2022. Under the DIN legislation persons who were not an eligible officer prior to 4 April 2021 are required during the transitional period to apply for a DIN within 28 days of becoming an eligible officer.

The ATO has released two legislative instruments which extend the application period in which new eligible officers (i.e. persons who become directors between 4 April 2021 and 31 October 2022) are required to apply for a DIN.

The extended deadline for applying for a DIN for such persons is 30 November 2022 for directors under the *Corporations Act 2001* and 30 November 2023 under the *Corporations (Aboriginal and Torres Strait Islander) Act 2006.*

After the transitional period, all individuals must have a director ID prior to their appointment as a director, or any later period as may be allowed under the regulations or by the Registrar.

w https://www.ato.gov.au/law/view/view.htm?docid=%22OPS%2FABRS20213%2F00001%22
w https://www.ato.gov.au/law/view/view.htm?docid=%22OPS%2FABRS20214%2F00001%22

3.9 Reporting on transactions in shares and units

The ATO has released draft Legislative instrument TPRE 2021/D1 which has retrospective effect from 1 July 2017.

This instrument replaces legislative instrument No. F2018L00473 *Excluded Classes of Transactions and Entities For Third Party Reports on Shares and Units Determination 2018* registered on 9 April 2018.

This instrument applies to:

1. companies whose shares are listed for quotation in the official list of an Australian financial market;
2. trustees of a unit trust; and
3. trustees of a trust (other than a unit trust) who hold shares in a company or units in a unit trust to which one or more beneficiaries of the trust are absolutely entitled, in relation to transactions in an income year for which the trustee does not give the Commissioner of Taxation an income tax return.

The instrument provides, amongst other things, that an entity to which the instrument applies is not required to provide information to the Commissioner of Taxation a trust is a unit trust and at the time of the transaction:

- the unit trust has fewer than 10 beneficiaries, and
- the total market value of the assets held by the trustee in the unit trust is less than $5 million.

COMMENT – without this exemption changes in unit holdings in small unit trusts would need to be reported to the ATO in the same way that transfers of shares in listed companies are.

w https://www.ato.gov.au/law/view/view.htm?docid=%22OPS%2FTPRE2021D1%2F00001%22

3.10 Update to the list of information exchange countries

On 1 April 2021, the *Taxation Administration Amendment (Updating the List of Exchange of Information Countries) Regulations 2021* was made to update the list of foreign countries and territories which are 'information exchange countries'.

Where a fund payment is made to a receipt from an 'information exchange country', the MIT income withholding tax rate of 15%, rather than 30% would apply to those recipients.

The Regulations commenced on 2 April 2021.

The Regulations amends section 34(2) of the *Taxation Administration Regulations 2017* by:

1. adding Dominican Republic, Ecuador, El Salvador, Hong Kong, Jamaica, Kuwait, Morocco, Republic of North Macedonia and Serbia to the list of information exchange countries to have effect from 1 July 2021;
2. removing Kenya from the list.

Taxation Administration Amendment (Updating the List of Exchange of Information Countries) Regulations 2021
w https://www.legislation.gov.au/Details/F2021L00410

4 Rulings

4.1 NSW State Taxes – making declarations under a power of attorney

Revenue NSW has released a Practice Note, effective from 1 March 2021, to clarify the position that arises when a person under a power of attorney declares that information provided in an approved form is true and correct.

The Duties Act requires that a number of exemptions and concessions require a declaration in an approved form to be completed by the taxpayer.

Under section 198D of the *Corporations Act 2001*, unless the company's constitution provides otherwise, a company may delegate its powers to directors, an employee of the company or any other person.

The exercise of the power by the delegate is effective provided it comes within the scope of the delegate's authority.

Where a person other than an actual officer employed by the entity makes a declaration on the form, the form will be accepted as being validly executed subject to evidence showing that:

1. the person is acting under a specific power of attorney for the corporation, and or
2. the person is acting for the entity as legal adviser in respect of the particular transactions, and
3. the person has express authorisation to execute the declaration required.

An attorney cannot make a declaration where a considerable amount of personal detail is required to be disclosed, which by its nature would not be available to an attorney. Making a declaration as to accuracy of the information in the form by a person under a power of attorney for an individual is not generally acceptable.

Revenue NSW Reference *CPN 008*
w https://www.revenue.nsw.gov.au/help-centre/resources-library/cpn/commissioners-practice-note-powers-of-attorney?SQ_VARIATION_978512=0

4.2 Queensland Land Tax – land used for primary production

On 20 April 2021, the Queensland Commissioner of State Revenue released Public Ruling LTA053.1.3 which clarifies the Commissioner's interpretation of section 53 of the *Land Tax Act 2010* (Qld) in relation to land used solely for the business of primary production.

Section 53 of the Land Tax Act provides an exemption for land (or part of land) that is used solely for the business of primary production, but only if the land or the part of land is used for an activity (prescribed by regulation) that is carried on for the business.

Section 2 of the *Land Tax Regulation 2021* (Qld) prescribes primary production activities, and includes (among other activities) maintaining animals for the purpose of selling the animals or their bodily produce, including their natural increase or cultivating land for the purpose of selling produce.

'Use' of the Land

The question of whether land is **used** when liability for land tax arises will be decided objectively based on the actual use of land and not on a notional or potential future or contemplated use. There must be recurring physical activity present on the land, and the use of the land must be bona fide and genuine. There must be some degree of substance and intensity attached to it.

The Commissioner accepts that in some circumstances, inactivity on land will be considered a use of the land where the maintenance of a state of inactivity is deliberate and necessary for a specific purpose. For example, if fields are left fallow as part of a crop-rotation cycle.

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Business of primary production

The Commissioner considers that the business of primary production is considered to end, and secondary production begin, when another process transforms the primary product into a derivative product.

Solely used for primary production

Section 53 requires that the land be solely used for the business of primary production. The Commissioner states that this requires the land to be used only or exclusively for a specified purpose.

Where land is used for activities that are incidental to the business of primary production, land used for the incidental activities will be exempt from land tax if the activities are directly related to and carried out to support the primary production activity and only if it is carried on for the same primary production business.

Where the land is used both for a business of primary production and for another purpose that is not otherwise incidental, and it is possible to clearly identify what part of the land is used for the other purpose, the Commissioner will apportion the taxable value of the land between use for the business of primary production and use for the other purpose. For example, if land is used as a vineyard for growing grapes and a separate part of the land contains the machinery for the pressing and fermentation of the grapes to make wine, the portion of the land attributable to the vineyard will be exempt under section 53, and land tax is payable in respect of the portion of the land which contains the winery.

Where the land is used both for a business of primary production and for another purpose that is not otherwise incidental, and it is **not** possible to clearly identify what part of the land is used for the other purpose, the exemption under section 53 will not be available.

When a business is being conducted

The Commissioner's view is that the conduct of a business involves a commercial enterprise in the nature of a going concern, consisting of activities engaged in for the purpose of profit on a continuous and repetitive basis. The Commissioner qualifies this by confirming that a business may still be conducted if the profit from the business is negligible or if a loss is made; what is necessary is the intention and purpose of the land use is to make a profit.

The organisation of activities and use of a system or systems are indicators that a business is being conducted. However, activities conducted on land of a token or trivial nature without evidence of sales or a business plan will not be considered the conduct of a business.

For start-up activities to amount to a 'business' the activities in this period must be more than the improvement of the land to bring it to a condition where it might be used for a primary production business.

Evidence

The Commissioner will determine whether land is being used solely for prescribed activities of a primary production business based on the ‘large or general impression gained’ from looking at all the relevant indicators and all the available evidence.

Evidence that the land is being used solely for prescribed activities of a primary production business may include:

1. evidence from the Australian Taxation Office that the person has received tax concessions or deductions as a primary producer;
2. financial statements for the business;
3. business plans, work journals or other evidence of the activities or intentions concerning the business;
4. stock details (e.g. movement records, purchase and sales receipts);
5. asset registers, including fixed assets;
6. maps, photos or other evidence of the specified area of land used;
7. leases, licences or other agreements with third parties; and
8. any other relevant evidence.

The relevance and weight given to the evidence will depend on the circumstances of each case. The Commissioner may look at evidence of the use of land for a reasonable period, before or after the liability date for land tax, to determine whether the land is being used solely for prescribed activities of a primary production business.

Queensland OSR Reference *LTA053.1.3*
w https://www.treasury.qld.gov.au/resource/lta053-1/

4.3 ACT Payroll Tax – relevant contract exemptions

The Commissioner for ACT Revenue released a circular relating to section 32(2)(b)(ii) of the *Payroll Tax Act 2011* following the Victoria Supreme Court decision in *Nationwide Towing & Transport Pty Ltd & Ors v Commissioner of State Revenue* [2018] VSC 262 (**Nationwide Towing**).

Section 32(2)(b)(ii) provides that the Commissioner may determine that a contract which would otherwise be a relevant contact, will be excluded from the relevant contract provisions, where the contractor is providing services to a principal, and also provides services of that same kind to the public generally.

Guidance issued by State Revenue Offices (PTA021 by Revenue NSW) suggested that in order for the Commissioner to exercise his discretion, a contractor was required to be conducting a 'genuine independent business' in providing the services to other persons.

The Victorian Supreme Court's decision in Nationwide Towing held that a genuine independent business is not necessary for the exemption to apply.

The ACT Revenue Office adopted the Victorian Supreme Court's reasoning in Nationwide Towing as follows:

1. a contract between a principal and a contractor may be a 'relevant contract' under Division 7 of the Payroll Tax Act;
2. if the contract is a relevant contract, the principal is deemed to be an employer (section 33), the contractor is deemed to be an employee (section 34) and the payments made pursuant to the contract are deemed to be wages (section 35);
3. deemed wages are taxable wages for the purposes of payroll tax;
4. if one of the exclusions in clause 32(2) applies, then the relevant contract will be excluded. One such exclusion is if the Commissioner determines that the person who performed the services under the contract ordinarily performs services of that kind to the public generally in that financial year;
5. in determining whether that exemption applies, the Commissioner will consider a number of factors, none of which are determinative on their own. These include:
   (a) whether the contractor derives income from, and provides services of the same kind to principals other than the principal claiming the exclusion (except if principals are a part of a group for payroll tax purposes);
   (b) whether the contractor enters into contracts which do not tie the contractor to the principal and do not restrict the contractor from providing the same type of services to other principals in the financial year;
   (c) whether the contractor is proactive in sourcing work i.e. whether they advertise their services;
   (d) whether the contractor performs work on separate contracts with separate principals at the same time.

The Safe Harbour

The Circular also sets out the ACT Revenue Office's position on a safe harbour that enables taxpayers to self-assess the availability of the exemption. The Commissioner will accept that the Safe Harbour will apply where:

1. a contractor provides services of the same type two or more principals (not being members of a group); and
2. the contractor provides services to the principal claiming the exclusion for an average of 10 days or less per month.

The calculation for an average of 10 days or less per month excludes months in which a contractor does not provide services to a principal. Any amount of work on a day will count as one day. For example, if a contractor provides services for one hour on a given day, that counts as one day.

ACT Revenue reference *PTA 021*
w https://www.revenue.act.gov.au/__data/assets/pdf_file/0011/1734824/PTA021.1.pdf

4.4 Permanent establishment

The ATO has updated *Taxation Ruling* TR 2002/5A3, which deals with the concept of 'permanent establishment'.

The addendum inserts a new example of when a period of 6 months or more might not constitute temporal permanence, in light of the COIVD-19 pandemic:

> *It is also conceivable that in some limited circumstances, a period of six months or more might not constitute temporal permanence, however the Commissioner considers this would be likely to occur in only the most extraordinary of circumstances. For example, the international travel restrictions and government-mandated lockdowns globally during the COVID-19 pandemic resulted in many businesses having employees present in Australia when they would ordinarily have been located outside of Australia, and many employees were typically required to continue their employment under 'working from home' arrangements. While temporal permanence remained a question of fact and degree in each case, the extraordinary circumstances of the COVID-19 pandemic presented some situations in which a forced presence in Australia for more than six months was considered temporary.*

The Addendum applies on and from 1 March 2020.

ATO Reference *TR 2002/5A3*
w https://www.ato.gov.au/law/view/document?docid=TXR/TR20025A3/NAT/ATO/00001

5 Private Binding Rulings

5.1 Franking dividends from current year profits when a company has prior year losses

Facts

Company X is listed on the Australian Stock Exchange. Company X primarily derives dividend income, including franked dividends, and gains from disposal of investments. Company X has a financial year ending 30 June, and prepares half year accounts as at 31 December, and full year accounts as at 30 June each year.

Company X has accumulated losses of $X. Company X's profit reserve policy is as follows:

- *At the meeting of Directors before each half year period end, the Directors will approve the transfer of net profits for that half year period to a profit reserve account (Profit Reserve account).*
- *Prior financial years' accumulated losses are not required to be recouped before the current financial year profits can be transferred to the Profit Reserve account.*

The constitution of Company X does not prevent the creation of a profit reserve account or the segregation of profits.

At 31 December, Company X intends to transfer any net profits to the Profit Reserve account. They may pay an interim dividend out of that Profits Reserve as at 31 December.

At 30 June, the directors will pass a resolution approving the following:

- *allocation (crediting) of the net profit for the second half of the financial year to the Profit Reserve account, which will be entirely separate from the 'Accumulated losses / retained earnings account' currently shown in the accounts*
- *audited financial accounts for the full year period, which include the balance of the Profit Reserve account at year end.*
- *notes to the audited financial accounts for the full year period will record that a meeting of the Directors resolved that the net profit for the second half of the financial year was appropriated to the Profit Reserve account.*
- *the balance of the Profit Reserve account will not be offset against the balance of the Accumulated losses / retained earnings account.*
- *dividend payments will be sourced from the Profit Reserve account for distribution to the shareholders of Company X.*

When allocating the net profit for the second half of the year, the Profit Reserve account will not be credited for the profit previously recognised in the 31 December financial statements, and will reflect a reduction which resulted from the payment of the interim dividend.

Company X will make a net profit for the 31 December period, and will credit that to the Profit Reserve account. The Profit Reserve account will not be used to offset accumulated prior losses. The balance of the Profit Reserve account will only be appropriated for distribution as a dividend. The end of year dividend will be paid entirely out of the Profit Reserve account.

Questions

Will a final dividend declared and paid out of the Profit Reserve account recognised in the full year audited accounts be unfrankable pursuant to paragraph 202-45(e) of the ITAA 1997 (as being sourced from capital) where the dividend amount does not exceed the balance of the Profit Reserve account?

Ruling

The ATO ruled 'no'.

The ATO noted that section 202-45(e) relevantly provides that where a distribution is paid out of the share capital account for the company, it will be unfrankable. Share capital account is defined under section 975-300 as:

(1) A company's share capital account is:

(a) an account that the company keeps of its share capital; or

(b) any other account (whether or not called a share capital account) that satisfies the following conditions:

(i) the account was created on or after 1 July 1998;

(ii) the first amount credited to the account was an amount of

(iii) share capital.

(2) If a company has more than one account covered by subsection (1), the accounts are taken, for the purposes of this Act, to be a single account.

The ATO considered *Commissioner of Taxation v Consolidated Media Holdings Ltd* [2012] HCA 55 which provides that an account will be a share capital account if it records transactions into which a company has entered regarding its share capital, or records the financial position of the company regarding its share capital.

The ATO noted that on the basis that the Profit Reserve account is only credited with net profit, it should not be considered to be a share capital account, as it does not fulfil the description provided by *Consolidated Media Holdings*.

A dividend paid at the end of the year out of the Profit Reserve account will be a dividend to shareholders as defined under section 6(1) of the ITAA 1936. This will be a 'distribution' for the purpose of considering the application of section 202-45.

Provided that the profits have not been appropriated for other purposes, as assumed in the facts, they will be available for distribution from the Profit Reserve account. For example, paragraph 45 of TR 2012/5 provides that if profits are applied against prior year losses of share capital or otherwise applied or appropriated, they will no longer be available for distribution by way of dividend.

The ATO noted that, as stated in TR 2012/5, a company is not prevented from paying a franked dividend out of profits recognised in the accounts merely because the company has accumulated losses in prior years.

Accordingly, the ATO concluded that a final dividend paid from the Profit Reserve account recognised in the full year audited financial accounts will not be unfrankable pursuant to 202-45(e) where the dividend amount does not exceed the balance of the Profit Reserve account.

ATO reference *PBR Authorisation No. 1051795900058*
w https://www.ato.gov.au/law/view/document?docid=EV/1051795900058

5.2 Sale proceeds from subdivision of property

Facts

A husband and wife purchased a property and lived in it as their main residence until they moved overseas. Their son then lived in the property and it was never rented out.

A number of years later, whilst still living overseas, the husband and wife decided to demolish the house and subdivide the land into two lots, and build two new houses to sell. The two properties were immediately sold after being built, and the husband and wife moved back to Australia.

Costs for the property development were financed through savings and without additional financing.

The couple had no history of property development transactions.

Questions

1. Will the profit from the sale of the two properties be assessable as ordinary income under section 6-5 of the ITAA 1997?
2. Are proceeds from the sale of the two properties assessable as statutory income under Parts 3-1 and 3-3 of ITAA 1997?

Ruling

Income or capital

Generally, profits from property sales are assessable as ordinary income under section 6-5 of the ITAA 1997, or statutory income under the CGT provisions of the ITAA 1997.

If a profit has been made as a result of a taxpayer carrying on a business of property development or as an isolated business transaction, the profit will be assessable as ordinary income. However, where profit is a mere realisation of a capital asset, it will be assessable under CGT provisions.

The extent of personal involvement of the taxpayer in the planning, organisation and management of the activities are significant factors of whether a business has been carried out.

TR 92/3 considers the following as the most important factors to consider when determining whether profits from an isolated business transaction are assessable income:

1. if intention or purpose of the taxpayer was to make a profit or gain;
2. if transaction entered into and profit was made in the course of carrying out a business operation or commercial transaction;
3. the nature of the entity undertaking the operation;
4. the nature and scale of other activities undertaken by the taxpayer;
5. the amount of money involved;
6. the nature, scale and complexity of the operation;
7. the nature of any connection between the relevant taxpayer and any other party to the operation or transaction;
8. whether the transaction involves the acquisition and disposal of property; and
9. the timing of the transaction.

Generally, a transaction or operation has the character of a business operation or commercial transaction if the transaction would constitute the carrying on of a business except that it does not occur as part of recurring transactions.

The fact that the couple were residing overseas when the decision to subdivide the property was made, and that they did not return until the new properties were sold, indicated to the ATO that they had very little personal involvement in the organisation and management of the activities. They did not have a history of undertaking similar activities, and therefore this was an isolated transaction.

The decision to knock down the property and subdivide to the ATO showed a distinct intention to make a profit or gain from these transactions, of a commercial nature. Should the activities be repeated, in the ATO view they would have constituted a carrying on of a business, which indicated that the activities had a commercial nature.

Therefore, the Commissioner viewed that the activities of demolition, subdivision and construction of two properties were more than a mere realisation of an investment and had the character of a business operation. Any profit arising from the sale will be assessable as ordinary income under section 6-5 of the ITAA 1997.

Capital gains tax

The subdivision of the land is not a CGT event. Each of the new assets are viewed as having been acquired at the same time as the original asset was acquired.

Whilst CGT event A1 will occur on disposal of the subdivided blocks, the disposal of each lot will be viewed as an isolated transaction. Any profit from the sale will be assessable as ordinary income. Any capital gain arising from each CGT event will be reduced to the extent of any profit is also assessable under section 6-5 of the ITAA 1997.

ATO reference *PBR Authorisation No. 1051804621099*
w https://www.ato.gov.au/law/view/document?docid=EV/1051804621099

5.3 No GST on sale of duplex

Facts

Two taxpayers (individual A and individual B) are employed full-time in a professional services business conducted by a related trust entity that is registered for GST. The trust owns business premises.

The taxpayers do not otherwise operate an enterprise as a partnership and are not registered for GST.

The taxpayers acquired a property and held it for many years. It was rented out the whole time.

The taxpayers then decided develop the property.

The house was demolished, land subdivided into 2 lots and a duplex was constructed.

It was initially intended that the taxpayers would use one duplex as their main residence and the other one for their parents/parents-in-law to live in.

There was significant delays with the construction due to a delay with council approval because of stormwater and driveway changes.

The taxpayers did not organise the construction themselves but engaged a person to manage the development.

The construction of the duplex was funded by the equity from refinancing a loan against the taxpayers' current main residence and their own savings. The taxpayers did not apply for a construction loan.

In completing of construction, the taxpayers encountered cashflow problems due to unexpected building and holding costs and, as they could not refinance their own home, decided to sell Duplex 1 and to lease Duplex 2.

The taxpayers did not claim any tax deductions for the construction of the duplex.

The taxpayers have no history of buying and developing land for profitable re-selling.

Question

Will GST be payable on the sale of the duplex being sold?

Ruling

No.

The ATO noted that the question here was whether the activities of the taxpayers amounted to an enterprise and whether the duplex was sold in the course or furtherance of that enterprise.

The ATO noted that, amongst other things, an enterprise includes:

- an activity or series of activities done in the form of a business;
- an adventure or concern in the nature of trade;
- leasing out property on a regular or continuous basis.

The ATO noted that the taxpayers purchased the property to earn rental income and for that period the taxpayers had an enterprise and the property was a capital asset.

When the leasing ceased, the taxpayers' enterprise also ceased. The development of the property was not undertaken for trading purposes and, accordingly, the property remained a capital asset. The intention of the taxpayers only changed due to financial circumstances.

Having regard to the circumstances, the ATO considered that the property remained a capital asset and that the taxpayers did not commence to carry on an enterprise when their intention changed.

ATO reference *PBR Authorisation No: 1051814396956*
w https://www.ato.gov.au/law/view/document?docid=EV/1051814396956

5.4 CGT – share sale arrangement

Facts

An Operational Director and CEO of a company held shares in that company and was 66 years of age.

The company carried a manufacturing and distribution business and derived 99.98% of its income from carrying on of the business.

The shares were active assets.

The CEO and the other shareholders in the company sold their shares in the company to a third party buyer under a share sale agreement. The sale of shares by the CEO and other shareholders was a result of a joint sales process, where there were commercial negotiations. The parties in the transaction had independent advisors engaged.

The consideration for the shares had an earnout component that was one year in length. The relevant clause provided that:

> *If the Final EBITDA Amount is greater than the Target EBITDA Amount, the Buyer will pay to [the applicant] the difference between the Final EBITDA Amount and the Target EBITDA Amount up to but not exceeding the Earnout Amount Cap (Earnout Amount) on the later of:*
> *a. 30 November 2021; and*
> *b. 5 Business Days after the Earnout Amount is finally determined in accordance with this agreement.*

The share sale agreement also provided that the CEO was to enter into a consultancy agreement with a consultancy firm and the company. The Consultancy Agreement was to commence from the day after the Completion Date of the share sale agreement.

Under the Consultancy Agreement, the CEO would work hours 37.5 hours a week. The Consultancy Agreement provided that the applicant's work hours will be reduced once a new general manager was trained in the position. The Consultancy Agreement had a term of 12 months.

Questions

1. Is the earnout right in relation to the sale of the shares considered by the Commissioner to be on revenue account?
2. Is the earnout right in relation to the sale of the shares considered by the Commissioner to be on capital account?
3. Is the earnout right a look-through earnout right for the purposes of Subdivision 118-I of the ITAA 1997 and associated provisions?

Ruling

<u>Earnout right on revenue account?</u>

The ATO ruled that earnout right was not on revenue account.

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The ATO referred to the *TR 2007/D10 Income Tax: capital gains tax consequences of earnout arrangements provided guidance on the treatment of earnout arrangements*. While the ATO noted that TR 2007/D10 was withdrawn, the ATO considered that the commentary regarding the classification of earnout amounts as capital or revenue is still relevant.

Paragraph 10 of TR 2007/D10 provided that only in extreme circumstances where an earnout of between one to five years on the sale of a business asset might conceivably generate ordinary income citing *Chadwick v. Pearl Life Insurance* [1905] 2 KB 507.

As the earnout arrangement was one year in length, the ATO considered that the arrangement did not give rise to an extreme circumstance. Accordingly, the earnout right was not considered to be on revenue account.

<u>Earnout right on capital account?</u>

The ATO considered that the sale of shares in the company under the share sale agreement will result in a CGT event A1 happening, and ruled that the earnout amount is received in respect of the sale of the shares under the share sale agreement, and therefore would be treated as capital proceeds of that sale.

<u>Look-through earnout arrangement?</u>

The ATO noted section 118-565 provides that the earnout right will be a 'look-through earnout arrangement' where:

1. the right is a right to future financial benefits that are not reasonably ascertainable at the time the right is created;
2. the right is created under an arrangement involving the disposal of a CGT asset;
3. the disposal causes CGT event A1 to happen;
4. just before the CGT event, the CGT asset was an active asset of the entity that disposed of the asset;
5. all of the financial benefits under the right are to be provided over a period ending no later than five years after the end of the income year in which the CGT event happens;
6. the financial benefits must be contingent on the economic performance of the CGT asset or a business for which it is expected that the CGT asset be an active asset for the period to which those financial benefits relate;
7. the value of those financial benefits reasonably relates to that economic performance, and
8. the parties to the arrangement deal with each other at arm's length in making the arrangement.

The ATO ruled that the earnout right will be a look-through earnout rights for the purpose of section 118-565 as:

1. the payment under the earnout right will be based in future EBITDA of the company which cannot be reasonably ascertainable at the time that the share sale agreement is entered into: section 118-565(1)(a);
2. the right is created under an arrangement to disposal of the shares: section 118-565(1)(b);
3. the sale of shares is a CGT event A1: section 118-565(1)(c);
4. the shares is an active asset of the applicant just before the CGT event: section 118-565(1)(d);
5. all of the financial benefits that can be provided are to be provided over a period ending no later than 5 years: section 118-565(1)(e);
6. sections 118-565(1)(f) – (j) were also satisfied.

ATO reference *PBR Authorisation No. 1051812284788*
w https://www.ato.gov.au/law/view/document?docid=EV/1051812284788

5.5 Apportionment of rental income

Facts

A and B were married and purchased property together as joint tenants.

A and B separated and have been financially independent.

On separation, A and B entered into an agreement to split and transfer into each party's personal primary savings account the net rental income each month after payment is received from the property agent.

The agreement provided that B would receive XX% of the net rental income and A would receive the remaining amount of the net rental income. The percentage split of rental income between A and B was not 50/50.

The property is leased and is positively geared. After the real estate agent deducts their agent fee out of the rent received and pays for any other property costs like rates, water and repairs, the remainder of the rent is deposited into a bank account of which B is the primary account holder and A is the joint account holder. Funds are then paid into each of A and B's individual accounts in the proportions agreed.

A declares the rental income for the Property in her tax return as to her 50% ownership interest. A wishes to include the rental income she has received in her tax return, rather than the amount that accords with her ownership interest.

Question

Is only XX% of the gross rental income from the property included in A's assessable income?

Ruling

No.

The Commissioner confirmed that income or losses from a rental property must be shared according to the legal interest of the owners except in those very limited circumstances where there is sufficient evidence to establish that the equitable interest is different from the legal title. Co-owners of a property who are joint tenants of that property will hold identical legal interests in the property. That is, their interest must be the same in extent, nature and duration.

An agreement with an ex-spouse does not alter or over-ride their respective entitlements for income tax purposes. No evidence was provided to establish that the equitable interest is different from the legal title.

Therefore, 50% of the gross rental income from the Property is included in A's assessable income as it reflects A's ownership interest of the rental income (not XX%).

ATO reference *PBR Authorisation No. 1051790833930*
w https://www.ato.gov.au/law/view/document?docid=EV/1051790833930

5.6 Deceased estates - CGT for transfer of property to a testamentary trust

Facts

The deceased passed away leaving a valid will, which contained a trust deed for a Testamentary Trust (**Trust A**). The primary beneficiaries of Trust A are the deceased's children, grandchildren and their lineal descendants.

The executors of the deceased estate are Person B, Person C and Person D.

The trustees of Trust A are set out in the will to be Person B, Person C and Person D, with Person D to be the appointor of this trust.

Under the trust deed the appointor has the ability to remove and appoint or substitute any trustee of Trust A.

Trust A was established upon the death of the deceased, with a bank account opened in the trust's name.

The estate of the deceased contains real property. Pursuant to the will, the real property is to be gifted to Trust A

Prior to the transfer of property from the deceased estate to Trust A under the deceased's will, the trustees of Trust A will be replaced by a corporate trustee (Company A), with written approval and authorisation by the appointer of this trust (Person D).

Question

Will subsection 128-15(1)(b) of the ITAA 1997 apply to the transfer of the property by the executors of the estate to the corporate trustee of the testamentary trust, such that the capital gain on the transfer will be disregarded under subsection 128-15(3) of the ITAA 1997?

Ruling

The ATO ruled that subsection 128-15(1)(b) of the ITAA 1997 will apply to the transfer of property.

The ATO noted that any capital gain or loss made by the trustee of a deceased estate is disregarded under section 128-15 of the ITAA 1997 if an asset of the estate 'passes' to a beneficiary in accordance with section 128-20.

An asset will 'pass' to a beneficiary if the beneficiary becomes the owner of an asset under a will (see128-20(1)(a)).

In this case, the transfer of property to the corporate trustee of the testamentary trust is pursuant to the terms of the will of the deceased and is taken to have 'passed' under section 128-20 when the transfer is affected. Therefore section 128-15 applies to disregard any capital gain or loss made by the Trustee of the Estate.

ATO Reference *PBR Authorisation No. 1051814713888*
w https://www.ato.gov.au/law/view/document?docid=EV/1051814713888

6 ATO and other materials

6.1 Decision Impact Statement – Apted

Following the interim decision impact statement published by the Commissioner for the case of *Apted* in the Administrative Appeals Tribunal (covered in our February 2021 notes), the Commissioner has published a Decision Impact Statement concerning the Full Federal Court appeal decision of *Commissioner of Taxation v Apted* [2021] FCAFC 45.

The Commissioner considers that the Full Federal Court's decision confirms that the requirement to hold an ABN on 12 March 2020 for JobKeeper purposes is a 'point in time' test, and the test will not be satisfied where an ABN is reactivated or applied for after 12 March 2020, but is given a retrospective date of effect on a date that is on or before 12 March 2020.

The Commissioner accepts that the Commissioner's exercise of the discretion is a reviewable decision under Part IVC of the TAA, and further accepts that Commissioner's exercise of the decision is not restricted to the limited circumstances set out in the extrinsic material to the CERP Act and the CERP Rules.

The Commissioner considers the approach to the exercise of the discretion is informed by the role of the 'integrity rule' contained in the subsection.

The Commissioner considers that the requirements that an entity be carrying on a business on 1 March 2020, the holding of an ABN as at 12 March 2020, and the reporting of income or supplies prior to 12 March 2020 are concerned with the transparency of a business being carried on, and support the inference that JobKeeper payments to business participants are in the ordinary case to be directed to businesses that are operating actively and doing so in view of the Commissioner as at 12 March 2020.

The Commissioner's view is that it is not the intention that the discretion is to be exercised in every case in which there was business activity prior to 12 March 2020. If the business is operating without visibility to the Commissioner as at 12 March 2020 (deliberately or otherwise), that would weigh against the exercise of discretion unless a reasonable explanation was given by the taxpayer.

The Commissioner considers that the Full Federal Court decision and the Commissioner's view of the decision will apply equally to the identical requirements in sections 5 and 6 of the CFB Act.

The Decision Impact Statement is open for comments until 28 May 2021.

ATO Reference *Decision Impact Statement – Commissioner of Taxation v Apted*
w https://www.ato.gov.au/law/view/document?docid=LIT/ICD/QUD11of2021/00001

6.2 Update to PS LA 2020/1 following Apted

Following the Full Federal Court decision in *Apted*, the Commissioner has updated *PS LA 2020/1: Commissioner's discretion to allow further time for an entity to hold an ABN or provide notice to the Commissioner of assessable income or supplies.*

The updates clarify the circumstances where the Commissioner will or will not exercise the discretion, make amendments to existing examples, and include three new examples of where the Commissioner considers it would be reasonable and unreasonable to exercise his discretion.

The new examples are:

> ***11. Example 8 - reasonable circumstances***
>
> *Annika is a hairdresser and works part time from her home. Annika is always busy, which means she does not focus on tax affairs. She does lodge tax returns but they are usually late and she will often lodge more than one tax return at a time. She lodged her 2017-18 return in February 2020. Annika is not registered (nor required to be registered) for GST.*

In late May 2020, Annika's business has completely ceased due to COVID-19 and Annika is not earning any income. Annika attempts to enrol in JobKeeper but cannot because she does not hold an ABN. Annika phones the ATO who tell her that she needs an ABN, needs to lodge her 2018-19 tax return, and will need to seek the Commissioner's discretion.

Annika organises for her 2018-19 tax return to be lodged by mid-June 2020, which includes close to $35,000 business income. Annika also applies online for an ABN and backdates the start date to 1 July 2017. Annika then requests discretion from the Commissioner to grant further time to hold an ABN and provide notice.

Annika has consistently reported business income as a hairdresser in past returns up to 2018. The no-ABN withholding rules would not apply to Annika. Further information is requested and Annika provides photographs of pages of her booking diary from multiple months through 2019 that show clients regularly between 10am-2pm on weekdays. She also provides bank statements that show small regular payments from individuals, which align with some booking requests. Annika provides a statement that some of her payments are in cash but she records all payments in her diary and returns all income in her returns. Annika also provides screen shots of numerous messages that confirm appointments with clients and prices charged.

Although Annika has a history of lodging her tax returns late, the Commissioner is satisfied that Annika is running an active business, supported by further information and contemporaneous evidence that shows appointments and receipt of income for services during the relevant period. The Commissioner also takes into account that the 2018-19 tax return was lodged within a short period of time of being reminded of her lodgement obligations and relatively soon after 12 March 2020 and, on balance, considers it reasonable to exercise the discretion. The Commissioner also provides further time to hold an ABN as the no-ABN withholding rules do not apply to Annika's payments. Annika meets all the other JobKeeper criteria, and as a result of exercising both discretions, Annika is entitled to JobKeeper.

12. Example 9 - operating outside the tax system

In 2015, Jasmine commenced trading in comic books in an organised way that amounted to carrying on a business.

Jasmine did not obtain an ABN, did not register for GST and never included income from her trading activities in her tax returns. From 2015 through to 2020 Jasmine, took no steps to engage with the Commissioner in respect of her business.

In June 2020, Jasmine lodged her 2018-19 tax return, which disclosed a small amount of business income. In June 2020, Jasmine also applied for and received an ABN.

Jasmine asks the Commissioner for more time to meet the requirement to hold an ABN and to report income for the purposes of the JobKeeper eligible business participant rules. Jasmine does not provide the Commissioner with an explanation as to why she did not comply with her lodgment obligations previously.

The Commissioner takes into account the consistent non-reporting of any business income for an extended period, and the lack of any transparency prior to 12 March 2020 that a business was being carried on. Although the Commissioner is satisfied that Jasmine's activities amount to carrying on a business, the Commissioner does not exercise the discretions to allow an ABN to be held and income to be reported at a later time.

13. Example 10 - unreasonable circumstances

Steve started his sole trader business in August 2018, providing consulting services to various clients. Steve obtained an ABN at the same time but did not register for GST as he projected his income staying under the GST threshold, which it did with Steve deriving gross income of $65,000 in the 2018-19 income year. Steve's business continued in the 2019-20 income year and was impacted by COVID-19 closures.

At 12 March 2020, Steve had not lodged either of his 2017-18 or 2018-19 tax returns. With no lodgments or other tax system information that gave the Commissioner any visibility of Steve's business in the tax system, the Commissioner does not know if Steve was running an active business.

Steve approaches his tax agent in late March 2021 to lodge his outstanding tax returns, which includes his now very late 2018-19 tax return. His tax agent tells Steve that he could have accessed JobKeeper payments as an eligible business participant. On 31 March 2021, Steve seeks the Commissioner's discretion for further time to provide notice, and provides supporting evidence of his active business, including invoices, bank statements showing receipt of payments, contracts for services and receipts for ad hoc office hire.

The Commissioner does not dispute that Steve was carrying on an active business in relevant periods for JobKeeper payment. However, given the very late lodgment of his 2018-19 tax return (thereby meaning the Commissioner had no visibility of Steve's business prior to March 2021) and taking into consideration that the JobKeeper scheme ended on 28 March 2021, it is not reasonable for the Commissioner to exercise the discretion. Steve is not entitled to JobKeeper payment.

Steve would have also required the exercise of a separate discretion to enrol late in JobKeeper, having missed all enrolment cut-off dates under the JobKeeper scheme. That discretion is separate and distinct from the time discretion to hold an ABN or provide notice; however it is unlikely Steve would have been granted discretion to enrol late either.

The date of effect of the guidance is 1 May 2020.

ATO Reference *PS LA 2020/1* w https://www.ato.gov.au/law/view/document?docid=PSR/PS20201/NAT/ATO/00001&PiT=20210429000001#fp7A

6.3 Decision impact statement – Slatter

The Commissioner has published a decision impact statement concerning the case of *Slatter Building Group Pty Ltd and Commissioner of Taxation (Taxation) [2021] AATA 456* (**Slatter**).

The Commissioner considers that the decision in Slatter is consistent with the Commissioner's views of the way that the Cashflow Boost rules are to be interpreted.

The Commissioner confirms in the Decision Impact Statement that:

1. entities that came into existence, or commenced business, after 31 December 2019 and report GST on a quarterly basis do not have a tax period that applied to them that ended before 12 March 2020 so that they will not be eligible for Cashlow Boost; and
2. entities that came into existence or commenced business on or after 1 July 2019 and elected to report goods and services tax annually will not have a tax period that applies to them that ended before 12 March 2020 so that they will also not be eligible for Cashflow Boost.

The Commissioner also considers that the same principles apply to eligibility criteria under the JobKeeper measures, and entities falling into the above circumstances will not be entitled to JobKeeper payments in relation to an eligible business participants.

ATO reference *Decision Impact Statement - Slatter Building Group Pty Ltd and Commissioner of Taxation* w https://www.ato.gov.au/law/view/view.htm?docid=%22LIT%2FICD%2F2020%2F6013%2F00001%22

6.4 ATO and disaster relief

On 6 May 2021, the ATO confirmed that support is available for:

1. those affected by the New South Wales and South-East Queensland flooding in March 2021; and
2. taxpayers across Western Australia who continue to be affected by the impact of the bushfires and Cyclone Seroja.

The ATO encourages people affected by this disaster to contact the ATO if they are struggling to meet their tax and super obligations. The ATO may:

1. give taxpayers extra time to pay debts or lodge tax forms such as activity statements;

2. help re-construct tax records that are lost or damaged;
3. fast track refunds;
4. set up a payment plan, which may include offering interest free periods;
5. remit penalties or interest charged during the disaster period;
6. if records are damaged or destroyed, re-issue copies of income tax returns, activity statements and notice of assessments.

w https://www.ato.gov.au/Media-centre/Media-releases/ATO-here-to-help-NSW-and-QLD-communities-affected-by-March-floods/
w https://www.ato.gov.au/Media-centre/Media-releases/ATO-here-to-help-WA-communities-affected-by-bushfires-and-Cyclone-Seroja/

6.5 Transition to strengthening client verification

The ATO has released a consultation paper on its proposed guidelines for client verification in tax and superannuation practices. This paper is targeted at all tax practitioners, particularly tax and BAS agents using the ATO's online services and those practising in the superannuation space.

The guidelines will set a minimum standard to be applied across the tax profession to ensure due diligence is taken when engaging new clients, or where a practitioner suspects that an existing client may have had their identity compromised.

The paper is open for comment until 10 June 2021.

w ato.gov.au/General/Gen/Consultation-paper---Transition-to-strengthening-client-verification/

6.6 TPB guidance on proof of identity requirements for client verification

The Tax Practitioners Board has released a draft Practice Note on verifying client identities.

The Practice Note states that, whilst there are no specific 'proof of identity' requirements in the Act, there are a number of overarching provisions of the Act that a registered tax practitioner may breach if they fail to take appropriate proof of identity steps to verify the identity of a client, or a representative of a client.

The Practice Notes provides examples of cases where the TPB, Administrative Appeals Tribunal or the Federal Court found that registered tax practitioners breached the provisions of the Act by failing to undertake appropriate proof of identity measures.

TPB's minimum requirements

The TPB requires that all registered tax practitioners take appropriate proof of identity steps prior to providing tax agent services, BAS services and tax (financial) advice services, and on an ongoing basis, as appropriate. Similarly, in circumstances where an individual is representing a client in engaging the registered tax practitioner, the registered tax practitioner must take steps to ascertain and verify the individual representative's identity, and the authority for the individual representative to engage the registered tax practitioner on behalf of the client.

In determining what verification steps are appropriate, tax practitioners must at a minimum comply with the requirements contained in Table 2 and Table 3 of the Practice Note, such as copies of primary photographic identification documents and secondary identification documents (rates notices, medicare cards, etc).

For clients whose identity is well-established, it may not be practical or necessary to undertake the proof of identity steps. Registered tax practitioners should exercise their professional judgement when making an assessment about whether a client or individual representative is a well-established client, and whether or not it remains appropriate to undertake the proof of identity steps.

Comments invited

The TPB has invited comments and submissions in relation to the draft Practice Note. The comment period is open for 42 days with the closing date for submissions being 10 June 2021.

w https://www.tpb.gov.au/exposure-draft-tpb-practice-note-tpbpn-d452021-proof-identity-requirements-client-verification

6.7 ATO guidance on hybrid mismatch rules

The Commissioner has released draft *Practical Compliance Guideline* PCG 2021/D3 regarding the ATO's compliance approach to the imported hybrid mismatch rule.

Broadly, the imported hybrid mismatch rule operates to deny a deduction for a payment if the income from such a payment is set-off, directly or indirectly, against a deduction that arises under a hybrid mismatch arrangement in an offshore jurisdiction.

The draft guidance sets out what self-assessment is required from taxpayers to demonstrate compliance in assessing arrangements under the imported hybrid mismatch rule. It includes details of the information the Commissioner expects an Australian taxpayer to obtain to identify imported mismatches or prove that none exist, how such information should be documented and a colour-coded risk framework.

The draft PCG is open for submissions until 21 May 2021. It is expected that the final guidance will apply retrospectively from 1 January 2019.

ATO reference *PCG 2021/D3*
w https://www.ato.gov.au/law/view/document?DocID=DPC/PCG2021D3/NAT/ATO/00001&PiT=99991231235958

6.8 ATO access to passenger movements

The ATO has published a Gazette notice advising that it will be accessing data from the Department of Home Affairs relating to passenger movements from the year ending 30 June 2017 until the year ending 30 June 2023. The ATO estimates that the information for around 670,000 individuals will be obtained for each year.

This data will be electronically compared with other ATO information to identify taxpayers that can be provided with information to assist them comply with tax and superannuation laws.

The stated objectives of the data-matching program are to:

1. promote voluntary compliance with the tax and superannuation systems;
2. increase community confidence in the integrity of the tax and superannuation systems;
3. improve knowledge of the residency compliance risks;
4. gain insight to better develop administrative strategies;
5. identify ineligible tax and superannuation claims;
6. improve existing risk detection systems;
7. identify new or emerging non-compliance and entities controlling or exploiting those methodologies.

COMMENT – in practice the ATO appear to commonly use passenger data together with Austrac records to identify income that may be unreported by Australian tax residents.

w https://www.ato.gov.au/general/gen/data-matching-protocols/
w https://www.legislation.gov.au/Details/C2021G00256

6.9 NSW crack down on payroll tax avoidance on wage theft

On 14 April 2021, the NSW Minister for Finance and Small Business issued a Media Release which confirmed that the NSW Government is set to introduce new laws designed to crack down on companies who avoid their payroll tax obligations on instances of wage theft.

The new legislation will allow Revenue NSW to name taxpayers who have underpaid payroll tax on wages, and disclose information to the Commonwealth Fair Work Ombudsman to assist in its wage theft investigations.

The new legislation will also enable Revenue NSW to reassess payroll tax more than five years after the initial tax assessment when wages have been underpaid, and intends to strengthen the penalties for taxpayers who do the wrong thing.

The Media Release includes a table which sets out the current and proposed new penalties for some offences under the *Taxation Administration Act 1996*, and many of the new penalties are five times more than the existing penalties. For example, if a person knowingly gives false or misleading information to a tax officer, including by deliberately omitting information the penalty is increased from 100 penalty units ($11,000) to 500 penalty units ($55,000). Where the offender has previously committed this same offence, the penalty is increased to 1000 penalty units ($110,000) or imprisonment of up to 2 years.

The timing of when the new legislation will be introduced has not been specified.

w https://www.treasury.nsw.gov.au/sites/default/files/2021-04/Damien%20Tudehope%20med%20rel%20-%20Crackdown%20on%20payroll%20tax%20avoidance%20on%20wage%20theft.pdf

6.10 ATO assessment of tax governance for top 500 privately owned groups

The ATO has released guidance on how they assess tax governance as part of the Top 500 private groups tax performance program.

The ATO has developed seven principles of effective tax governance to assess the quality of tax governance across the top 500 privately owned groups. These seven areas are:

1. accountable management and oversight;
2. recognise tax risks;
3. seek advice;
4. integrity in reporting;
5. professional and productive working relationship; and
6. timely lodgements and payments;
7. ethical and responsible behaviour.

The ATO has a number of focus areas which they use to demonstrate effective tax governance. These include examining the roles and responsibilities of decision makers, ensuring clear documentation, record keeping and having systems and controls for accurate reporting. The ATO also looks at well documented communication processes for businesses to escalate tax risks, audit plans, and sign-offs to manage commercial and tax risks on businesses.

w https://www.ato.gov.au/Business/Privately-owned-and-wealthy-groups/What-you-should-know/Tax-performance-programs-for-private-groups/Top-500-private-groups-tax-performance-program/How-we-assess-tax-governance-for-Top-500-privately-owned-groups/

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