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THE TAX INSTITUTE

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

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Tax News – at a glance

by TaxCounsel Pty Ltd

April – what happened in tax?

The following points highlight important federal tax developments that occurred during April 2021. A selection of the developments is considered in more detail in the "Tax News – the details" column on page 509 (at the item number indicated).

Draft ruling: personal services income and businesses

The Commissioner has issued a draft ruling which considers the personal services income rules contained in Pt 2-42 of the *Income Tax Assessment Act 1997* and how they apply to an individual or entity (TR 2021/D2). **See item 1.**

FBT: working from home and COVID-19

The Commissioner has released a fact sheet to assist employers in understanding their FBT obligations where employees are provided with benefits to support working from home arrangements during the COVID-19 pandemic. **See item 2.**

GST: ACT development works

The Commissioner has released a final determination that considers the GST treatment of arrangements between government agencies and private developers in the context of the development of land in the Australian Capital Territory (TD 2021/1). **See item 3.**

Administrative overpayment

The Full Federal Court (McKerracher, Davies and Thawley JJ), reversing a decision of Steward J at first instance, has unanimously held that an amount of over $2m paid by the Commissioner to the taxpayer was an "administrative overpayment" for the purposes of s 8AAZN of the *Taxation Administration Act 1953* and, so, could be recovered by the Commissioner (*FCT v Auctus Resources Pty Ltd* [2021] FCAFC 39). **See item 4.**

Presumption of advancement

The Federal Court (McKerracher J) has recently upheld a contention that, in the circumstances of the case, the presumption of advancement applied to the purchase of a matrimonial home in the name of the wife (Ms Bosanac) of the taxpayer and that, therefore, the taxpayer had no interest in the home which the Commissioner could utilise for the purpose of satisfying the taxpayer's substantial tax debt (*FCT v Bosanac (No. 7)* [2021] FCA 249). **See item 5.**

JobKeeper: ABN issues

In a decision handed down on 24 March 2021, the Full Federal Court (Allsop CJ, Logan and Thawley JJ), reversing in part a decision of the AAT, has held that an applicant for a JobKeeper payment who did not in fact have an ABN on 12 March 2020 (if the ABN register were to have then been inspected) could not satisfy the requirement of having an ABN for entitlement to a JobKeeper payment (*FCT v Apted* [2021] FCAFC 45). **See item 6.**

Tax agent deregistration

In a recent decision, the AAT has upheld the decision of the Tax Practitioners Board (the TPB) to cancel the registration of a tax agent who had breached various provisions of the Code of Professional Conduct, but reduced the non-reapplication period imposed by the TPB from four to two years (*McCarthy and Tax Practitioners Board* [2021] AATA 641). **See item 7.**

President's Report

by Peter Godber, CTA

The home of leading tax knowledge

President Peter Godber writes about our vital role in empowering young practitioners with tax knowledge.

I was recently asked why I first joined The Tax Institute.

It took me back to when I started work, in my early twenties. I was lucky enough to be mentored by several fantastic senior tax professionals. They guided my career by giving me opportunities and they took a strong interest in my professional development. They understood the importance of continual learning. In those early days, tax reform was happening quickly, and everyone had the chance to skill up on new laws.

For my mentors, The Tax Institute was the "go to" place for tax knowledge and resources. We were encouraged to read the monthly journal articles and, if we were lucky enough, we might be sponsored to attend a Tax Institute event. Many events in those days were twilight events, lasting just a couple of hours, but they were topical and very valuable. I was always struck by the quality of the leading professionals who gave up their time to deliver presentations at these events. They were also very good mentors, always willing to stay around and have a chat, and even take an interest in what a youngster like me was doing there, and what I was getting out of it — there was a real camaraderie.

It wasn't too long before I found myself stepping in for one of my more senior staff members at the last minute and speaking at an event myself. I was nervous, but well researched. I learnt a lot from the experience.

Today is no different in terms of what we do as a professional organisation to encourage new young members and guide their professional development. The Tax Institute is still your go-to for tax knowledge, resources and support on your professional pathway.

It seems like these days it is more and more challenging to be a tax professional — more to know, more specialisations. Access to knowledge is the key to us all doing a better job.

As the tax profession becomes increasingly complex and more opportunities open up before you, The Tax Institute remains committed to delivering the resources, tools and knowledge you need to forge your way. In the near future, our knowledge delivery will be continually improving with the investment we are making in our content management systems and the associated revamping of our website.

We have also put much thought into how best to deliver our events for the balance of the 2021 calendar year. There are some great events to look forward to. It has been wonderful to attend face-to-face events in recent times and share the experience with our members once more. I look forward to seeing more of you over the rest of this year. We have also been able to increase access to events through technology and online streaming, so stay informed and join in whenever you can. The knowledge and insight that you will gain aren't bound by borders, and now nor are the networks you can build at our events.

Don't forget that our federal Budget report will be coming out early on 12 May. Our fantastic Tax Policy and Advocacy team will be producing and delivering something special again that night, which will lead to better, quicker understanding of relevant tax measures for our busy members.

This is all within our core vision for The Tax Institute. National Council, our Board of Directors, had a full strategy planning day with our leadership team in April. Through that process, we reaffirmed and refined our commitment to educating, supporting and connecting our members across the tax profession, and developed some exciting ideas for how to achieve those goals as our organisation grows.

On that note, our Board has also recently welcomed Leanne Connor from Victoria. As Leanne joins us, we recognise, and give special thanks to, our Board members from Victoria, Stuart Glasgow and Tim Neilson, who have completed their terms. I appreciate all of the effort and support put forth by our Board members and state councillors, both national and state, and the many volunteers across the country. That volunteer effort keeps The Tax Institute vibrant and so very relevant.

The opportunity to pass on knowledge to the next generation of tax professionals and younger members of The Tax Institute is one of our most important and enduring features. It certainly got me in 35 years ago.

Enjoy the month of May, which I know will be very, very busy for so many of our members. It has been wonderful to have you with The Tax Institute on our journey so far, and I look forward to growing with you in the future.

CEO's Report

by Giles Hurst

Make your voice heard as a member

As a member with us, your thoughts, ideas and feedback are vital to who we are.

In recent weeks, we have been readying our teams for the busy annual renewal period here at The Tax Institute. This year, I wish to kick off our renewals period with a word of heartfelt thanks. We have had an unbelievable year — in many ways, some more positive than others — and I am pleased to say that the Institute has come out the other side as a strengthened organisation, with big goals in our sights.

Our ability to progress in this way is largely thanks to you; thanks to your time, expertise, questions, backing and presence. The Institute is thriving because of dedicated professionals like you. Through your support of the Institute, you have also supported all of the other tax professionals, businesses and communities that benefitted from the work we conducted in very trying times. Your impact is bigger than you know.

In the last 12 months, your assistance and contributions have allowed us to continue our work to better serve the tax profession and everyone within it. Some of the highlights include the way we were able to:

- advocate to ensure that you and your colleagues were able to understand and secure stimulus assistance for clients, up to and including advocating on your behalf when client cases have needed review in recent months;
- enrich your day-to-day practice with materials, resources and tools to further your understanding of and simplify your work, from webinars untangling JobKeeper, to SME-focused insights in our Taxing Times webinar series and the recent Div 7A webinar — all free for members;
- shape *The Case for Change* through our landmark endeavour, The Tax Summit: Project Reform. This grassroots approach to tax reform amplified your voice, allowing us to identify the issues and possible solutions affecting practitioners at the coal face; and
- launch The Tax Institute: Higher Education and microcredentials, a venture that opens so many doors for our educational offering and means that the Institute will continue to be the preeminent tax education body as we move into the future of learning.

The future is shaping up to be just as exciting, both within the Institute, as we launch our new website and continue our leadership on tax reform, and within the wider profession, as we deal with the economic fallout of COVID-19.

So, thank you for being part of our journey so far. I hope that we will have you with us for another year, and many more after as you progress through your career.

Building Community at The Tax Institute

We are also pouring our efforts into ensuring that our community can stay connected. We want to hear your thoughts, opinions and feedback. We want you to be able to share them with your colleagues and with regulators. And we want to make sure that when you do share them, they are heard and, where necessary, addressed in an effective manner.

I know some of you still miss the member feedback in our weekly *TaxVine* newsletter. You want the chance to connect; to have a voice and be heard. Please trust that we at the Institute understand this and are working on a way that you can continue this connection through our Community platform.

I have written about our Community platform before, and I am pleased to report that it is steadily growing. In the coming months, we hope to grow it into a thriving, bustling hub where the tax profession meets. To do that, we need you.

There are many benefits to shifting your discussion and member feedback onto this new platform. In a practical sense, it facilitates conversation in a much more streamlined way — you won't have to wait for the next *TaxVine* to discuss your problems or ideas with colleagues from The Tax Institute and across our membership base. Instead, you are free to speak your mind as and when you please (within the Community guidelines, of course) and receive responses as soon as possible.

Instead of distant pen-pals, waiting on the mail delivery to arrive, you and your colleagues are in the same room, more genuinely connected than before.

Using Community as a space for your thoughts and feedback also gives the Institute greater opportunity to identify and address common concerns or challenges felt among our people. Where, before, a single topic of discussion might stretch out over weeks of *TaxVine* issues, now we will have a bird's eye view of trending topics as they arise and be able to get ahead of emerging challenges. In this way, we can raise your concerns with regulatory bodies in a constructive process which is more likely to secure a satisfactory resolution.

Our aim is never to hamstring connection and communication between our members, only to facilitate this in ever more useful ways. We are working to ensure that your individual voice can always be heard and that, when it comes time to act, you have the strength of our full community behind you.

We welcome your support and feedback as we build up our Community platform. Don't be shy about posting questions, ideas and solutions. The Tax Institute is one community, and you are at its heart. We are looking forward to hearing from you.

The membership renewal window is now open. Remember you can renew online today, or if you need assistance, please get in touch with our team.

Associate Tax Counsel's Report

by Michelle Ma, ATI

My experience at The Tax Institute

This month, get to know our resident Associate Tax Counsel, Michelle Ma, and why she loves working at The Tax Institute.

As your Associate Tax Counsel at The Tax Institute, I enjoy meeting new people and communicating with members. I am passionate about helping others advance their cause, particularly young women in their professional and personal journeys.

Reflecting on my six years as a full-time tax professional, I have been fortunate to work in a number of different organisations, including two of the Big 4 accounting firms and international law firms. It is important for my personal values to align with those of my team and organisation. When you believe in the purpose and the "why" of an organisation, it transcends the experience beyond just a "career".

Set out below are some of the aspects of The Tax Institute that resonate with me.

Dedication to technical excellence and advocacy

One of our aims is to be the leading professional body in meaningful and relevant government engagement and the one that all government agencies turn to for insight, advice and consultation on tax matters.

I love having a voice and helping others to have theirs heard too. I enjoy being involved in a range of technical matters, including working on submissions containing well-considered analysis of technical and administrative matters and practical recommendations. Thought leadership is a key part of what we do and, importantly, making sure that our submissions capture issues that are crucial to our members. Our technical committees play a primary role in this, raising key issues and concerns and engaging with the Tax Policy and Advocacy (TPA) team.

It has been wonderful to see the friendly faces of former co-workers and, across our various committees, the growing diversity of people who represent our membership base. This diversity not only ensures that we have access to a greater range of talent, but it also gives us balanced insights on technical submissions.

Staying connected

Anyone who is close to me will tell you that I am a naturally bubbly and chatty person. Conversations are how I connect and build relationships, and they are essential for my general wellbeing.

COVID-19 and remote working arrangements forced us into an uncertain environment and additional effort had to be made to find opportunities to connect. When our workplaces are physically scattered, how we work and take our internal and external stakeholders on the same journey with us becomes even more important. The pandemic has allowed all of us to grow on a human level by further developing our resilience and ability to empathise and collaborate with others.

At The Tax Institute, we are improving the ways in which we connect with our members, with the current platforms being:

- the Tax Policy email inbox — a vital and direct link to the TPA team;
- discussions on the Community forum;
- weekly updates through the *TaxVine* newsletter;
- events (virtual and face-to-face);
- the website (which is currently being transformed to make navigation easier); and
- TaxVibe, our new and popular podcast where we talk all things tax.

A supportive workplace: continuous learning and work–life balance

I love my job because people care about me as a person and about my professional growth. The Tax Institute offers a safe and supportive environment to learn and evolve. I am encouraged to take initiative, challenge myself, and take ownership of my self-development.

Most recently, I chaired the NSW Women in Tax event. Key speakers Kirsten Fish, CTA, Second Commissioner for Law Design and Practice, ATO, and Karen Payne, CTA, Inspector-General of Taxation and Taxation Ombudsman were generous in sharing their career journeys and experiences across public service and the profession. Kirsten and Karen are leading examples of how women can support other women and, more broadly, how our members can support other members.

There is a general level of understanding, respect and prioritisation for work–life balance. Even though I work a lot, my job enables me to enjoy my other passions and pursuits in life, such as being a group fitness instructor and continuing post-graduate studies. The Tax Institute is a workplace that empowers and encourages me to feel good about myself and my development.

Another great thing about the Institute? We're growing!

We are currently looking to expand our TPA team by welcoming a new Tax Consultant. If you are interested or know of anyone who would be suitable for the role, please contact us via our Tax Policy Inbox.

Tax News – the details

by TaxCounsel Pty Ltd

April – what happened in tax?

The following points highlight important federal tax developments that occurred during April 2021.

The Commissioner's perspective

1. Draft ruling: personal services income and businesses

The Commissioner has issued a draft ruling which considers the personal services income (PSI) rules contained in Pt 2-42 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) and how they apply to an individual or entity (TR 2021/D2).

The PSI rules are aimed at improving the integrity of, and equity in, the tax system by ensuring that individuals cannot reduce or defer their income tax by alienating or splitting their PSI through the use of interposed companies, partnerships or trusts, that is, the personal services entity (PSE). The PSI rules ensure that the PSI received by a PSE is attributed to the individual who performed the personal services. The rules also limit the deductions available to PSEs and to individuals who provide personal services but not through a PSE (referred to as "sole traders" in the draft ruling).

It is necessary to first establish whether the individual is an employee or independent contractor. Guidance on whether or not an individual is an employee or independent contractor is provided in TR 2005/16.

The PSI rules do not apply if an individual provides their personal services to a service acquirer as an employee. Any income derived in this capacity will be the ordinary assessable income of the individual. If the individual is not an employee of the service acquirer, the PSI rules may apply.

The PSI rules also do not apply if the PSE or sole trader conducts a personal services business (PSB). A PSE or sole trader conducts a PSB if it meets at least one of four PSB tests or if they have received a personal services business determination from the Commissioner.

The four PSB tests are:

– the results test;
– the unrelated clients test;
– the employment test; and
– the business premises test.

TR 2021/D2 points out that a PSE or sole trader that conducts a PSB may still be subject to the general anti-avoidance provisions (Pt IVA of the *Income Tax Assessment Act 1936* (Cth) (ITAA36)). Part IVA gives the Commissioner the power to cancel a "tax benefit" that has been obtained, or would, but for s 177F ITAA36, be obtained, by a taxpayer in connection with a scheme to which the Part applies. Regard must be had to the individual circumstances of each case when making a determination under s 177F to cancel a tax benefit. Part IVA may apply to the sole trader or PSE that conducts a PSB involving an income-splitting arrangement where the dominant purpose is to obtain a tax benefit resulting in the alienation or the splitting of the PSI of the sole trader or the individual undertaking the work for or on behalf of the PSE.

2. FBT: working from home and COVID-19

The Commissioner has released a fact sheet to assist employers in understanding their FBT obligations where employees are provided with benefits to support working from home (WFH) arrangements during the COVID-19 pandemic.

The fact sheet covers certain residual, property or expense payment benefits which may be exempt from FBT or have their taxable value reduced under the otherwise deductible rule.

An eligible work-related item given or loaned to an employee so that they could work from home as a result of COVID-19 will be exempt from FBT if it is:

– primarily for use in the employee's employment; and
– not a duplicate of something with a substantially identical function that has already been provided to the employee in the FBT year (unless it is a replacement).

An eligible work-related item is: a portable electronic device (for example, a laptop, tablet, smart phone or calculator, but not a desktop computer); computer software; protective clothing; a briefcase; or a tool of trade.

A small business entity (with an aggregated turnover of less than $10m or $50m from 1 April 2021) may be eligible for an exemption, so that multiple portable electronic devices can be provided to an employee, even where the items have substantially identical functions.

The term "tools of trade" refers to items that are handheld for use in mechanical operations or require manual operation to produce a defined result. They are of a specialist nature for use by an operator in a particular occupation (for example, an employee carpenter is provided with a hammer, screwdriver or chisel). It does not cover desktop computers, computer peripherals, or general office equipment.

General office equipment

The way FBT applies to general office equipment depends on how the benefit is provided to an employee. General office equipment includes desks, chairs, cabinets, stationery, computer monitors and peripherals, and other items generally available for use in an office setting.

Lending office equipment

The benefit arising from lending general office equipment to an employee during temporary WFH arrangements due to COVID-19 may be exempt from FBT. For ongoing WFH arrangements, the benefit may also be exempt in some circumstances, and where it is not exempt, the taxable value may be reduced by the otherwise deductible rule.

Temporary WFH arrangements

During periods of temporary WFH arrangements due to COVID-19, the provision of office equipment will be exempt from FBT if it is:

- property that is ordinarily located on the employer's business premises; and
- wholly or principally used directly in connection with the employer's business operations.

The concept of office equipment being "ordinarily located on the employer's business premises" is explained.

Ongoing WFH arrangements

Office equipment that is lent to an employee to support a WFH arrangement that will continue on a long-term basis is unlikely to meet the exemption referred to above. However, the benefit may be exempt if a no-private-use declaration is made that covers all office equipment loaned to employees to support their WFH arrangements where both of the following apply:

- the equipment is subject to a consistently enforced policy in relation to its use; and
- this use means that the benefits would have a taxable value of nil.

Where general office equipment is provided to employees solely to enable them to work from home, and there is a consistently enforced policy documenting this purpose, the Commissioner will accept that the requirements of this exemption are met. The employer will not be required to provide documentation that demonstrates the employment use of the office equipment. The fact that there may be some incidental use of an item outside of work hours while it is located at an employee's home does not prevent the benefit from meeting this exemption.

3. GST: ACT development works

The Commissioner has released a final determination that considers the GST treatment of arrangements between government agencies and private developers (developers) in the context of the development of land in the Australian Capital Territory (GSTD 2021/1).

More particularly, the determination considers whether "building works" carried out by developers on land they have acquired under a long-term Crown lease and "associated site works" are non-monetary consideration for the supply of that lease by a government agency.

The arrangements considered in the determination typically have the following features:

- a developer enters into what is described as a contract for sale (contract) with a government agency for the grant, at completion of the contract, of a Crown lease over land in the ACT for a monetary purchase price;
- on completion of the contract, the government agency is required to grant the Crown lease to the developer;
- the contract is usually contingent on the developer entering into a project delivery agreement or deed (PDA) with a government agency prior to, or at the same time as, entering into the contract; and
- the Crown lease and the PDA provide that the developer must complete an approved development (building works and associated site works) within a specified time period.

Under the approved development, the developer is required to complete building works on the land (for example, residential buildings) in accordance with plans and specifications that the developer prepared and previously submitted to a government agency for approval in writing, and also associated site works.

The developer does not receive a specific monetary sum from the government agency for any building works or associated site works.

The Crown lease may be terminated if the approved development is not completed within the agreed timeframe from the commencement of the Crown lease. In that event, the developer (as lessee) is entitled to compensation for the value of the improvements on the Crown lease land (for example, any building works or associated site works on the Crown lease land).

GSTD 2021/1 states that, under a building arrangement, the monetary amount that a developer pays to a government agency on completion of the contract to acquire a Crown lease over land in the ACT is consideration for the supply of the Crown lease by the government agency for the purposes of s 9-5 of the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (GSTA99).

However, the building works that a developer completes under a building arrangement (in accordance with the terms of the PDA and the Crown lease) are not consideration for the supply of the Crown lease by the government agency under s 9-5.

In relation to associated site works that the developer may also be required to undertake, if ownership of the completed associated site works is retained by the developer, they are not non-monetary consideration for the supply of the Crown lease land by the government agency. This is because the associated site works retained by the developer provide no measurable economic value to the government agency. However, completed associated site works that automatically belong to a government agency, or are transferred to a government agency or a third party nominated by the government agency, are non-monetary consideration for the supply of the Crown lease land, provided Div 81 and Div 82 GSTA99 do not apply. The operation of these Divisions is not considered in the determination.

If the PDA also imposes certain obligations on a developer, for example, the requirement to construct a certain number of dwellings that the developer will sell as affordable housing, this type of obligation is in the nature of a restriction on the development and does not involve the provision to the government agency of something which has measurable economic value. Accordingly, the building works involved in constructing the affordable housing are not non-monetary consideration for the supply of the Crown lease by the government agency.

Recent case decisions

4. Administrative overpayment

The Full Federal Court (McKerracher, Davies and Thawley JJ), reversing a decision of Steward J at first instance, has unanimously held that an amount of over $2m paid by the Commissioner to the taxpayer was an "administrative overpayment" for the purposes of s 8AAZN of the *Taxation Administration Act 1953* (Cth) (TAA53) and, so, could be recovered by the Commissioner (*FCT v Auctus Resources Pty Ltd*[1]).

In 2013, the ascertainment of the amount of a tax offset refund to which a taxpayer was entitled was not a part of the formal assessment process as it now is, even though the tax offset refund was claimed in the tax return. In its 2013 return, the taxpayer "self-assessed" a loss of $6,615,895 and an R&D tax offset refund of $2,269,336. The loss was carried forward. The tax offset refund of $2,269,336 was paid to the taxpayer. There was no dispute at trial or on appeal that, on a correct application of the law to the true facts, the taxpayer was not entitled to the tax offset or the consequent refund.

The question to be decided was whether the payment of the tax offset refund to the taxpayer was an "administrative overpayment", which was defined as "an amount that the Commissioner has paid to a person by mistake, being an amount to which the person is not entitled" (s 8AAZN(3) TAA53).

At first instance, Steward J held that the payment of the refund was not "paid … by mistake" within the meaning of s 8AAZN(3) because it was paid automatically under the self-assessment regime without the Commissioner making any assumption such that there was no "mistake which [was] the activating cause of the overpayment". Also, Steward J held that s 8AAZN was not in any event intended to apply in relation to mistaken payments of tax offset refunds even at a time when such refunds did not form part of the process of assessment; it was not ever intended to apply to an incorrect claim made in a return about a deduction, assessable income or a tax offset refund.

On appeal, Thawley J, in a judgment concurred in by the other members of the Full Court, after pointing out that neither the word "mistake" nor the phrase "paid … by mistake" in s 8AAZN(3) was defined, said that the concept of mistaken payments has a well understood meaning at general law and there was nothing about s 8AAZN, or the TAA53 more generally, which suggested that "paid … by mistake" should be taken to have some special or different meaning; indeed, the terms of s 8AAZN(3) suggested a consciousness of the general law relating to mistaken payments.

His Honour said that the tax offset refund was "paid … by mistake" within the meaning of s 8AAZN(3) at the time of the payment. It did not matter that the Commissioner did not actively make any assumption at the time of the refund or that the refund was made by automated electronic processes and did not involve a person turning their mind to whether or not payment of the refund should be made. Further, s 8AAZN(3) was introduced at the least to address errors likely to occur in the context of various automated processes used in administering the running balance account.

The actual issue decided in this case could not now arise because a taxpayer's entitlement to a tax offset refund is now a formal part of the process of assessment. The decision of the Full Court, however, is of continuing practical interest because it provides a contemporary review of the issues relating to statutory construction. Among these issues were:

- whether it was permissible to take into account the term that was defined ("administrative overpayment") for the purposes of construing the definition;
- the relevance of the heading to a provision in the construction of that provision;
- the use of an explanatory memorandum as an aid to the construction of a provision; and
- the relevance of subsequent amendments to the construction of a provision as in force before the amendments.

The taxpayer is seeking special leave to appeal to the High Court from this decision of the Full Federal Court.

5. Presumption of advancement

The Federal Court (McKerracher J) has recently upheld a contention that, in the circumstances of the case, the presumption of advancement applied to the purchase of a matrimonial home in the name of the wife (Ms Bosanac) of the taxpayer and that, therefore, the taxpayer had no interest in the home which the Commissioner could utilise for the purpose of satisfying the taxpayer's substantial tax debt (*FCT v Bosanac (No. 7)*[2]).

The basic facts were as follows. Mr and Ms Bosanac were married on 3 October 1998. They separated in 2012 or 2013, but continued to live together until about mid-2015 and did not divorce at that time. On 27 April 2006, Ms Bosanac offered to purchase the matrimonial home (the Dalkeith property) from Badenport Constructions (WA) Pty Ltd for $4,500,000, subject to her obtaining approval for a loan of $3,000,000 from Westpac. The offer to purchase was accepted on 3 May 2006. The sale contract formed by that acceptance required Ms Bosanac to pay a deposit of $250,000 within 30 days (by 2 June 2006). On 2 June 2006, $250,000 was withdrawn from a pre-existing joint loan account in the names of Mr and Ms Bosanac.

On 24 October 2006, Mr and Ms Bosanac applied for, and were granted, two new joint loans from Westpac in the amounts of $3,500,000 and $1,000,000 (a total of $4,500,000). It was apparent that the purpose (or predominant purpose) of the October 2006 loans was to purchase the Dalkeith property.

On 3 November 2006, the Dalkeith property was transferred into the name of Ms Bosanac as sole registered proprietor. On the same day, Westpac sent a letter to Mr Bosanac confirming that a joint loan account in the amount of $3,500,000 had been opened. The letter confirmed that amount plus $998,570 in "customer's contribution" were applied towards the settlement. It was to be inferred that the customer's contribution was the $1,000,000 joint loan minus some fees. Mr and Ms Bosanac moved into the Dalkeith property in late 2006.

No suggestion had been raised that the Dalkeith property was registered in the name of Ms Bosanac with a view to

Mr Bosanac avoiding meeting commitments to creditors with equity in that property.

The Commissioner argued that the "presumption" of advancement (that is, broadly, of a gift) did not arise on the present facts or was, in any event, rebutted. These closely related yet alternate contentions both relied on the fact that the Dalkeith property was the matrimonial home such that, it was contended, the proper inference was that it was intended that each spouse would hold a one-half interest in the property. It was thus submitted by the Commissioner that "the presumption of a resulting trust arose with the effect that Ms Bosanac held a one-half interest in the Dalkeith property on trust for Mr Bosanac".

McKerracher J said that the "presumption" of advancement was not precluded from arising where the transaction involves the matrimonial home, and, on the basis of longstanding authority, the presumption of advancement arose in Ms Bosanac's favour. The Commissioner had not adduced evidence sufficient to rebut the "presumption"; the evidence adduced was not capable of supporting an inference that Mr Bosanac intended to retain a beneficial interest in the Dalkeith property.

Later, his Honour said that the registration choice may have been made for many reasons but, here, the evidence as to the intent of either party was very slim indeed and the court could not impute to the parties an intention based on what would be reasonable or fair with hindsight. There was much to be said for the register to prevail; the system was, after all, one of title by registration. The estate of the registered proprietor was usually paramount.

6. JobKeeper: ABN issues

In a decision handed down on 24 March 2021, the Full Federal Court (Allsop CJ, Logan and Thawley JJ), reversing in part a decision of the AAT, has held that an applicant for a JobKeeper payment who did not in fact have an ABN on 12 March 2020 (if the ABN register were to have then been inspected) could not satisfy the requirement of having an ABN for entitlement to a JobKeeper payment (*FCT v Apted*[3]).

The Full Court, however, also held that the AAT's decision to exercise the discretion to allow the JobKeeper applicant to have an ABN at a later time was legally correct.

The requirement to have an active ABN (described as an "integrity rule") in order to be eligible for a JobKeeper payment is provided for in s 11(6) of the *Coronavirus Economic Response Package (Payments and Benefits) Rules 2020* (Cth) (the CERP Rules) which, so far as is relevant, provide:

> "*Integrity rule*
>
> (6) An entity is *not* entitled to a jobkeeper payment under this section unless the entity had an ABN on 12 March 2020 (or a later time allowed by the Commissioner) …"

The applicant previously had an ABN for a business that he carried on of providing property and real estate services. He decided to retire and did not accept new work after July 2018. On 28 August 2018, he cancelled his GST registration because he anticipated that he would make substantially less than $75,000 in turnover in the 2018-19 financial year as the business wound down. On 28 August 2018, he also advised the Registrar of the Australian Business Register (the ABR) that he had ceased his business and wished to cancel his ABN registration with effect from 4 June 2018.

The applicant's former colleagues and business associates, however, encouraged him to accept some new work, which he did. On 31 March 2020, the applicant applied online to have his ABN reinstated. He was informed that his ABN was reinstated in the ABR with a date of effect of 31 March 2020. On or about 10 June 2020, the applicant contacted the ABR Registrar to discuss the date of effect of his registration. After making representations about his business history, the Registrar confirmed that the ABR was adjusted or corrected to show his ABN registration as having a date of effect of 1 July 2019 (that is, on or about the date when the applicant had resumed trading).

On 20 April 2020, the applicant applied for a JobKeeper payment and this was rejected by the Commissioner. The applicant's objection to the Commissioner's rejection was disallowed by the Commissioner and the applicant then applied to the AAT for a review of the Commissioner's objection decision.

The AAT rejected the Commissioner's contention that the words of s 11(6) contemplated a point-in-time assessment that was not affected by subsequent entries on (or adjustments to) the ABR.

Although, having regard to this conclusion, it was not necessary to do so, the AAT also held that, if (contrary to its view) the applicant did not have an ABN on 12 March 2020, the Commissioner's exercise of the discretion as to whether to allow a later date for the purposes of s 11(6) was a decision that was reviewable by the AAT and should be exercised in the applicant's favour.

The AAT was satisfied that the applicant was not even aware of the disincentive posed by the no-ABN rules. He certainly did not make a decision to persist in business without an ABN until he became aware of the JobKeeper scheme. The AAT was satisfied that the applicant was the kind of person who was intended to benefit from the JobKeeper scheme. While his business was small and his income irregular, he still satisfied all of the eligibility criteria in s 11(1) CERP Rules. There was nothing to be achieved by denying him access to the payments in order to make a point about the desirability of obtaining an ABN.

Thawley J (in a judgment with which Allsop CJ agreed) held that the preferable construction of s 11(6) was that it required the person to have an ABN on the ABR on 12 March 2020 in the sense that, if the ABR had been inspected on 12 March 2020, it would have shown the entity as having an effective ABN; any person who did not in fact have an ABN on 12 March 2020 could ask for the "later time" discretion in s 11(6) to be exercised. In the context of a provision described as an "integrity rule", it was unlikely that the Treasurer intended that the rule could be satisfied by later altering the "date of effect" of an ABN registration in order to satisfy the condition of having an ABN on 12 March 2020. That was particularly so when account was taken of the circumstances in which the provision was introduced. It was clear enough that the CERP Rules were intended to provide a quick and easy mechanism to determine as efficiently as possible who was, and who was not, entitled to an economic stimulus payment.

This conclusion meant that two further issues arose. The first of these was whether the Commissioner's decision not to exercise the discretion in s 11(6) to allow a later time than 12 March 2020 to have an ABN formed part of the reviewable decision (the "later time" discretion). The second of these further issues was whether, if the decision not to allow a later time did form part of the reviewable decision, the AAT erred in law when exercising the discretion in the applicant's favour. As to these issues, Thawley J held as follows:

1. the "later time" discretion in s 11(6) formed part of the reviewable decision. Accordingly, the AAT had jurisdiction to exercise the discretion. Further, even if the discretion did not form part of the reviewable decision, the tribunal had jurisdiction to exercise the discretion by reason of s 43(1) of the *Administrative Appeals Tribunal Act 1975* (Cth); and
2. the Commissioner had not established that the AAT relevantly erred when exercising the discretion in s 11(6) to allow a "later time".

In relation to the second point above, Thawley J said that the applicant submitted that the tribunal's reasoning did not disclose error of the kind identified by Dixon J in *Avon Downs Pty Ltd v FCT*.[4] The reference to *Avon Downs* was not to be understood as suggesting that the "later time" discretion was one based on a state of satisfaction or the formation of an opinion conditioning the exercise of the power. Rather, it should be understood as a reference to the fact that the matters referred to by Dixon J are ones which, if shown in relation to the exercise of a statutory discretionary power, might be capable of establishing jurisdictional error. This was because it was to be presumed that the Treasurer intended the discretion to be exercised reasonably, and if the matters referred to by Dixon J in *Avon Downs* were established, it might be shown that the decision was legally unreasonable. Each of the matters which the tribunal took into account was relevant. It had not been shown that the tribunal had taken into account any irrelevant material. It did not misunderstand its task so far as the exercise of the "later time" discretion was concerned. Accordingly, no jurisdictional error has been shown.

In a separate judgment, Logan J (the other member of the Full Federal Court) reached the same conclusions as Thawley J.

7. Tax agent deregistration

In a recent decision, the AAT has upheld the decision of the Tax Practitioners Board (the TPB) to cancel the registration of a tax agent who had breached various provisions of the Code of Professional Conduct, but reduced the non-reapplication period imposed by the TPB from four to two years (*McCarthy and Tax Practitioners Board*[5]).

The breaches of the Code arose out of the agent's failure to comply with the TPB's order to get his personal tax obligations under control.

The AAT, confirming the TPB's deregistration decision, said that there had been: a failure by the agent to comply with employee SG obligations to the detriment of employees; a failure to pay significant tax debts over a four-year period; a failure to comply with payment arrangements entered into with the ATO; and a failure to comply with a TPB order. In addition, almost half of the tax debt owed related to GST which the agent had collected. It was never his money to use. The agent also considered it reasonable to make his need to pay the debt somehow conditional on being able to remain in practice as a tax agent.

The tribunal said that it considered the agent's conduct to be serious. A lack of rigour in the conduct of one's own tax affairs reflected poorly on the agent's character. Not only that, the agent kept and (clearly used) money belonging to the ATO (GST moneys). He also failed to keep his employee superannuation payments up to date. This conduct was unacceptable and warranted deregistration. Accordingly, the tribunal was not satisfied that the agent was a fit and proper person as required by s 20-5 of the *Tax Agent Services Act 2009* (Cth).

However, in the tribunal's view, a four-year prohibition on reapplication was inappropriate, given the uncontested dire family circumstances and taking into account that there was no allegation of incompetency. A four-year prohibition was also inconsistent with other tribunal decisions. In the circumstances, the tribunal considered that a two-year prohibition was more appropriate and varied the TPB's decision accordingly.

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References

1 [2021] FCAFC 39.
2 [2021] FCA 249.
3 [2021] FCAFC 45.
4 [1949] HCA 26.
5 [2021] AATA 641.

Tax Tips

by TaxCounsel Pty Ltd

CGT: first income-producing use of main residence

The CGT main residence exemption provision that applies where a main residence is first used to produce income raises a number of issues.

Background

The provisions of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) that govern the operation of the CGT exemption for a main residence are among the most common of the CGT provisions that are called into play. The provisions as they are now enacted are, however, quite complex.

This article briefly considers the special CGT main residence provision that can give a cost base uplift where a main residence is first used to produce income. This provision is s 118-192 ITAA97 and was enacted by the *Tax Law Improvement Act (No. 1) 1998* as the Tax Law Improvement Project rewrite of former s 160ZZQ(20D) of the *Income Tax Assessment Act 1936* (Cth) (ITAA36).

The explanatory memorandum to the amending Bill[1] that proposed the enactment of the former s 160ZZQ(20D) explained the rationale for the provision as follows:

> "5.24 Where a taxpayer starts using a principal residence (which is subject to a full CGT exemption) for income producing purposes, the taxpayer requires appropriate records of expenses that form part of the cost base of the dwelling so they can work out their CGT liability (if any).
>
> 5.25 Often the taxpayer would not have contemplated that the dwelling would be used for income producing purposes and would not have retained the necessary records. In particular, costs of improvements (such as extensions, pergolas and fencing) and other incidental costs (such as rates, land taxes and repairs) which also form part of the cost base may not be readily obtainable especially if the dwelling is disposed of some time after the expenses were incurred.
>
> 5.26 The amendments will remove the requirement to retain these records. Under the proposed new rules, taxpayers who first use their principal residence for income producing purposes will be required to calculate any CGT liability on the basis that they acquired the dwelling at the time it was first used for income production for a consideration equal to its market value at that time."

It is only possible in this article to consider some of the implications of the first use to produce income provision to illustrate that the provision can give rise to quite fundamental issues which, it is submitted, require legislative clarification.

What does s 118-192 say?

Section 118-192 ITAA97 provides as follows:

> "**118-192 Special rule for first use to produce income**
>
> (1) There is a special rule if:
>
> (a) you would get only a partial exemption under this Subdivision for a CGT event happening in relation to a dwelling or your ownership interest in it because the dwelling was used for the purpose of producing assessable income during your ownership period; and
>
> (aa) that use occurred for the first time after 7.30 pm, by legal time in the Australian Capital Territory, on 20 August 1996; and
>
> (b) you would have got a full exemption under this Subdivision if the CGT event had happened just before the first time (the ***income time***) it was used for that purpose during your ownership period.
>
> (2) You are taken to have acquired the dwelling or your ownership interest at the income time for its market value at that time.
>
> (3) If your ownership interest in the dwelling passed to you as a beneficiary in a deceased estate, or you owned it as the trustee of a deceased estate and the CGT event did not happen within 2 years of the deceased's death, you apply this Subdivision as if:
>
> (a) you had acquired the interest as an individual and not as a beneficiary or trustee of a deceased estate; and
>
> (b) for applying the formula in section 118-185, your *non-main residence days* were the number of days in your ownership period when the dwelling was not the main residence of an individual referred to in item 2, column 3 of the table in section 118-195.
>
> Note: There are special rules for dwellings acquired before 7.30 pm on 20 August 1996: see section 118-195 of the *Income Tax (Transitional Provisions) Act 1997*."

Putting to one side the case of a beneficiary of a deceased estate,[2] it will be seen that the broad effect of s 118-192 ITAA97 is that, where a dwelling that the taxpayer owns commences to be used for income-producing purposes in circumstances where a full CGT main residence exemption would not apply because of that use, the taxpayer is taken to have acquired the dwelling at its market value when the income-producing use commenced.

The legislative context

When considering the operation of the first use to produce income rule, it is necessary to have regard to the legislative context and, in particular, how the partial exemption rules operate.

Section 118-185

Section 118-185 ITAA97 applies where a dwelling was (or is deemed to be) the taxpayer's main residence for part only of the taxpayer's ownership period, and provides for a partial exemption on a pro rata basis having regard to non-main residence days, that is, the number of days in the taxpayer's ownership period when the dwelling was not the taxpayer's main residence.

Section 118-190

Section 118-190 ITAA97 provides for a partial main residence exemption where a dwelling is used to produce assessable income. Relevantly, the section provides:

> "(1) You get only a partial exemption for a CGT event that happens in relation to a dwelling or your ownership interest in it if:
>
> (a) apart from this section, *because the dwelling was your main residence or someone else's during a period*:
>
> (i) you would not make a capital gain or capital loss from the event; or
>
> (ii) you would make a lesser capital gain or loss than if this Subdivision had not applied; and
>
> (b) the dwelling was used for the purpose of producing assessable income during all or a part of *that period*; and
>
> (c) if you had incurred interest on money borrowed to acquire the dwelling, or your ownership interest in it, you could have deducted some or all of that interest." (emphasis added)

The important point for present purposes is the reference to "that period" in s 118-190(1)(b). The period referred to is a period during which the dwelling was the taxpayer's main residence. In other words, there must be a concurrent dual use of the dwelling: as a main residence and also for the purpose of producing assessable income.

This means that, if the dwelling is not in fact (and is not deemed to be) the taxpayer's main residence during a period, it is s 118-185 ITAA97 that will be the relevant provision that governs the allowance of a partial exemption.

Effect for s 118-192

One condition that must be satisfied for s 118-192 ITAA97 (quoted above) to apply is that the taxpayer would get only a partial main residence exemption because the dwelling was used for the purpose of producing assessable income during the taxpayer's ownership period (see s 118-192(1)(a) ITAA97).

But, as seen above, s 118-190 ITAA97 (which provides for a partial main residence exemption where there is an income-producing use) can only apply in relation to a period during which the dwelling is not only the taxpayer's main residence, but is also used for the purpose of producing assessable income.

The following simple examples illustrates this.

Example 1

Murray acquired a strata unit under a contract entered into on 15 August 2010.

He uses the unit solely as his main residence until 1 September 2014 when he commences to also use the unit for the purpose of running his consulting business. He sells the unit on 30 November 2020.

In these circumstances, the effect of s 118-192 ITAA97 is that, for the purposes of the CGT main residence exemption, Murray would be taken to have acquired the unit on 1 September 2014 at its then market value.

Murray will be entitled to a partial CGT main residence exemption under s 118-190 ITAA97 in respect of the period 1 September 2014 to 30 November 2020 based on the market value of the unit at 1 September 2014.

Example 2

Pam acquired a dwelling under a contract entered into on 8 May 1998. She uses the dwelling solely as her main residence until 26 July 2010 when she acquired a new dwelling which she commences to use as her main residence immediately after the purchase contract was completed.

Pam then put the first dwelling on the market for sale but, after three months, is still unable to secure a purchaser. She then decides to undertake significant renovations to the first dwelling and to let it out. The renovations take eight months and a tenant moves in on 26 June 2011.

Pam sells the first dwelling under a contract entered into on 12 April 2021 and does not make an absence choice in relation to the first dwelling.

In these circumstances, Pam would be only eligible for a partial CGT main residence exemption in respect of the capital gain that arises from the disposal of the first dwelling. This is because that dwelling was not (after she vacated it) used by her as her main residence (that is, the period commencing when she vacated the first dwelling would be a period of non-main residence days for the purposes of the partial exemption formula in s 118-185 ITAA97). The fact that the dwelling was used for income-producing purposes would be completely immaterial for the purposes of the partial exemption formula.[3]

It is further submitted that, even if Pam had let the first dwelling out immediately after the contract for the purchase of the second dwelling was completed, the result would, for the reasons given above, be the same, that is, the first use to produce income provision would not apply. In this regard, it should be noted that the hypothesis required by s 118-192(1)(b) ITAA97 is that a full exemption would have applied under the CGT main residence exemption rules if the CGT event happened "just before" the first time the dwelling was used for the purpose of producing assessable income during the taxpayer's ownership period. This would not be so in the example because, if Pam were to have disposed of the first dwelling immediately before 26 June 2011, she would, on the facts, only have been entitled to a partial CGT main residence exemption. As Pam does not make an absence election, a partial main residence exemption would apply if the CGT event occurred just before the dwelling was rented out.

The Commissioner's view

The Commissioner, however, takes a contrary view. The ATO document *Using your home to produce income* gives the following example:

> "**Example: Home becomes a rental property**
>
> Erin bought a house in July 2000 for $280,000. The house was her main residence until she moved into a new house on 1 August 2003. On 2 August 2003, she began renting out the old house. At that time, the market value of the old house was $450,000.

> Erin did not want to treat the old house as her main residence under the 'continuing main residence status after moving out' rule as she wanted the new house to be treated as her main residence from the date she moved into it.
>
> On 14 April 2020, Erin sold the old house for $696,000. Erin is taken to have acquired the old house for $450,000 on 2 August 2003 and calculates her taxable capital gain to be $246,000.
>
> Because Erin is taken to have acquired the old house on 2 August 2003, and held it for more than 12 months, she can use the discount method to calculate her capital gain. As Erin has no capital losses she includes a capital gain of $123,000 ($246,000 × 50%) on her 2020 tax return."

The Commissioner's rationale appears to be what is stated in ATO ID 2003/1112 (now withdrawn). This interpretative determination states:

> "The first condition is that a partial main residence exemption is available because the dwelling was used for income-producing purposes. It has been suggested that this condition is only satisfied if there is concurrent use of the dwelling as both a main residence and for the purpose of producing assessable income, such that a partial main residence exemption is available under section 118-190 of the ITAA 1997.
>
> It could be argued that the condition is not satisfied in the present case, where the dwelling is used solely for producing assessable income after it ceases to be a main residence, such that a partial main residence exemption is available under section 118-185 of the ITAA 1997. It might be possible to conclude that the partial main residence exemption in that situation stems from the fact that the dwelling was not a main residence for the whole ownership period, whereas the condition requires the partial exemption to arise 'because' the dwelling was used for income-producing purposes.
>
> However, it is considered that the condition in paragraph 118-192(1)(a) can apply in a case such as this, where the income-producing use of the property is incompatible with the taxpayer's continued use of the dwelling as their main residence. In that case, the partial exemption can be said to arise 'because' the dwelling was used for income-producing purposes. That is, there is a direct nexus between the income-producing use and the partial exemption."

It is submitted, however, that these views are contrary to the clear words of the relevant provisions.

Discount capital gain concession

The Commissioner takes the view that, where the first income-producing use rule applies, the 12-month eligibility period for the CGT discount capital gain concession to apply runs from the time that the residence was first used to produce income (that is, the income time). While that may well be what was intended, the position is a little unclear.

What s 118-192(2) ITAA97 provides is that the taxpayer is taken to have acquired the dwelling at the "income time". This raises a question of whether this deeming is confined to the main residence exemption provisions or whether it has a wider application for the purposes of the CGT provisions generally.

The terms of s 118-192(2) ITAA97 contrast with the terms of the former corresponding provision of the ITAA36 which provided that the deeming applied "for the purposes of this Part", that is, for the purposes of the former CGT provisions in Pt IIIA ITAA36 generally (former s 160ZZQ(20D)(f)). The explanatory memorandum to the Tax Law Improvement Bill (No. 1) 1998 made no mention of any intended change. Having regard to this and to s 1-3 ITAA97, it would seem likely that there has been no change. But it is submitted that the drafting of the former s 160ZZQ(20D)(f) was certainly better and was not improved in this regard by the drafting of s 118-192(2) ITAA97.

As indicated, the Commissioner takes the view that s 118-192 ITAA97 made no change in the law in this respect. The ATO document *Using your home to produce income* states:

> "If the 'home first used to produce income' rule applies and the period between when you first use the dwelling to produce income and the CGT event happening is less than 12 months, you can't use the CGT discount method. If you use your home to produce income from the time you acquire it, the rule doesn't affect you. If you choose to continue treating a dwelling as your main residence after you move out, and the dwelling is fully exempt, the 'home first used to produce income' rule does not apply."

Conclusion

It is suggested that the first income-producing rule in s 118-192 ITAA97 requires the attention of the legislature to ensure that what is intended of the provision (as stated in the extract from the explanatory memorandum to the Taxation Laws Amendment Bill (No. 3) 1997 which is set out at the beginning of this article) is achieved.

In the interim, it is submitted that the Commissioner could issue a binding ruling which sets out his views. That would enable taxpayers to choose the best course of action in particular circumstances, that is, by applying the Commissioner's view or applying what is suggested is the result of the application of the strict legal position.

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References

1 Taxation Laws Amendment Bill (No. 3) 1997.

2 The deceased estate issues are not considered in this article.

3 It is assumed for the purposes of the discussion that Pam does not make a choice for the absence concession to apply.

Mid Market Focus

by Guy Brandon, CTA, HLB Mann Judd

Division 83A: employee share schemes

A review of a couple of key areas of Div 83A ITAA97, if incorrectly judged, may cause an unexpected tax liability.

Introduction

There is considerable commentary regarding Div 83A of the *Income Tax Assessment Act 1997* (Cth) (ITAA97), but there are some key areas that still appear to be taken "as read".

10% limit on shareholding and voting power

There have been occasions where individuals have unwittingly fallen foul of s 83A-45(6) ITAA97 and have subsequently discovered that they are taxed upfront with no concessions available.

Legislative references

> "83A-45(6) This subsection applies to an ESS interest in a company if, immediately after you acquire the interest:
>
> (a) you do not hold a beneficial interest in more than 10% of the shares in the company; and
>
> (b) you are not in a position to cast, or to control the casting of, more than 10% of the maximum number of votes that might be cast at a general meeting of the company."

But note:

> "83A-45(7) For the purposes of subsection (6), you are taken to:
>
> (a) hold a beneficial interest in any shares in the company that you can acquire under an ESS interest that is a beneficial interest in a right to acquire a beneficial interest in such shares; and
>
> (b) be in a position to cast votes as a result of holding that interest in those shares."

And of further note:

> "83A-305(1) If an associate (other than an employee share trust) of an individual acquires an ESS interest in relation to the individual's employment (including past or prospective employment), then, for the purposes of this Division:
>
> (a) treat the interest as having being acquired by the individual (instead of the associate); and
>
> (b) treat any circumstance, right or obligation existing or not existing in relation to the interest in relation to the associate as existing or not existing in relation to the individual; and
>
> (c) treat anything done or not done by or in relation to the associate in relation to the interest as being done or not done by or in relation to the individual.
>
> …
>
> 83A-305(2) For the purposes of subsections 83A-45(6) and (7), subsection (1) of this section also applies if the associate acquired the ESS interest otherwise than in relation to the individual's employment."

Section 83A-45(6) ITAA97 is critical as it must apply, inter alia, to access the following concessional treatments afforded in Div 83A:

Reducing amounts included in assessable income: start-ups

Section 83A-33(1) ITAA97 reduces the total amount included in the individual's assessable income under s 83A-25(1) ITAA97 for an income year by the total of the amounts included in the individual's assessable income under that subsection, for the income year.

Failure to comply with s 83A-45(6) ITAA97 precludes the benefits of the start-up concessions being available. The benefits lost include:

- the upfront assessable value for the employee share scheme (ESS) interest satisfying the start-up concessions will effectively be reduced to nil;[1]
- the 50% CGT general discount acquisition date taken from the date the ESS interest was acquired (ie from the date option was acquired rather than its exercise date when dealing with shares);[2] and
- the possibility of using a safe harbour valuation method.[3]

Reducing amounts included in assessable income: other cases

Section 83A-35(1) ITAA97 reduces the total amount included in the individual's assessable income under s 83A-25(1) ITAA97 for an income year by the total of the amounts included in the individual's assessable income under that subsection, for the income year.

Failure to comply with s 83A-45(6) precludes the ability to reduce the assessable income relating to the ESS interest by the lesser of the assessable value of the ESS interest and $1,000.

Deferred inclusion of gain in assessable income

Failure to comply with s 83A-45(6) precludes the ability to access a deferred taxing point for a right (option) or a share. That many individuals rely on Subdiv 83A-C, satisfying the 10% test is critical.

Complexity in satisfying the 10% test

To determine whether an individual (critically, this includes their associates) has a greater than 10% shareholding or control at a general meeting (and therefore fails the 10% test), the following key issues must be taken into consideration:

- the calculation must be determined immediately after the interest has been received; and
- the individual either holds a beneficial interest in more than 10% of the shares or can cast, or control the casting of, more than 10% of the shares.

This means that:

- the individual must review their position effectively on a *fully diluted basis* after the ESS interest was received *and* on an *associate-inclusive basis*; and

- the individual must review who their associates are (it is noted that the meaning of "associates" in this context is broader than most individuals understand; see s 318 of the *Income Tax Assessment Act 1936* (Cth) (ITAA36)).

To highlight the complexity, see example 1 below.

Example 1

Interests owned by the individual (and associates) prior to receiving new performance rights:

Total shares on issue in the specific company prior to the issue of the new performance rights	100,000,000
Individual's shares	4,750,000
Individual's options/rights	3,000,000
Individual's associate(s) options	1,000,000
***Proposed* performance rights to individual's associate**	**1,500,000**

Given the information in the above table in example 1, the individual will *fail* the 10% test for the following reasons:

- the fully diluted position for the individual immediately after the associate acquired the new performance rights (associate included) is 10,250,000 (effectively a beneficial interest in 10,250,000 shares);
- the company's issued shares are calculated on an actual basis immediately after the performance rights are acquired (not on a fully diluted basis for the company), ie there are 100,000,000 ordinary shares on issue; and
- therefore, 10,250,000/100,000,000 is 10.25% (not 9.29% as it would have been if the fully diluted position of the company was the denominator, ie 110,250,000).

Ability to use the tables in Subdiv 83A-E of the Income Tax Assessment (1997 Act) Regulations 2021

It is noted that the *Income Tax Assessment Regulations 1997* (Cth) were repealed[4] on, and the *Income Tax Assessment (1997 Act) Regulations 2021* (Cth) (the regulations) commenced from, 1 April 2021.[5]

The three tables in example 2 highlight potential material differences between the values calculated under AASB standards (specifically AASB 2 *Share-based payment*) and Div 83A ITAA97, but for taxpayers receiving options in "small cap" stocks, this differential is not unusual. There is a clear concessional approach taken by Div 83A[6] when calculating the value of the unlisted options.

Example 2.1. Unlisted options (rights)

Facts

Number of options	10,000,000
Exercise period	3 years (36 months)
Underlying share price[7]	$0.05
Exercise price[8]	$0.06
Risk-free interest rate	0.11%
Volatility	80%
Dividend yield	nil

The table in example 2.2 details the concessional treatment taken primarily in the volatility and dividend yield.

Example 2.2. Unlisted options (rights): variation in result

Facts

Number of options	10,000,000	
Exercise period	3 years (36 months)	
Underlying share price[9]	$0.05	
Exercise price[10]	$0.06	
	AASB 2[11]	**Subdiv 83A-E[12]**
Risk-free interest rate	0.11%	4.00%
Volatility	80%	12%
Dividend yield	nil	4.00%
Option valuation	$233,800	$3,600

The table in example 2.3 details the impact on the value of the options (rights) per input to the model.

Example 2.3. Unlisted options (rights): what causes the variation in result

Other inputs being equal, an increase in …	Has a corresponding impact on the option's price
Exercise period	Increase
Underlying share price	Increase
Exercise price	Decrease
Risk-free interest rate	Increase
Volatility	Increase
Dividend yield	Decrease

When reviewing the last three inputs in the table in example 2.3, Subdiv 83A-E is likely to concessionally value the options (ie using more favourable inputs than would otherwise be used in calculations, say, in AASB 2), in particular, due to the specified amounts for:

- volatility; and
- dividend yield.

Though the risk-free rate is the reverse, the impact is immaterial when compared to the difference in the volatility and dividend yield.

From the above, it is obvious that a taxpayer would want the ability to choose the concessional treatment of Div 83A.

Section 83A-315 ITAA97 requires the use of the regulations, if the regulations specify such an amount (ie the regulations stipulate the method and ultimate value). Section 83A-315.01 of the regulations allows the choice of the market value of the right (option) or the value worked out in accordance with ss 83A-315.02 to 83A-315.09.

The tables in Subdiv 83A-E of the regulations are only applicable in respect of Div 83A ITAA97. Should the value of an option be required outside of Div 83A, the market value of the right must be used.[13]

While s 83A-10 ITAA97 references "employees … in relation to the employees' employment", s 83A-325 ITAA97 effectively expands the ability of a taxpayer to access Div 83A (and the tables in Subdiv 83A-E of the regulations).

Of particular interest is item 3 of the table in s 83A-325 ITAA97, "[an individual who] … provides services to an entity (other than services covered by a previous item in [the] table and services provided as an employee)".

Paragraph 1.375 of the explanatory memorandum to the Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009 states that the rules also cover taxpayers who are "independent contractors".

"Independent contractors" are a vexed issue when it comes to tax and superannuation etc (including when operating through a company or trust structure). In this instance, who is included or excluded from item 3 of the table in s 83A-325 ITAA97 is critical for those wanting to rely on item 3, as there may be a material disadvantage of not being an "independent contractor" for the purposes of valuing unlisted options (as is shown in example 2.2 above for those unable to access Div 83A ITAA97).

From a review of the ATO fact sheet *ESS – Benefits provided to non-employees*,[14] it appears that the Commissioner is differentiating between an individual contracting in their individual name[15] where that individual comes within item 3 of the table in s 83A-325 or the individual contracting via an entity[16] which appears to fall outside it.[17]

It is interesting with the continuing push to "look through" entities where an individual is providing services. This appears to be a form over substance approach and may result in a detrimental outcome to the individual contracting through an entity.

What is the real difference between a director's entity receiving options in relation to the individual's directorial role (and possibly charging director's fees via the entity) and an individual (say, a civil engineer from the example in the ATO fact sheet) contracting through an entity? Both associated entities are receiving the options. Both individuals are being assessed, but possibly at differing values. Or is it a separate argument and that care should be taken by directors when contracting their director's services through an entity and receive options and that they may not fall within s 83A-325 ITAA97 and therefore not receive the concessions afforded in Div 83A?

Care in the use of the tables in Subdiv 83A-E of the regulations

The previous discussion related to the ability to use the tables in Subdiv 83A-E of the regulations. There are times where the terms of issue of the options have been drafted in a manner that clearly relates to minimising upfront taxation (eg where the taxpayer fails the 10% test or wishes to force the initial taxing point).

The potential problem is where the inputs to the model are otherwise than that expected. For example:

- the incorrect date of acquiring the ESS interest is used. This may result in (the following would result in a higher market value of the option):
  - a greater underlying share price; and
  - if the acquisition date is earlier than expected, a longer exercise period;[18] and
- the exercise price may be based on, say, the five-day volume weighted average price up to and including, say, the annual general meeting multiplied by a factor. This has some historical precedence from the time when the view was that the acquisition date was when shareholders agreed at the annual general meeting.[19]

Let us say that the taxpayer fails the 10% test. How do they then value their discount? In the absence of concessional treatment (eg s 83A-33 and Subdiv 83A-C), what is the point when the ESS interest discount has to be valued?[20] This is dependent on when the ESS interest is acquired (as determined pursuant to ss 83A-10, 83A-20 and 83A-30 ITAA97 — see "Legislative references" below) or whether there is an earlier taxing point caused by an earlier "right to a right" (that is, an "indeterminate right" being brought to account under s 83A-340 ITAA97).

Legislative references

"83A-10(1) An ***ESS interest***, in a company, is a beneficial interest in:

(a) a share in the company; or

(b) a right to acquire a beneficial interest in a share in the company."

"83A-20(1) This Subdivision applies to an ESS interest if you acquire the interest under an employee share scheme at a discount."[21]

"83A-30(1) For the purposes of this Act (other than this Division), the ESS interest (and the share or right of which it forms part) is taken to have been acquired for its market value (rather than for its discounted value)."

Example 3 sets out some scenarios by which options (rights) may be issued and provides the timing point for the value of those options (rights).

Example 3. Timing of valuation[22]

Time	Details	Timing of valuation of rights
T1.1 T1.2 T1.3 T1.4	– Individual enters into agreement (rights issued subject to commencing employment and shareholder approval). – Commence employment. – Shareholder approval to issue rights – Rights issued.	T1.2 When commences employment. This is the time when indeterminate right received.
T2.1 T2.2 T2.3	– Individual enters into agreement (rights issued subject to commencing employment). – Commence employment. – Rights issued.	T2.1 When enters into agreement. This is the time when indeterminate right received.
T3.1 T3.2	– Employee enters into agreement to receive rights. – Rights issued.	T3.1 When enters into agreement. No indeterminate rights.
T4.1 T4.2 T4.3	– Employee enters into agreement to receive rights (rights issued subject to shareholder approval). – Shareholder approval to issue rights. – Rights issued.	T4.1 When enters into agreement. This is the time when indeterminate right received.

cont …

Time	Details	Timing of valuation of rights
T5.1	– Shareholder approval to issue rights in the future to key employees (not being directors).	T5.2 When enters into agreement. No indeterminate rights as the approval was not specific to the employee.
T5.2	– Employee enters into agreement to receive rights.	
T5.3	– Rights issued.	

When it comes to valuing options (rights) under Div 83A, it is critical to determine:

– the options (rights) that are acquired; and
– if there were prior indeterminate rights that directly resulted in subsequent options (rights) — this can be more of an issue if the individual does not meet one of the concessional treatments in Div 83A (eg deferred taxing point).

As can be seen from example 3 above, the administrative process of the issue of the rights is not a taxing point. It is easier to work backwards. When there is agreement between all parties to the option issue, the options (rights) have been acquired. The next step is to determine the most recent earlier step which creates the "right to a right" (if in fact there is any). If there is a prior "right to a right", that is the effective date for valuation (assuming there is no deferral), eg T1.2, T2.1 and T4.1. If there is no prior right to a right (ie there is no indeterminate right), the effective date for valuation (again, assuming there is no deferral) is when the agreement is entered into, eg T3.1 and T5.2.

Summary

The above discussion by no means gives an exhaustive list of the key areas to be reviewed when dealing with Div 83A. However, they appear to be areas that are more likely to be taken as a given and may result in a materially different tax liability than otherwise expected.

Guy Brandon, CTA
Tax Consulting Partner
HLB Mann Judd WA

References

1 S 83A-33(1) ITAA97.

2 Item 9A of the table in s 115-30 ITAA97.

3 See *Income Tax Assessment (Methods for Valuing Unlisted Shares) Approval 2015,* and ESS 2015/1 (available at www.ato.gov.au/law/view/document?DocID=ITD/ESS20151/00001).

4 *Treasury Laws Amendment (Income Tax Assessment Repeal and Consequential Amendments) Regulations 2021*.

5 In respect of ss 83A-315.05 to 83A-315.09 of the regulations, the "changes are intended to improve readability but have not altered the scope or substantive operation of the provisions" (Attachment A to the *Income Tax Assessment (1997 Act) Regulations 2021*).

6 It is noted that the House of Representatives Committee on Tax and Revenue commenced an inquiry into the tax treatment of ESS in February 2020 (see www.aph.gov.au/Parliamentary_Business/Committees/House/Tax_and_Revenue/EmployeeShareSchemes). The current inquiry status is "Accepting submissions".

7 Assumed to equate to "Market value, on the particular day, of the share that is the subject of the right", being the numerator in step 1 of the method statement to s 83A-315.03 of the regulations.

8 Assumed to equate to "Amount, or lowest amount, that must be paid to exercise the right", being the denominator in step 1 of the method statement to s 83A-315.03 of the regulations.

9 Assumed to equate to "Market value, on the particular day, of the share that is the subject of the right", being the numerator in step 1 of the method statement to s 83A-315.03 of the regulations.

10 Assumed to equate to "Amount, or lowest amount, that must be paid to exercise the right" being the denominator in step 1 of the method statement to s 83A-315.03 of the regulations.

11 AASB 2 Sh*are-based payment.*

12 T*reasury Laws Amendment (Income Tax Assessment Repeal and Consequential Amendments) Regulations 2021.*

13 See Subdiv 960-S ITAA97, and ATO QC 21245 (available at www.ato.gov.au/General/Capital-gains-tax/In-detail/Market-valuations/Market-valuation-for-tax-purposes).

14 See ATO QC 23916 (available at www.ato.gov.au/General/Employee-share-schemes/In-detail/Benefits-provided-to-non-employees/ESS---Employee-share-scheme-benefits-provided-to-non-employees).

15 Example 1 of ATO QC 23916 (available at www.ato.gov.au/General/Employee-share-schemes/In-detail/Benefits-provided-to-non-employees/ESS---Employee-share-scheme-benefits-provided-to-non-employees).

16 Example 6 of ATO QC 23916 (available at www.ato.gov.au/General/Employee-share-schemes/In-detail/Benefits-provided-to-non-employees/ESS---Employee-share-scheme-benefits-provided-to-non-employees).

17 Example 6 of ATO QC 23916 goes further to discuss the possibility of the individual being assessed under Pt 2-42 ITAA97.

18 The exercise period for a right is the period, in months, from the particular day (referred to in s 83A-315.02 of the regulations) until the last day on which the right may be exercised under s 83A-315.09 of the regulations. This period may be different to that calculated having regards to AASB 2.

19 If the reason was the manner by which the exercise price was determined (ie to fix the "calculation percentage", given a set exercise period (note comments on exercise period above), to minimise or provide a nil value of the option. The oft-used percentage is 150%. This would result in a 66.7% calculation percentage, and, under the table in s 83A-315.08 of the regulations, would effectively result in a nil value of the option for an exercise period of up to four years (48 months).

20 Although TD 2016/17 relates to s 83A-340(1) ITAA97, it does provide useful information in determining the timing of when the right to acquire a beneficial interest in a share happens.

21 Note that Div 83A ITAA97 does not define "acquires". Compare this to former s 139G of Div 13A ITAA36:

"139G Meaning of acquiring or providing a share or right

A person acquires a share or right if:

…

(c) in the case of a right — another person creates the right in that person; or

…"

22 There are a number of detailed examples in TD 2016/17 and ATO QC 25098 (available at www.ato.gov.au/general/employee-share-schemes/in-detail/indeterminate-rights/ess---indeterminate-rights/#Examples_of_what_are_and_are_not_indeter).

Higher Education

Discovering a renewed enjoyment for learning

The Dux of Corporate Tax for 2020 study period 2 discusses his strategies for successful study.

Matt Coombes, Manager, Boroughs Australia, NSW

Please provide a brief background of your career in tax.

I have been in public practice within business services/ advisory for 15 years. While business services is not 100% tax, we do our fair share, so it is important to be in the know.

What is the most valuable aspect of studying this subject?

Without being too philosophical, I would say that the most valuable aspect of studying the Corporate Tax subject was a renewed enjoyment for learning. The challenges that come with our industry can dampen the reason why we started in the first place. Stepping back and revisiting an unadulterated version of what we do can really help in getting your learning/ tax mojo back.

What are your areas of new confidence?

"A little knowledge is a dangerous thing" … I won't profess to be an expert in any of the topics presented in this module due to their complexity, but it is safe to say that my knowledge base is no longer on the "little" side.

Why did you undertake this specific subject?

CPD! I joke, but it is a nice bonus. This subject gave me an opportunity to challenge myself and to ensure that I know my s 45B from my s 177EA.

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

Assuming COVID-19 settles, I think we will see ramped up activity from the ATO in the private wealth space, so I believe "Tax for Trusts in Estate Planning and Wealth Management" is absolutely worth a look.

What are some challenges of juggling study and work?

It can be tough to jump back on the computer after a big day at the office. What works for me is building a study program and ensuring that I stick to it. I normally front-end the week and taper as the weekend approaches. It is really important to get outdoors and make sure you have downtime. During COVID-19, my wife and I adopted Disco, and she has been a great motivator to get outside and have a break from studying.

What advice do you have for other tax professionals considering structured education?

Get involved. The sooner you start, the sooner your confidence will grow.

Member Profile

This month's column features Lauren Jones, CTA, from Deloitte, Western Australia.

Member since

2012

Areas of specialty

Mergers and acquisitions tax; energy and resources tax.

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

Tax provides a dynamic, interesting career with lifelong learning as domestic and international tax law continues to evolve and change (The Tax Institute has a great database of papers and presentations!). It is a career which requires deep tax technical skills, as well as broader business and industry knowledge. As a tax adviser, I get the opportunity to work with people from all parts of my clients' business, together with their other advisers, to create value and manage risk, particularly in M&A where tax can potentially be a deal breaker.

How is your membership beneficial to your practice and clients?

The Tax Institute facilitates fantastic conferences (the National Resources Tax Conference, state conventions, and the National Infrastructure Conference, to name a few). These conferences provide a wonderful opportunity to network with colleagues and clients and hear from specialists across industry, government, professional practice and the ATO.

What is your most memorable career achievement to date?

I was admitted to the Deloitte partnership as a tax partner in 2018. This was the culmination of many years of hard work and recognition from my clients, fellow partners and team. Being promoted to partner was particularly exciting as it has allowed me to grow our M&A tax team and capabilities, and have a greater influence on the development and progression of my team.

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

From a tax technical perspective, ensuring that our clients and businesses have thorough, contemporaneous documentation to support any COVID-19 tax relief obtained during 2020-21. As the state and federal tax relief measures, in particular JobKeeper, were released quickly with evolving guidance, it will be important to review the application of these measures and ensure that documentation is on file to support any claims.

More broadly, as our "new normal" hybrid way of working evolves, it will be important to find effective ways of maintaining and growing our relationships with clients and colleagues, in person and/or virtually, to ensure that tax is at the front of people's minds when considering new ventures or projects.

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

I believe that the key attributes of an effective leader in the tax profession are integrity, an ability to distil and effectively communicate complex issues, passion, technical knowledge, and empowering and developing others.

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

The role of technology in tax is only going to increase and expand over time. Seek out courses or learning available to become technology savvy.

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

Work–life balance means working flexibly, where possible, to ensure that my clients' and team's needs are met, spending quality time with my husband, my eight-month-old daughter and my Labrador and Kelpie, and squeezing in crossfit and pilates. Having just returned to work from parental leave, finding this balance is a work in progress! We spend most weekends outdoors at the beach, exploring Perth's dog-friendly walking trails and, more recently, playgrounds near our house (with coffee in hand!).

Contributions: the latest and greatest

by Jemma Sanderson, CTA, Director, Cooper Partners Financial Services

With the substantial taxation concessions provided by superannuation, Australian taxpayers are highly incentivised to build up assets within this structure. However, there are a plethora of contribution rules and contribution caps that we need to be aware of. With the contribution limits being indexed in the 2021-22 financial year, and many superannuation benefits being impacted by COVID-19 valuations at 30 June 2020, it is important that we are aware of the contribution strategies to be implemented prior to 30 June 2021 and into the new financial year to ensure that clients' positions are optimised.

Introduction

Since 1 July 2017, the superannuation contribution rules in Australia became more complex and more stringent. This article aims to unpack various areas for consideration by advisers and tax agents, and to provide some strategies to consider for the 2020-21 financial year and into 2021-22 when the contribution caps are to be indexed.

Work test

Pursuant to reg 7.04(1) of the *Superannuation Industry (Supervision) Regulations 1994* (Cth) (SISR94), under age 67, no work test applies to superannuation contributions and, accordingly, a superannuation fund trustee can accept a contribution for a member regardless of their work status. After age 67 and up to age 75, the work test for a fund to accept a superannuation contribution is 40 hours of gainful employment in a consecutive 30-day period (reg 7.01(3) SISR94).

The work test applies in the year the contribution is made. The conditions for this test to be met are:

– the work must be gainful employment for gain or reward — charity work does not meet the criteria; and

– the work test must be met before a contribution is made.

Paragraph 21 of *Superannuation Circular I.A.1 — Contribution and benefit accrual standards for superannuation funds* provided APRA's view with respect to a fund accepting a contribution prior to the work test being met:

> "The trustee cannot take prospective employment into account — the member must have worked at least 40 hours in the financial year before the trustee can accept the contribution."

APRA replaced Superannuation Circular I.A.1 with *Prudential Practice Guide SPG 270 — Contribution and benefit accrual standards for superannuation funds* in November 2013. SPG 270 no longer contains this absolute requirement. There is no legislative requirement to meet the work test before a contribution is made. However, it is prudent to ensure that no adverse circumstances occur that may result in the fund being unable to accept the contribution.

Over age 75, the only contributions that are able to be accepted by a superannuation fund are:

– superannuation guarantee for a member; and

– downsizer contributions.

This restriction can provide some challenges when people are wanting to avail themselves of the CGT cap because, for example, they have to satisfy the contribution acceptance provisions to actually have the contribution remain in superannuation.

Carry forward unused concessional contributions

Since 1 July 2018, individuals have been able to carry forward their unused concessional contributions cap over a rolling six-year period where their total superannuation balance as at 30 June of the year prior to the contribution is less than $500,000. The ability to carry forward only applies to an individual's unused cap from 1 July 2018.

On the basis that the total superannuation balance is less than $500,000 at the 30 June prior to the contribution where someone wants to avail themselves of the provision, Table 1 shows three examples of the operation of the unused concessional cap provisions, including how the increase in the concessional contributions cap from 1 July 2021 will apply to contributions in the prior years that were unused.

Accordingly, where someone has not fully utilised their concessional contributions cap in the prior years since 1 July 2018, and they have less than $500,000 in superannuation at the prior 30 June, they can make a more substantial contribution in a particular year. This may apply where the individual has sold an asset and made a substantial capital gain that they wish to manage, that is, the combination of their ability to claim a tax deduction, as well as a carry-forward amount, would enable them to add to their superannuation and assist in managing their CGT position.

The relevant legislative provisions, from s 291-20 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97), are as follows:

> "(3) However, your ***concessional contributions cap*** for the financial year is increased in accordance with subsection (4) if:
>
> (a) your concessional contributions for the year would otherwise exceed your concessional contributions cap for the year; and
>
> (b) your total superannuation balance just before the start of the financial year is less than $500,000; and
>
> (c) you have previously unapplied unused concessional contributions cap for one or more of the previous 5 financial years.
>
> (4) Apply your unapplied unused concessional contributions cap for each of the previous 5 financial years to increase your

Table 1. Carry forward concessional cap examples

2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Cap $25,000	Cap $25,000	Cap $25,000	Cap $27,500	Cap $27,500	Cap $27,500
Cont* $10,000	Cont $10,000	Cont $10,000	Cont $10,000	Cont $10,000	Cont $107,500
Unused $15,000	Unused $30,000	Unused $45,000	Unused $62,500	Unused $80,000	No excess
2018-19	**2019-20**	**2020-21**	**2021-22**	**2022-23**	**2023-24**
Cap $25,000	Cap $25,000	Cap $25,000	Cap $27,500	Cap $27,500	Cap $27,500
Cont $10,000	Cont $10,000	Cont $40,000	Cont $10,000	Cont $50,000	Cont $37,500
Unused $15,000	Unused $30,000	Unused $15,000	Unused $32,500	Unused $10,000	No excess
2018-19	**2019-20**	**2020-21**	**2021-22**	**2022-23**	**2023-24**
Cap $25,000	Cap $25,000	Cap $25,000	Cap $27,500	Cap $27,500	Cap $27,500
Cont $0	Cont $0	Cont $0	Cont $0	Cont $0	Cont $157,500
Unused $25,000	Unused $50,000	Unused $75,000	Unused $102,500	Unused $130,000	No excess

* Cont = Contribution

concessional contributions cap (but not by more than the excess from paragraph (3)(a)).

(5) For the purposes of increasing your concessional contributions cap under subsection (4), apply amounts of unused concessional contributions cap for previous financial years in order from the earliest year to the most recent year.

Your unused concessional contributions cap

(6) You have ***unused concessional contributions cap*** for a financial year if the amount of your concessional contributions for the year falls short of your concessional contributions cap for the year. The amount of the unused concessional contributions cap is the amount of the shortfall.

(7) However, you do not have ***unused concessional contributions cap*** for a financial year earlier than the 2018-2019 financial year."

Non-concessional contributions

Non-concessional contributions are contributions made to superannuation from after-tax money and are not subject to a tax on contribution to superannuation or on withdrawal from superannuation. The definition of "non-concessional contributions" is outlined in s 292-20(2) ITAA97, with various inclusions:

- contributions that will not be included in the assessable income of the fund:
- undeducted contributions;
- capital gains tax amounts that exceed the CGT cap;
- non-assessable amounts received from an overseas transfer;
- spouse contributions (are included in the receiving spouse's cap); and
- contributions that are in excess of the concessional contributions cap where a refund is not sought will be included in non-concessional contributions.

Non-concessional contributions do not include co-contributions or "roll-over superannuation benefits".

The annual non-concessional contributions cap is four times the concessional contributions cap (four times $25,000 in 2020-21 is therefore $100,000). As the concessional contributions cap is indexed, so too will the non-concessional contributions cap. Therefore, for 2021-22, the non-concessional cap will be four times the new concessional cap of $27,500, that is, $110,000.

There is a provision available for taxpayers under age 65 (proposed at the time of writing to increase to age 67, with legislation yet to pass through parliament) that allows them to bring forward two future years of their non-concessional contribution limit and make a large one-off contribution of up to $300,000 (or $330,000 from 2021-22). Section 292-85(3) to (4) ITAA97 would apply instead of the four times concessional contributions cap if:

- the non-concessional contributions for the first year exceed three times the concessional contributions cap; and
- the individual is under age 65 at any time in the first year.

Section 292-85(4) outlines the three-year period that applies that will allow an individual to bring forward two future years of contributions.

The non-concessional contributions cap for the first year and for the following two financial years is as follows:

1. the cap for the first year is three times the non-concessional contributions cap;
2. the cap for the second year is:
   a. if the non-concessional contributions for the first year are less than the cap for the first year (under (1) above), the shortfall; or
   b. otherwise — nil;
3. the cap for the third year is:
   a. if the non-concessional contributions for the second year are less than the cap for the second year (under (2) above), the shortfall; or
   b. otherwise — nil.

Contributions in excess of the relevant non-concessional contributions cap will be subject to excess non-concessional contributions tax of 47%.

Any excess non-concessional contributions can be refunded to the contributor, with any deemed "associated earnings" on the excess over the relevant period being taxed at the marginal tax rate of the individual, with an offset. This has therefore enabled the 47% tax rate on excess non-concessional contributions to be mitigated.

Total superannuation balance and bring-forward provisions

With the intention that members only receive tax-exempt benefits on retirement pensions of up to the transfer balance cap ($1.6m in 2020-21, but this will increase to $1.7m in 2021-22) in superannuation, the total superannuation balance test is also benchmarked to this general transfer balance cap value.

Section 307-230 ITAA97 defines "total superannuation balance", which is in the context of accumulation accounts in superannuation, as well as a member's pension accounts in superannuation, including the value of account-based pensions, market-linked pensions and any defined benefit income streams:

"(1) Your ***total superannuation balance***, at a particular time, is the sum of the following:

(a) if you have one or more superannuation interests that are not in the retirement phase — the accumulation phase values, at that time, of each such interest;

(b) if you have a transfer balance account — the transfer balance of the account at that time (but not less than nil);

(c) the amount of each roll-over superannuation benefit:

(i) paid at or before that time; and

(ii) received by the complying superannuation plan, or the entity from which the superannuation annuity is being purchased, after that time; and

(iii) not reflected in the value in paragraph (a) or the balance in paragraph (b);

(d) if you have an LRBA amount under section 307-231 (about limited recourse borrowing arrangements) in relation to one or more regulated superannuation funds — the LRBA amounts for each such regulated superannuation fund.

Modification for structured settlement contributions

(2) However, if a structured settlement contribution is made at or before a time in respect of you, your ***total superannuation balance*** at that time is modified by:

(a) if you do not have a transfer balance account — reducing the sum worked out under subsection (1) by the sum of any such structured settlement contributions; and

(b) if you have a transfer balance account:

(i) first, working out the transfer balance mentioned in paragraph (1)(b) disregarding the operation of item 2 of the table in subsection 294-80(1); and

(ii) then, reducing the sum worked out under subsection (1) (having regard to subparagraph (i) of this paragraph) by the sum of any such structured settlement contributions.

Modification for account-based income streams

(3) For the purposes of working out the transfer balance mentioned in paragraph (1)(b):

(a) if a transfer balance credit has arisen, at or before that time, in your transfer balance account in respect of a superannuation income stream covered by subsection (4) — disregard the operation of the following provisions in relation to the superannuation income stream:

(i) items 1 and 2 of the table in subsection 294-25(1);

(ii) items 1, 3, 4, 5 and 6 of the table in subsection 294-80(1); and

(b) if, at that time, you have a superannuation interest that supports a superannuation income stream covered by subsection (4) of this section — increase the amount of that balance by the total amount of the superannuation benefits that would become payable if:

(i) you had the right to cause the superannuation interest to cease at that time; and

(ii) you voluntarily caused the superannuation interest to cease at that time.

(4) This subsection covers a superannuation income stream that is any of the following:

(a) an allocated annuity;

(b) an allocated pension;

(c) an allocated pension (within the meaning of the *Retirement Savings Accounts Regulations 1997*);

(d) an account-based annuity;

(e) an account-based pension (within the meaning of the *Superannuation Industry (Supervision) Regulations 1994*);

(f) an account-based pension (within the meaning of the *Retirement Savings Accounts Regulations 1997*);

(g) a market linked annuity (within the meaning of the *Superannuation Industry (Supervision) Regulations 1994*);

(h) a market linked pension (within the meaning of the *Superannuation Industry (Supervision) Regulations 1994*);

(i) a market linked pension (within the meaning of the *Retirement Savings Accounts Regulations 1997*)."

Where a member's total superannuation balance as at 30 June of the prior year is equal to or greater than the general transfer balance cap, s 292-85(2)(b) ITAA97 operates such that the individual is unable to make any non-concessional contributions to superannuation without the amount being excessive:

"(2) Your ***non-concessional contributions cap*** for a financial year is:

(a) unless paragraph (b) applies — the amount (the ***general non-concessional contributions cap*** for the year) that is 4 times your concessional contributions cap under subsection 291-20(2) for the year; or

(b) if, immediately before the start of the year, your total superannuation balance equals or exceeds the general transfer balance cap for the year — nil."

Where the taxpayer has superannuation under $1.6m (currently), and more importantly between $1.4m and $1.6m, s 292-85(3) to (7) ITAA97 provides modified provisions with respect to a taxpayer's available non-concessional contributions cap:

"(3) Despite subsection (2), work out your ***non-concessional contributions cap*** for a financial year (the ***first year***) under subsection (5), and your ***non-concessional contributions caps*** for the following 2 financial years (the ***second year*** and ***third year***) under subsections (6) and (7), if:

(a) your non-concessional contributions for the first year exceed the general non-concessional contributions cap for that year; and

(b) paragraph (2)(b) does not apply to you in relation to the first year; and

(c) you are under 65 years at any time in the first year; and

(d) a previous operation of subsection (6) or (7) does not determine your non-concessional contributions cap for the first year; and

(e) the difference (the ***first year cap space***) between the general transfer balance cap for the first year and your total superannuation balance immediately before the start of the first year exceeds the general non-concessional contributions cap for the first year.

(4) However, do not work out your non-concessional contributions cap for the third year under subsection (7) if the first year cap space does not exceed an amount equal to twice the general non-concessional contributions cap for the first year.

…

(5) Your ***non-concessional contributions cap*** for the first year is an amount equal to:

(a) if the first-year cap space does not exceed an amount equal to twice the general non-concessional contributions cap for the first year – twice the general non-concessional contributions cap for the first year; or

(b) otherwise — 3 times the general non-concessional contributions cap for the first year.

…

(6) Your ***non-concessional contributions cap*** for the second year is:

(a) if:

(i) your total superannuation balance immediately before the start of the second year is less than the general transfer balance cap for the second year; and

(ii) your non-concessional contributions for the first year fall short of your cap for the first year (worked out under subsection (5));

that shortfall; or

(b) otherwise — nil.

…

(7) Your ***non-concessional contributions cap*** for the third year is:

(a) if:

(i) your total superannuation balance immediately before the start of the third year is less than the general transfer balance cap for the third year; and

(ii) your non-concessional contributions for the second year fall short of your cap for the second year (worked out under subsection (6));

that shortfall; or

(b) if

(i) your total superannuation balance immediately before the start of the third year is less than the general transfer balance cap for the third year; and

(ii) your cap for the second year is nil; and

(iii) your non-concessional contributions for the first year fall short of your cap for the first year (worked out under subsection (5));

that shortfall; or

(c) otherwise — nil."

In summary, the non-concessional contributions that are able to be made depending on the total superannuation balance in 2020-21 are as set out in Table 2.

For the 2021-22 financial year, in light of indexation, the thresholds are as set out in Table 3.

The total superannuation balance is important when determining an individual's non-concessional contributions cap for a particular year. The issues with this criterion include:

– at the time a contribution is desired to be made, the individual may not know what their total superannuation balance is, particularly in light of:
  – the balance of multiple superannuation accounts; and
  – where they have an SMSF, and the financial statements and therefore member balances for the prior year have not been finalised; and

Table 2. Non-concessional contribution thresholds: 2020-21

Total superannuation balance at 30 June of the prior year	Bring-forward available $	Bring-forward period
Under $1.4m balance	300,000	Three years
Between $1.4m and $1.5m	200,000	Two years
Between $1.5m and $1.6m	100,000	One year
Greater than $1.6m	nil	nil

Table 3. Non-concessional contribution thresholds: 2021-22

Total superannuation balance at 30 June of the prior year	Bring-forward available $	Bring-forward period
Under $1.48m balance	330,000	Three years
Between $1.48m and $1.59m	220,000	Two years
Between $1.59m and $1.7m	110,000	One year
Greater than $1.7m	nil	nil

– if the member does not know their total superannuation balance given the circumstances above, and they are approaching age 65 (67 under the proposed rules) and would not meet the work test at the time of the contribution, it can prove difficult.

Non-concessional contributions cap in second or third year of bring-forward

It is important to note that, where a taxpayer triggers a bring-forward period in the first year and does not fully utilise the amount, if they seek to fully utilise the remaining bring-forward amount in a subsequent financial year, their total superannuation balance as at 30 June of the prior year would also need to be assessed. However, it is only the upper threshold that is relevant.

Example: Homer

Scenario 1

- Homer: DOB 18 October 1955.
- Homer's benefits in superannuation at 30 June 2020 — see Table 4.
- Homer's contribution history – see Table 5.
- Can Homer make any contributions in 2020-21?
- What is the impact of:
  - His current total superannuation balance?
  - His contribution history?
  - The $300,000 contribution in 2018-19?
- What else is relevant to Homer in 2020-21?
- Considerations for Homer:
  - Homer turned 65 last October — as he was under age 65 at 1 July 2020, he can still access the bring-forward provisions in the current financial year.
  - Further, as the work test age has increased and he is under age 67, he does not need to meet a work test this year to make such a contribution.
  - Homer's current total superannuation balance is $1,236,000, so it is less than $1.4m, meaning that the $300,000 cap could be available.
  - Homer's contribution history is that he made a $300,000 in 2018-19 — does that mean he is still serving the bring-forward period for that contribution?
- The bring-forward period available to an individual is based on their total superannuation balance in the year of the contribution made that is greater than the single year contribution. For Homer, that total superannuation balance was $1,489,548.
- That means that he would only be eligible to make a two-year contribution and have a two-year bring-forward period.
- Therefore, the $300,000 contribution was $100,000 excessive (which would need to be dealt with by Homer).
- But this also means that Homer's bring-forward period expired on 30 June 2020.
- He is therefore eligible to use a bring-forward again.
- As Homer's total superannuation balance at 30 June 2020 was $1,236,000, and therefore less than $1.4m, he is able to make a $300,000 non-concessional contribution.

Scenario 2

- Homer's contribution history – see Table 6.
- As Homer's total superannuation balance at 30 June 2018 was under $1.4m, he would have had a three-year bring-forward period available, and therefore, in 2020-21, he would still be serving that and is not able make any contributions this financial year without there being an excess.

Table 4. Homer's superannuation benefits

At 30 June 2020	Pension #1 $	Pension #2 $	Pension #3 $	Total $
Tax-free component	150,000	45,000	250,000	445,000
Taxable component	250,000	435,000	106,000	791,000
Total	**400,000**	**480,000**	**356,000**	**1,236,000**

Table 5. Homer's contribution history

	NCC $	TSB at prior 30 June	TSB date
2016–2017	180,000	N/A	N/A
2017–2018	100,000	1,548,000	30 June 2017
2018–2019	300,000	1,489,548	30 June 2018
2019–2020	—	1,795,000	30 June 2019

Table 6. Homer's contribution history

	NCC $	TSB at prior 30 June	TSB date
2016–2017	180,000	N/A	N/A
2017–2018	100,000	1,548,000	30 June 2017
2018–2019	300,000	1,389,548	30 June 2018
2019–2020	—	1,795,000	30 June 2019

Scenario 3

- Back to original Homer (in scenario 1). We have established that Homer can contribute $300,000 in 2020-21:
  - Should he?
  - What alternative strategy could he consider to maximise his contributions to superannuation?
  - What does he need to take into account?
- Considerations for Homer:
  - An alternative strategy is:
    - 2020-21: $100,000 single-year non-concessional contribution.
    - 2021-22: $330,000 three-year bring-forward non-concessional contribution.
  - Could that be achieved?
  - Many elements would need to line up for Homer:
    - The three-year bring-forward extension is available for taxpayers aged under 67 at 30 June of a relevant year — otherwise Homer only has a single year available:
      - So, 2020-21 could be Homer's last year available of a bring-forward if that legislation does not pass.
      - It is expected to pass, but who knows.
    - Assuming that the above occurs and Homer can use the three-year bring-forward period next year, his total superannuation balance needs to be less than $1.48m at 30 June 2021:
      - The total superannuation balance was $1,236,000 at 30 June 2020.
      - To consider balance now, subtract the pension payments made.
      - Was the $1,236,000 due to COVID-19 depreciation or otherwise?
      - What is the value now?
      - If Homer was to contribute $100,000 this financial year, what might his total superannuation balance be at 30 June 2021, especially if investments have recovered?
      - Even if Homer does not make a $100,000 non-concessional contribution this year, would his total superannuation balance allow him to make a non-concessional contribution of $330,000 next year?
  - Ultimately, Homer needs to monitor the position in the lead up to 30 June 2021 as this year could be the last opportunity for a substantial contribution due to the total superannuation balance and bring-forward provisions.

Withdrawal and recontribution

A withdrawal and recontribution strategy can be incredibly beneficial for both the pensioner and their children. It involves the withdrawal of benefits from superannuation that comprise taxable components and, more often than not, some tax-free components in proportion to the components of the benefit, and the subsequent contribution of the amount withdrawn as a non-concessional contribution, thereby being classified as a tax-free component.

Accordingly, it is the conversion of a proportion of the taxable component within a benefit to the tax-free component that has the longer-term benefit of reducing the amount that is subject to tax on the passing of a member (where the ultimate beneficiaries are not death benefit dependants and tax is payable on the taxable component).

However, to get the full benefit, such a withdrawal and recontribution strategy needs to be implemented correctly. It is most effectively implemented:

- where there are no adverse taxation implications of withdrawing the money from superannuation; and
- when the contribution limits are appropriately considered because any amount recontributed to superannuation would be a non-concessional contribution and therefore subject to the caps.

Any amounts withdrawn from superannuation accumulation benefits are subject to the proportioning rule under s 307-125 ITAA97. Therefore, a member is unable to specifically withdraw taxable components only; they must withdraw a proportionate amount of taxable and tax-free components from the relevant account.

A withdrawal and recontribution strategy can assist in hedging against any future legislative risk of the introduction of taxing superannuation fund income stream payments after age 60. By having the benefits as a tax-free component, it would be quite difficult for these to subsequently be taxed like a taxable component may be. This would only occur if such a drastic change was made to superannuation, which is unlikely when considering the substantial changes made to superannuation in the 2016-17 federal Budget. However, it could be on the agenda in the future.

The other benefit of a withdrawal and recontribution strategy is that it provides the mechanism for couples to try to equalise their superannuation benefits in order to fully utilise their respective transfer balance cap amounts.

Areas to watch: withdrawal and recontribution

When undertaking a withdrawal and recontribution strategy, you need to be aware of a number of issues:

- the taxation implications of a withdrawal if under age 60, and whether there is any low-rate cap remaining;
- the account that the withdrawal/payment is made from — there is little point in making a withdrawal from the pension account that is 75% tax-free already, rather than the account that is a 50% taxable component;
- withdrawing funds that cannot be recontributed where the non-concessional contributions cap may have been exhausted already;
- getting the timing wrong in terms of leading up to age 65 (hopefully soon to be 67) and triggering bring-forward periods inadvertently (under the current non-concessional contribution provisions);

- contributing the funds prior to a pension being commenced with the remaining accumulation balance, as the benefits would be aggregated from a proportioning rule perspective which then defeats some of the objectives of undertaking the strategy;
- commuting and combining pensions each year without the consideration of the taxable and tax-free components — the benefit of a withdrawal and recontribution strategy is reshuffling the components around for an immediate tax saving (if under age 60), or to benefit the financially independent children in the future;
- considering the total superannuation balance provisions for non-concessional contributions;
- considering the assets within the fund that need to be transferred out. The easiest way to undertake such a strategy is with cash. However, if there is insufficient cash available, you may need to consider a lump sum payment (provided a lump sum can be paid — the member could be in transition to retirement phase and therefore ineligible to take out a lump sum). Alternatively, you could look at multiple cash transfers. However, this requires additional administration which may not be able to be easily processed depending on the software system and the administrator;
- taking out additional pension payments may adversely impact those members who are in receipt of the Commonwealth Seniors Health Card, and any pension payments could be assessed towards their income test for eligibility (if they are subject to the rules from 1 January 2015); and
- once aged 60, the main benefit of implementing a withdrawal and recontribution strategy is the estate planning for non-dependent (adult) children, although as discussed above, there are other benefits.

Tip. Maximise any contribution of assets from sources outside superannuation to superannuation before undertaking any withdrawal and recontribution.

Example: Homer

Scenario 4

- Homer: DOB 18 October 1955.
- Homer's benefits in superannuation at 30 June 2020 — see Table 7.
- Homer's contribution history – see Table 8.
- Homer has exhausted all avenues in which to contribute funds from outside superannuation.

Table 8. Homer's contribution history

	NCC $	TSB at prior 30 June	TSB date
2016–2017	180,000	N/A	N/A
2017–2018	100,000	1,548,000	30 June 2017
2018–2019	300,000	1,489,548	30 June 2018
2019–2020	—	1,795,000	30 June 2019

- Homer has three adult, independent children:
  - Bart: age 40.
  - Lisa: age 38.
  - Maggie: age 30.
- Strategies that Homer could consider in 2020-21:
  - He could consider a withdrawal and recontribution, with a few items to confirm:
    - Is he eligible to make a withdrawal?
      - He is retired, so yes;
    - How much can he contribute?
      - As previously established, he can contribute up to $300,000, given his bring-forward period reset on 1 July 2020 and his total superannuation balance at 30 June 2020 is less than $1.4m.
    - From which account should a withdrawal be made?
      - Pension #2 — as this has the highest taxable component.
      - How should any withdrawal be treated?
      - Partial commutation so that when the money is recontributed into the fund, he can start pension #4 with a 100% tax-free component.
      - Homer will need to report the partial commutation and new pension to the ATO with the lodgment of a transfer balance account report form;
      - Even though Homer's balance at 30 June 2020 was $1,236,000, and then with a $300,000 contribution he was still under the $1.6m transfer balance cap, his actual transfer balance account is likely to be just under $1.6m due to the value of his total superannuation balance at 30 June 2017.

Table 7. Homer's superannuation benefits

At 30 June 2020	Pension #1 $	Pension #2 $	Pension #3 $	Total $
Tax-free component	150,000	45,000	250,000	445,000
Taxable component	250,000	435,000	106,000	791,000
Total	**400,000**	**480,000**	**356,000**	**1,236,000**

- What else does Homer need to be aware of?
  - Homer needs to be aware of the minimum pension requirements regarding the pension #2 account, that is:
    - Still 2% on $480,000.
    - Homer could classify some of the payment out as part of that minimum, which will reduce the partial commutation amount.
  - Homer needs to take out a pro-rated minimum on the new pension #4 account.
  - How will Homer practically implement this strategy?
    - Should the assets be transferred? Is there enough cash?
    - Is it over a few transactions in cash?

"... many areas require consideration with respect to optimising the contribution position for superannuation fund members."

Downsizer contribution

Since 1 July 2018, a new contribution has been in place — the downsizer contribution. This contribution is aimed at boosting the superannuation savings for those taxpayers who:

- are over age 65;
- may be unable to satisfy a work test; and
- are downsizing their principal residence, and therefore are releasing some capital.

To date, in excess of $1b has been contributed to superannuation under this particular measure.

The downsizer contribution operates as follows:

- it is *only* available where the contribution is made after age 65;
- the contribution has to be made within 90 days of receipt of the proceeds;
- there will be no work test or total superannuation balance test applied with respect to the contribution;
- the amount of the downsizer contribution will be the lesser of $300,000 for each spouse, or the proceeds from the sale of the relevant property. So, at most, $600,000 between spouses;
- a spouse is eligible to make the contribution, even if the property was not in their name;
- the property has to have been owned for at least 10 years;
- the property that is sold does not have to be the primary residence of the individual at the time of the sale — the requirement is that the main residence exemption is available for a portion of the capital proceeds from the sale of the property. Therefore, the individual could be selling a current investment property but, at some stage over the ownership period for the property, the individual utilised the property as their primary residence such that a portion of the gain is eligible for that concession. This has wider implications in that the designation of this property as the primary residence for a period of time would mean that another property would not be able to satisfy the requirement over that period. This should be considered in detail before this is applied to the sale of an investment property;
- this is a once-only contribution for the individual making the contribution;
- no actual downsize of a property is required — the individual could choose not to acquire a new property, or they could be upsizing, and have the available capital to make the relevant contribution;
- the ability to utilise this measure does not interrupt any other contribution provisions that may apply to a particular taxpayer. That is, if the taxpayer is also eligible to make non-concessional contributions under the other contribution provisions (bring-forward as an example), they are able to, in addition to making a downsizer contribution; and
- if no actual additional capital is realised from the sale, this could be a prompt for a withdrawal and recontribution strategy.

Section 292-102 ITAA97 is the relevant section where these provisions are contained.

Example: Homer

Scenario 5

- Back to original Homer (in scenario 1) in terms of the values and balances.
- Homer has just sold his home of 25 years, where he is expecting to receive net proceeds of $800,000 (after buying a new property).
- The property will settle in June 2021.
- Homer can use the downsizer measure and make a contribution of $300,000, provided the contribution is made within 90 days of settlement.
- Although he is now 65, Homer does not need to be over 65 at the time of sale, but at the time of the contribution.
- Homer could also make a $300,000 non-concessional contribution as he was under age 64 at the start of the year (the current rules), in line with scenario 1.
- Of the $800,000, he could contribute up to $600,000.
- If Homer releases no capital from the downsizing of his home, he can use the opportunity to undertake a larger withdrawal and recontribution strategy (consistent with scenario 4), as he can make $600,000 worth of contributions.

Conclusion

As is evident, there are many areas that require consideration with respect to optimising the contribution position for superannuation fund members. The lead-up to 30 June 2021 may provide some unique strategic opportunities due to valuations at 30 June 2020 impacting total superannuation balances, and therefore it will be important to monitor fund values to ensure that any strategies are optimised.

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An earlier version of this article was presented at The Tax Institute's 2021 Superannuation Intensive Series held on 24 to 25 March 2021.

Disclaimer

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Pensions, SMSFs and the transfer balance cap

by Craig Day, Head of Technical Services, Colonial First State

This article explores the implications of the indexation of the general transfer balance cap on 1 July 2021 for members commencing or receiving a retirement phase income stream from their self-managed superannuation fund. In particular, it analyses how the indexation of the general transfer balance cap impacts the calculation of a member's personal transfer balance cap, as well as strategies to maximise the amount that can be transferred to tax-effective retirement phase income streams. The article also explores the issues that a professional adviser needs to consider when advising a spouse who is receiving a death benefit in the form of an income stream, and provides a number of case studies demonstrating how the transfer balance cap rules apply and what options are available in a range of situations.

Transfer balance cap

The transfer balance cap rules were introduced on 1 July 2017 to limit the amount of superannuation benefits that a member could transfer to retirement phase income streams. Specifically, the government was concerned that the tax-exempt status of earnings on capital used to support superannuation income streams provided a significant tax concession to high wealth individuals who would almost certainly never be reliant on the age pension.[1]

The general transfer balance cap was originally set at $1.6m for 2017-18[2] and is subject to indexation on an annual basis in $100,000 increments, in line with changes in the CPI.[3] This means that the transfer balance cap will only ever increase in increments of $100,000 and will not increase every year.

Indexation of the general transfer balance cap

The ATO has confirmed that the general transfer balance cap will increase for the first time to $1.7m from 1 July 2021 due to indexation.

The indexation of the general transfer balance cap is calculated as follows:

- step 1: $1.6m × CPI for December quarter prior to the financial year/CPI for December 2016 quarter; and
- step 2: round the result from step 1 down to the nearest $100,000.

For 2021-22, the general transfer balance cap will increase to $1.7m as follows:

- step 1: $1.6m × 117.2/110.0 = $1,704,727; and
- step 2: $1,704,727 rounded down to the nearest $100,000 = $1.7m.

The general transfer balance cap impacts the following superannuation thresholds and concessions:

- the personal transfer balance cap (which governs how much a member can transfer to the retirement phase);
- the defined benefit income cap;
- the non-concessional contributions cap (including the bring-forward rule);
- the spouse contribution tax offset; and
- the government co-contribution.

Personal transfer balance cap

A member's personal transfer balance cap governs the amount of superannuation benefits that can be transferred to retirement phase income streams without being subject to excess transfer balance tax.

Initial personal transfer balance cap

A member's personal transfer balance cap equals the general transfer balance cap in the financial year in which they first become entitled to receive a retirement phase income stream.

Members commencing their first retirement phase income stream in 2021-22 will therefore have a personal transfer balance cap of $1.7m due to the increase in the general transfer balance cap. As a result, they can commence retirement phase income stream(s) up to $1.7m.

Proportional indexation of personal transfer balance cap

Where a member already has a personal transfer balance cap prior to 2021-22, the member will only receive part of the indexation that applies to the general transfer balance cap based on any unused portion of their personal transfer balance cap. This is known as "proportional indexation".

Proportional indexation is calculated by determining the maximum proportion of the member's personal transfer balance cap ever used — even if their transfer balance account has subsequently reduced.

To calculate proportional indexation for a financial year, the first step is to calculate a member's "unused cap percentage" as follows:

1. determine the client's highest transfer balance account value at the end of any day prior to the financial year. Determine the earliest day on which that highest transfer balance account value occurs; then
2. express their highest transfer balance account value as a percentage of their personal transfer balance cap on the day identified in step 1 and then round down that used cap percentage to the nearest whole number; then
3. calculate the unused cap percentage by subtracting the used cap percentage from 100%.

Tip. Remember to round down the used cap percentage and not the unused cap percentage when calculating the member's proportional indexation.

For example, if a member has used 67.8% of their transfer balance cap, their used cap percentage is rounded down to 67%. Their unused cap percentage is then calculated as 100% – 67% = 33%.

The next step is to multiply the increase in the general transfer balance cap by the unused cap percentage calculated above. This determines the increase in the member's personal transfer balance cap.

Due to the way in which the unused cap percentage is calculated, a member's personal transfer balance cap is always indexed in $1,000 increments.

Example

Audrey commenced an account-based pension (ABP) with $905,000 in August 2018 — her only transfer balance account credit.

The general transfer balance cap is indexed by $100,000 for the 2021-22 financial year.

Audrey has therefore used 56.56% of her transfer balance cap ($905,000/$1.6m). Her used cap percentage is then rounded down to 56%.

Audrey's unused cap percentage is then calculated as 44% (100% – 56%) and her personal cap is therefore increased by $44,000 ($100,000 × 44%) to $1,644,000 on 1 July 2021.

As a result, her remaining cap space will increase from $695,000 to $739,000 ($1.644m – $905k) from 1 July 2021.

Note: this outcome would not be any different if Audrey's transfer balance account value had since reduced to $855,000 (due to her commuting $50,000 from her pension at some point) as she would still be required to use her highest transfer balance account value ($905,000) when calculating her proportional indexation.

Each person to have their own personal transfer balance cap

Proportional indexation means that there will not be a single transfer balance cap that applies to everyone.

Clients who have already commenced one or more retirement phase income streams prior to 1 July 2021 but who have not fully utilised their transfer balance cap will have different personal transfer balance caps due to proportional indexation.

The ATO has indicated that members will be able to view their personal transfer balance cap from 1 July 2021 in ATO online (via MyGov).[4] It appears that this is the only place a member will be able to view a personal transfer balance cap that has been proportionally indexed.

Prior to 1 July 2021, members will be able to view their highest ever transfer balance account value and see whether their personal transfer balance cap will be proportionally indexed.

Proportional indexation and SMSF reporting time frames

Clients and their professional advisers should take care before relying on any personal transfer balance cap figures reported by the ATO via MyGov where an SMSF is involved. Depending on an SMSF's reporting requirements, any credits or debits in relation to the commencement or commutation of a retirement phase income stream during 2020-21 may not have been reported by 1 July 2021, and therefore would not have been taken into account when determining any proportional indexation entitlement.

For example, where a member fully commuted an $800,000 ABP in an SMSF during 2020-21 to roll-over to commence another ABP in a large fund, the large fund is likely to report the $800,000 credit immediately while the SMSF may not report the debit until May 2022 when it lodges its annual return. As a result, the client's highest balance will be significantly overstated on 1 July 2021 and would result in any proportional indexation figures reported via MyGov being incorrect until the SMSF reported the debit.

No indexation if personal transfer balance cap fully utilised

If, at the end of any day prior to the indexation of the general transfer balance cap, a member has ever had a transfer balance account equal to or greater than their personal transfer balance cap, they will receive no proportional indexation when the general transfer balance cap is subsequently indexed. This is because their unused cap proportion would be nil.

Potential trap/disadvantage: commencing retirement phase income streams just prior to 1 July 2021

Because of the proportional indexation of a member's personal transfer balance cap, the timing of commencing retirement phase income streams can be critical to ensure that a member receives the highest possible increase in their personal transfer balance cap.

In the lead-up to an increase in the general transfer balance cap, this is generally achieved by waiting until after the general cap has increased before commencing a retirement phase income stream (rather than doing so just prior to the increase).

Example

Jen (who had previously commenced an $800,000 ABP — her only transfer balance account credit) has a superannuation accumulation balance of $1m and now wishes to fully use her transfer balance cap.

She could:

– commence an $800,000 ABP in late 2020-21. This would use up her whole personal transfer balance cap prior to 1 July 2021, and she would therefore receive no increase in her personal transfer balance

Example (cont)

cap in 2021-22 (as the cap would already be fully used); or

– wait until on or after 1 July 2021 to commence a retirement phase income stream. When the general transfer balance cap is indexed, Jen would receive proportional indexation of $50,000, taking her personal transfer balance cap to $1,650,000. She could therefore commence an $850,000 ABP.

The same strategic consideration applies where a member does not yet have a transfer balance account and is considering commencing a retirement phase income stream. By waiting until after the general transfer balance cap has been indexed, they are able to access a higher personal transfer balance cap (as the member's personal transfer balance cap starts at the general transfer balance cap in the financial year in which they first have a retirement phase income stream).

Example

Cassie (who has never commenced a retirement phase income stream) has a superannuation accumulation balance of $3m and now wishes to fully use her transfer balance cap.

She could:

– commence a $1.6m ABP in late 2020-21. This would use up her whole personal transfer balance cap prior to 1 July 2021, and she would therefore receive no increase in her personal transfer balance cap in 2021-22 (as the cap would already be fully used); or

– wait until on or after 1 July 2021 to commence a retirement phase income stream. When Cassie commences an ABP, her personal transfer balance cap is equal to the general transfer balance cap for 2021-22. She could therefore commence a $1.7m ABP.

However, in both of the situations in the examples above, it will be important to weigh up the tax benefits that may be forgone by delaying the commencement of a retirement phase income stream with any future tax benefits that may accrue from being able to transfer a larger amount into the tax-free retirement phase.

For example, where a member only had a modest amount of retirement savings and would never be expected to be impacted by the transfer balance cap, there may be no point in delaying the commencement of an ABP as it would not provide any future tax benefits. However, in this case, it will be important to take into account the transfer balance cap implications of taking any future death benefits as a retirement phase income stream on the death of a spouse, as these amounts will count towards the survivor's transfer balance cap.

The transfer balance cap and death benefit income streams

Where a member dies and their spouse[5] takes their death benefit as a retirement phase income stream, a credit will arise in the spouse's transfer balance account. However, the timing and methodology for valuing the credit varies as follows:

– where a member died in the accumulation phase or with a non-reversionary pension and the spouse takes a death benefit in the form of a new ABP, the value of the credit will be the commencement value of the pension and the credit will arise on the date the ABP starts;

– where a member died with a reversionary ABP, the credit will be the market value of the ABP at the date of death, with the credit arising in the reversionary beneficiary's transfer balance account 12 months after the date of death; and

– where a member died with a reversionary capped defined benefit income stream (such as a market-linked income stream that commenced prior to 1 July 2017), the credit will be the special value[6] of the income stream, with the credit arising in the reversionary beneficiary's transfer balance account 12 months after the date of death.[7]

As a result, an adviser assisting a deceased member's spouse to understand the transfer balance cap implications of taking their death benefit in the form of an income stream will need to consider a number of issues, including:

– the value of the spouse's personal transfer balance cap;

– how much of the spouse's transfer balance cap they have already used, ie the running balance of their transfer balance account;

– the value of the death benefit that will be used to commence a new retirement phase income stream (including any life insurance proceeds); and/or

– the value of the deceased member's reversionary pension at the time of death, or the special value of a capped defined benefit income stream payable to the reversionary beneficiary.

Where a spouse will end up exceeding their transfer balance cap due to receiving a death benefit in the form of a reversionary pension, it will also be important to consider the type of income stream that has reverted. For example, where the reverted income stream is a capped defined benefit income stream, special rules may apply to limit the value of any commutations required to resolve an excess, as these income streams are generally non-commutable.

Transfer balance cap and proportional indexation

When undertaking any calculations, it is important to take into account any increase in the value of the member's personal transfer balance cap due to the indexation of the general transfer balance to $1.7m on 1 July 2021. For example, a spouse that has yet to commence their own retirement phase income stream will get the full benefit of the indexation of the transfer balance cap to $1.7m in the following situations:

– the spouse commences to receive a non-reversionary death benefit income stream on or after 1 July 2021; or
– the spouse received a reversionary death benefit income stream where the original member died on or after 1 July 2020 (for an example of this, see example 4 below).

However, for a spouse who has already commenced to receive a retirement phase income stream,[8] they will only be entitled to proportional indexation based on the highest ever balance of their transfer balance account.

For more information on the indexation of the transfer balance cap and how the proportional indexation rules operate, see "Indexation of the general transfer balance cap" above, or case studies 2 and 4 below.

Resolving excess amounts

Where a beneficiary ends up exceeding their personal transfer balance cap due to the receipt of a death benefit as an income stream, they will need to commute the amount of excess to reduce the running balance of their transfer balance account to below the value of their personal transfer balance cap.

However, it is important to note that, from 1 July 2017, a death benefit must only be taken in the form of a continuing death benefit income stream or as a death benefit lump sum (or a combination of both). Therefore, a spouse could not roll an amount from a death benefit income stream to the accumulation phase to resolve an excess.

Instead, a spouse would need to pay the excess amount out as a death benefit lump sum, or they could consider fully or partially commuting their own retirement phase income stream and rolling that amount back to the accumulation phase to free up some of their transfer balance cap.

The benefit of commuting their own retirement phase income stream is that it maximises the amount that can continue to be held in superannuation. However, whether this provides the best outcome for a beneficiary will depend on a range of issues, including taxation and estate planning considerations.

> *"... each member with a retirement phase income stream will have their own personal transfer balance cap ..."*

Case studies: death benefits involving ABPs

The following case studies provide examples of the transfer balance account implications of taking a death benefit as an ABP in a range of different situations.

Case study 1. Mei and Yuu: death benefits and negative returns

Mei retired and commenced an ABP for $1.6m on 1 January 2018. She therefore received a transfer balance credit for $1.6m on that date.

In late 2019, Mei's husband Yuu passed away. Yuu had yet to retire and left behind a death benefit in the accumulation phase valued at $1m (including life insurance proceeds).

In early/mid-2020, Mei's personal ABP balance had reduced to $900,000 due to the financial impacts of the COVID-19 pandemic. However, the value of Yuu's death benefit had remained stable as his account balance was sold down to cash on death to protect it from any negative returns.

Under the transfer balance cap rules, any decline in actual account balance due to negative returns and/or pension payments is ignored. Therefore, as Mei's transfer balance account running balance would still be $1.6m, she will not have any space left under her personal transfer balance cap. However, if Mei wanted to maximise the amount of assets she was able to hold in superannuation, she could fully commute her own ABP and roll $900,000 back to the accumulation phase to free up some of her transfer balance cap.

In this case, it is important to note that Mei's transfer balance account running balance would still be $700,000 (ie $1.6m credit – $900,000 debit). Therefore, the maximum that Mei could take of Yuu's death benefit as a retirement phase income stream would be limited to $900,000 and she would need to take at least $100,000 of his death benefit as a lump sum.

Case study 2. Audrey and Fred: death benefits and proportional indexation

Audrey retired in August 2018 and commenced an ABP with $905,000 — her only transfer balance account credit and therefore her highest ever transfer balance account value.

On 1 August 2021, her spouse Fred died suddenly, leaving a $900,000 superannuation death benefit in accumulation phase. Audrey would like to take the full amount of Fred's death benefit as an income stream. However, she is unsure whether that would cause her to exceed her personal transfer balance cap.

To calculate Audrey's personal transfer balance cap under the proportional indexation rules, the first step is to calculate her "unused cap percentage" as follows:

1. determine her highest transfer balance account value ($905,000) at the end of any day prior to when indexaton occurs. Determine the earliest day on which that highest transfer balance account value occurs; then
2. express her highest transfer balance account value as a percentage of her personal transfer balance cap on the day identified in step 1 (56.56%[9]) and then round that figure down to the nearest whole number (56%); then
3. calculate the unused cap percentage (44%) by subtracting the used cap percentage (56%) from 100%.

To determine Audrey's proportional indexation entitlement, she needs to multiply the increase in the general transfer balance cap ($100,000) by her unused cap percentage (44%) to give $44,000.

Audrey's new personal transfer balance cap from 1 July 2021 is then calculated by adding the indexation entitlement ($44,000) to her previous cap amount ($1.6m) to give $1.644m.[10]

In this case, Audrey's remaining cap space will have increased from $695,000 to $739,000 ($1.644m – $905k) from 1 July 2021.[11] As a result, Audrey would only be able to take up to $739,000 of Fred's $900,000 death benefit as a retirement phase income stream without exceeding her personal transfer balance cap.

Alternatively, if Audrey wanted to maximise the amount she could hold in superannuation, she could commute and roll $161,000 from her own ABP back to accumulation phase to free up enough cap space to allow her to take the whole of Fred's death benefit as a retirement phase income stream.

Case study 3. Juliette and Bill: reversionary pension credit timing and changes in market value

Juliette and Bill both retired in September 2017 and commenced reversionary ABPs for $500k and $1.6m, respectively. They both received a credit to their respective transfer balance accounts for those amounts at that time.

In mid-April 2019, Bill died suddenly and his ABP automatically reverted to Juliette. At the time of Bill's death, his ABP had a market value of $1.7m due to positive investment returns. However, 12 months later in April 2020, the value of Juliette's ABPs (including Bill's death benefit ABP) had reduced in market value by approximately 30% to the following values:

- Juliette's ABP: $350,000; and
- Bill's death benefit ABP: $1.2m.

On the anniversary of Bill's death, a credit of $1.7m arose in Juliette's transfer balance account (being the market value of Bill's ABP at the time of his death). As a result, Juliette's transfer balance account would increase to $2.2m ($500k + $1.7m), despite the fact that the total value of her ABPs at that time would have been just $1.55m.

To avoid breaching the cap, Juliette has the following options:

- fully commute her own ABP and transfer $350,000 back to the accumulation phase plus partially commute $250,000 from Bill's death benefit ABP and pay a death benefit lump sum; or
- partially commute $600,000 from Bill's death benefit pension and pay a death benefit lump sum.

In this case, the combination of negative returns plus the delay in the credit and the use of the market value at the time of Bill's death has significantly adversely impacted Juliette.

Case study 4. Monty and Betty: reversionary pension credit timing and proportional indexation

In July 2018, Monty retired and commenced a $1.6m ABP and nominated his spouse Betty as the reversionary beneficiary. At the same time, Monty received a $1.6m credit in his transfer balance account.

On 20 August 2020, Monty died and his ABP automatically reverted to Betty.

At the time of his death, Monty's ABP was valued at $1.7m and therefore Betty will receive a credit of $1.7m to her transfer balance cap on 20 August 2021. However, on 1 July 2021, the general transfer balance cap will be indexed by $100,000 to $1.7m.

To determine the value of Betty's personal transfer balance cap under the proportional indexation rules, she must identify her highest ever transfer balance account value.

In this case, assuming that Betty had not yet commenced her own retirement phase income stream, Betty's highest transfer balance account value at the time the general transfer balance cap was indexed (1 July 2021) would be nil, as the $1.7m credit for Monty's death benefit ABP has not arisen in her transfer balance account yet.

As a result, Betty will be entitled to the full $100,000 indexation on 1 July 2021 and her personal transfer balance cap will increase from 1.6m to $1.7m.

In this case, Betty will not have any excess amount and will not be required to commute any amount from Monty's death benefit ABP.

Death benefits involving capped defined benefit income streams

The type of death benefit income stream that a person receives can also have a significant impact on any transfer balance calculation. This section looks at the rules surrounding a capped defined benefit income stream.

Capped defined benefit income streams,[12] such as a complying lifetime pension or market-linked income streams (otherwise known as term allocated pensions), commenced before 1 July 2017, are superannuation pensions or annuities that meet specific standards in the *Superannuation Industry (Supervision) Regulations 1994* (Cth) and are generally non-commutable with no residual capital value.

Where a capped defined benefit pension reverts to a spouse, any excess transfer balance that would arise is subject to special rules and modified treatment.

Excess transfer balance modification

Due to the non-commutable nature of capped defined benefit income streams, where a client holds only one or more of these income streams, a modification[13] applies to prevent the income stream from exceeding a member's personal transfer balance cap to the extent that the excess is attributable to capped defined benefit income streams only.

Therefore, if the reversion of a capped defined benefit income stream to a member's beneficiary would otherwise cause them to exceed their personal transfer balance cap, the modification would apply to ensure that the beneficiary would not be required to commute any amount, providing they did not have any other commutable retirement phase income streams, such as an ABP.

In addition, where a client has both a capped defined benefit income stream and a commutable retirement phase income stream, such as an ABP, the client can only exceed their transfer balance cap if the value of their transfer balance account exceeds both:

- their personal transfer balance cap; and
- their capped defined benefit balance, which is generally the sum of the credits in a person's transfer balance account at that time in respect of any capped defined benefit income streams.[14]

This can lead to significantly different outcomes on the level of retirement phase income streams that a beneficiary can hold without breaching their transfer balance cap.

Case study 5. ABPs experience growth since commencement

Paly had an existing ABP valued at $1.6m as at 30 June 2017. As a result, she received a transfer balance credit of $1.6m on 1 July 2017. Her ABP has since grown to $2m. There are no further credit or debit transactions in her transfer balance account.

Her husband Marlo had a market-linked income stream, which he commenced prior to 1 July 2017 and therefore qualified as a capped defined benefit income stream.

On Marlo's death on 5 May 2020, his market-linked income stream automatically reverted to Paly and the fund reported a credit of $2m for Paly, which represented the special value of the market-linked income stream on reversion. As a result, the running balance of Paly's transfer balance account increased to $3.6m ($1.6m + $2m) on 5 May 2021 (12 months after Marlo's death) when the credit for the market-linked income stream arose in her transfer balance account.

To avoid having an excess transfer balance, Paly needs to ensure that the value of her transfer balance account does not exceed the higher of:

- her personal transfer balance cap (ie $1.6m); and
- her capped defined benefit balance (ie $2m).

In this case, Paly would only need to commute $1.6m from her own ABP prior to 5 May 2021 to ensure that the value of her transfer balance account did not exceed her capped defined benefit balance ($2m) from that date.

As a result, Paly would then have two retirement phase income streams:

- her ABP with a residual balance of $400k; and
- her death benefit market-linked income stream.

Clients in Paly's situation can therefore effectively retain all of the earnings that have accrued in their ABP since commencement in the retirement phase.

Case study 6: ABPs experience losses since commencement (continued from case study 5)

In this scenario, let us assume that Paly's existing ABP has instead declined in value from $1.6m to $900,000 due to the financial impacts of the COVID-19 pandemic.

To avoid having an excess transfer balance, Paly is still required to commute $1.6m prior to 5 May 2021 to reduce the value of her transfer balance account to $2m. However, the maximum amount that Paly is able to commute (from her own ABP) is only $900,000.

As a result, Paly's transfer balance account will be reduced to $2.7m ($1.6m credit – $900,000 debit + $2m credit) once she rolls her own ABP back to accumulation and the credit representing the special value of the reversionary capped defined benefit pension arises on 5 May 2021.

In this case, Paly appears to have $700,000 excess transfer balance, while the only retirement income stream that she has left is her non-commutable market-linked income stream. However, in the situation where there is a non-commutable excess that is solely attributable to a capped defined benefit income stream, the ATO will issue a notice to provide a special debit for the remaining excess balance to be applied in Paly's transfer balance account. This is to recognise that, although she has an excess transfer balance, she no longer has any retirement phase income streams that she is able to commute to resolve the excess.

Conclusion

The indexation of the transfer balance cap to $1.7m on 1 July 2021 will require professional advisers to be aware of any potential issues and strategic opportunities it may pose to their clients. In particular, advisers need to understand that each member with a retirement phase income stream will have their own personal transfer balance cap due to proportional indexation. Advisers will also need to exercise care when dealing with transfer balance implications of commencing death benefit income streams. In addition to the calculation of any excess transfer balance, advisers must also consider the impact of past earnings from existing ABPs as well as the impacts of the type of death benefit income stream received.

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References

1 See para 3.7 of the explanatory memorandum to the Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016, and the Superannuation (Excess Transfer Balance Tax) Imposition Bill 2016.

2 S 294-35(3)(a) of the *Income Tax Assessment Act 1997* (Cth) (ITAA97).

3 Ss 960-265 and 960-285 ITAA97.

4 See www.ato.gov.au/Individuals/Super/In-detail/Withdrawing-and-using-your-super/Indexation-of-Transfer-balance-cap/#Proportionalindexation.

5 Note that a minor child, a child under age 25 and financially dependent, or another person who qualifies as a SIS dependant (who is not an adult non-financially dependent child unless the child has a prescribed disability) may also receive a death benefit as a retirement phase income

stream and may therefore receive a credit in their transfer balance account in these situations.

6 Special value is calculated by annualising the first pension payment after reversion and multiplying that amount by the remaining term.

7 The reversionary beneficiary may also receive a debit in their transfer balance account if the amount payable to the reversionary reduces after a number of payments under the pension rules.

8 Either due to retiring and commencing a retirement phase income stream or taking a death benefit as a retirement phase income stream.

9 $905,000/$1.6m.

10 Note that, due to the way the unused cap percentage is calculated, a member's personal transfer balance cap is always indexed in $1,000 increments.

11 Note that this outcome would not be any different even if Audrey's transfer balance account value had since reduced to $855,000 due to her commuting $50,000 from her pension at some point. This is because she is required to use her highest transfer balance account value ($905,000) when calculating her proportional indexation entitlement.

12 S 294-130 ITAA97.

13 S 294-140 ITAA97.

14 S 294-140 ITAA97.

Estate planning and superannuation: current issues

by Scott Hay-Bartlem, CTA, Partner, and Clinton Jackson, Partner, Cooper Grace Ward Lawyers

This article discusses the following: when to use reversionary pensions, and when not to; alternatives for when binding death benefit nominations are not the answer; how to correctly pass control of self-managed superannuation funds on death or incapacity — and how not to; and the importance of knowing your trust deeds.

Introduction

Superannuation is increasingly a major asset for Australians. Because superannuation does not automatically form part of a deceased estate, we are seeing more disputes about the payment of the superannuation death benefit.

Increasing attacks on the superannuation death benefit payments over the last decade has highlighted the number of potential issues that can arise when paying a death benefit, the control of a self-managed superannuation fund (SMSF), and the actions of the trustee after the death of a member.

The aim of this article is to provide an overview of some of these issues and the opportunities we have as advisers to assist clients in achieving their objectives (whether that be the trustee of a fund, a potential death benefit beneficiary, or a client completing their estate planning and trying to avoid such disputes).

Death benefits

There are many elements that interact together and must be considered when dealing with superannuation death benefits, including:

- the terms of the trust deed, which are paramount, and the applicable trust law;
- the requirements of the *Superannuation Industry (Supervision) Act 1993* (Cth) (SISA93) and the *Superannuation Industry (Supervision) Regulations 1994* (Cth) (SISR94);
- the tax implications on superannuation death benefits under the *Income Tax Assessment Act 1997* (Cth); and
- where there is a trustee company, the terms of the constitution and the application of the *Corporations Act 2001* (Cth).

Payment of superannuation death benefits

Superannuation death benefits do not automatically form part of an estate and therefore cannot be primarily dealt with in a will. As a result, it is critical to understand how superannuation death benefits are paid so that we can properly advise our estate planning clients, trustee clients, and eligible beneficiaries.

Death is a compulsory cashing condition. Therefore, a benefit must be paid from the superannuation fund in some form after the death of a member.

Regulation 6.21(1) SISR94 provides that “a member’s benefits in a regulated superannuation fund *must be cashed as soon as practicable after the member dies*” (emphasis added).

The SISR94 set out how and to whom the superannuation death benefit can be paid, and within that class, the trust deed will usually provide the trustee with an absolute discretion.

Who can receive a superannuation death benefit?

Under reg 6.22 SISR94, the trustee can pay to any “dependant” or to the legal personal representative (LPR).

If the death benefit is paid to the LPR to be dealt with in accordance with the will, there is no restriction on who can receive the death benefit. The will can leave the death benefit to a person even if they are not a “dependant”.

“Dependant” is defined in s 10 SISA93 to include:

- the deceased’s spouse;
- the deceased’s children; and
- people who are, at the date of the deceased’s death:
  - actually financially dependent on the deceased; or
  - in an interdependency relationship with the deceased.

Spouse

Under s 10 SISA93, a spouse includes:

- another person (whether of the same sex or a different sex) with whom the person is in a relationship that is registered under a law of a state or territory prescribed for the purposes of s 2E of the *Acts Interpretation Act 1901* (Cth) as a kind of relationship prescribed for the purposes of that section; and
- another person who, although not legally married to the person, lives with the person on a genuine domestic basis in a relationship as a couple.

Section 2F(2) of the *Acts Interpretation Act 1901* contains a list of factors to consider when determining whether two people are living together on a genuine domestic basis. The factors are:

- the duration of the relationship;
- the nature and extent of the couple’s common residence;
- whether a sexual relationship exists;

– the degree of financial dependence or interdependence, and any arrangements for financial support between the couple;
– the ownership, use and acquisition of the couple's property;
– the degree of mutual commitment to a shared life;
– the care and support of children; and
– the reputation and public aspects of the relationship.

Child

The definition of "child" in s 10 SISA93 includes:

– an adopted child;
– a step-child;
– an ex-nuptial child;
– a child of the person's spouse; and
– a child under the *Family Law Act 1975* (Cth).

This definition expands who can be considered a "dependant" for superannuation. For example, if you have a "spouse", your "child" includes your spouse's children, which effectively includes your spouse's step-children.

In relation to a member's step-child, the Australian Taxation Office has followed the common law definition which provides that your spouse's children will only remain your "step-child" while their parent remains your spouse. If that child's parent dies first, that child will not be a "step-child'" for the purposes of the survivor's superannuation death benefit, and therefore the child will only be an eligible beneficiary if they have been formally adopted or are in a financial or interdependency relationship with the survivor.

However, the Superannuation Complaints Tribunal (SCT) in D19-20\023 followed an updated view of the common law definition of "step-child" to allow the step-child relationship to continue provided the relationship with the natural parent was not dissolved earlier other than by death.

In that decision, the SCT upheld the superannuation fund trustee's decision to pay the death benefit to a step-child where their natural parent's relationship with the deceased had ended because of the natural parent's death.

Interdependency

The "interdependency relationship" is an older addition to the definition. Two people are in an interdependency relationship if:

– they have a close personal relationship;
– they live together;
– one provides the other with financial support; and
– one provides the other with domestic support and personal care (s 10A SISA93).

Section 10A(2) provides an exception to the requirement to "live together" where one or both of the parties to the relationship suffer from a physical, intellectual or psychiatric disability which prevents them from living together.

In what form can a superannuation death benefit be paid?

Regulation 6.21 SISR94 permits the trustee of a superannuation fund to pay the death benefit as either a lump sum or a pension. This article will not explore the issues in relation to the form of the superannuation death benefit payment in detail.

However, it is important to note that a pension can only be paid where the recipient is a "dependant" of the deceased at the time of death. Also, there are additional restrictions where that person is a "child" of the deceased (reg 6.21(2A)).

The importance of the trust deed

While the SISA93 and the SISR94 outline the compliance requirements for the payment of death benefits, the trust deed for the superannuation fund is paramount when it comes to paying a superannuation death benefit.

Particularly when dealing with an SMSF, the terms of the deed will determine:

– who can act as trustee;
– what constitutes a binding death benefit nomination;
– how the trustee can make a death benefit decision;
– the process that the trustee must follow when making a death benefit decision; and
– who is an eligible beneficiary.

It is essential that the terms of the trust deed are properly considered when dealing with a death benefit payment as each of the above areas can be the source of a dispute and has been the subject of the cases discussed in this article.

Paying the death benefit

After the death of a member, the trustee of the fund has to make decisions about the payment of the superannuation balance. Those decisions will consist of one or more of the following:

– whether there was a reversionary pension;
– whether to pay the benefit in accordance with a binding death benefit nomination; and
– if neither are present (or validly binding), that the trustee must exercise their discretion, and then actually exercise that discretion.

Reversionary pensions

This section of the article briefly discusses the nature of a reversionary pension.

A reversionary pension is a pension that continues to another beneficiary on the death of the original pensioner.

Set up properly, the reversion is automatic — it takes no decision of the trustee for it to occur. This means that it can be an effective way to remove the trustee's discretion in choosing the recipient of a death benefit payment.

After the death of the member, although a reversionary nomination means that the trustee does not have any discretion about paying the balance of the pension or whether the pension continues, the trustee must decide that the reversionary nomination is valid. This decision of the trustee must be documented, along with the enquiries that the trustee made to reach this decision.

A pension can only revert to a "dependant" (see above). There are further limits on a dependant who is a child receiving a death benefit as a pension (broadly, the child must be under 18, or under 25 and dependent, or disabled, and, except in the last case, must commute to a lump sum when the child turns 25).

A death benefit pension cannot be paid, for example, to the estate of the deceased member. As discussed earlier, a former step-child ceases to be a child, and therefore ceases to be a "dependant" merely because of the step-parent/step-child relationship (although it is possible that they may be a "dependant" due to financial dependency or being in an inter-dependency relationship). When choosing who is to be a reversionary beneficiary, it is important to make sure that the trustee can pay a pension to the nominated recipient.

There is some controversy about whether a pension can be changed between reversionary and non-reversionary, or the reversionary beneficiary changed, once the pension has commenced. Current practice has been generally to stop the pension (roll back into accumulation phase) and then start a new pension with the changed reversion. This can have issues with component changes, as the pension will mingle with any accumulation balance and other pensions rolled back at the same stage, and may provide Centrelink issues if it is rolled back and restarted after 1 January 2015.

There is little in the SISA93 and the SISR94 about reversionary pensions, and over the years, the ATO has put out two opposite views on this topic.

Practitioners generally now accept that, if a pension is commenced and the pension terms allow the pensioner to change the reversionary status, the pension can change the reversionary beneficiary. However, there is no clear legislative authority to support this.

As with all SMSF issues, it is important to check the trust deed to ensure that it allows for reversionary pensions so the trustee *must* follow the reversion and no longer has discretion about how and to whom the death benefit is paid. Not all trust deeds adequately deal with this and many leave room to argue that the trustee is not bound to continue to pay the pension.

Other vital documents are the pension documents themselves and whether they require the trustee to continue the pension after the death of the member to the reversionary beneficiary. It is important that this is spelt out clearly in the pension documents, and this means that the pension documents themselves can be produced at the time of death — which may be years or even decades after the pension commenced.

Another trust deed issue is what happens if there is both a reversionary pension and an inconsistent binding death benefit nomination in place when a member dies — which must the trustee follow? A good trust deed will prescribe which has precedence, but, again, many do not deal with this issue, which again could lead to arguments. There is no clear authority that determines which would have precedence.

Binding death benefit nominations

This article discusses binding death benefit nominations in detail below.

Exercise of discretion

If the trustee has determined that it must pay the death benefit by exercising its discretion, it is important that the trustee does so properly and carries out (and documents) a process for informing themselves of the decision to be made — otherwise the trustee risks their actions being criticised and their decision being reviewed by the court.[1]

We know that, generally, a trustee does not need to give reasons for their decision.

Where the trustee declines to provide reasons for the decision, provided the decision has not been made in bad faith or with an ulterior purpose, the court is not able to review the trustee's decision.[2] This, however, does not mean that the trustee can simply make the decision about the payment of a death benefit without properly informing themselves of certain things.

The court will review a trustee's decision if:[3]

- there was a failure of the trustee to act honestly and in good faith;
- the trustee failed to give genuine consideration to the decision;
- the discretion was not exercised with due consideration for its proper purpose; and
- the trustee's reasons (if given) were not sound.

When exercising the discretion to pay a death benefit, the trustee must consider:[4]

- the intention of the deceased (looking at any previous binding and non-binding death benefit nominations, or other documentation or circumstances);
- the relationship between the deceased and each of the eligible beneficiaries;
- the financial circumstances and needs of each of the eligible beneficiaries;
- the tax implications of the payment;
- the purpose of superannuation; and
- if the LPR is an eligible beneficiary:
  - who will receive the superannuation under the will;
  - what the debts of the estate are; and
  - whether there is a risk of dispute.

If a trustee's decision is disputed, the trustee must be able to provide evidence that the trustee made proper enquiries to obtain the relevant information.

The duty of the trustee to properly inform themselves is higher for a trustee of a superannuation fund.[5] The exclusion of relevant information and the failure to seek relevant information will likely amount to a breach of trust.[6]

The actions of the trustee in *Re Marsella; Marsella v Wareham (No. 2)*[7] are clear examples of the trustee of an SMSF breaching their duty when exercising the discretion to pay a death benefit. In that case, the court found that the trustee:

- did not understand her duties to consider the other eligible beneficiaries of the death benefit (including the husband and the executor of the estate);

– was either ignorant of or had deliberately mischaracterised the true circumstances;
– had denied her conflict of interest in being a trustee and eligible beneficiary (despite the conflict being clear);
– wrongly concluded that the discretionary decision allowed the trustees to pay the death benefit without a genuine consideration of the trustee's duty to exercise the power in good faith; and
– had not tried to resolve these issues by seeking proper advice.

When a dispute arises about the payment of a death benefit, the court's role is to look at:[8]

– the inquiries made by the trustee;
– the information that the trustee had available;
– the trustee's reasons for exercising discretion; and
– the manner in which the discretion was exercised.

It is not the court's role to assess the fairness or reasonableness of the trustee's decision. However, the trustee's decision itself may form part of the evidence to prove that the discretion was not properly exercised.[9]

The decision to pay a death benefit is not as simple as preparing a resolution of trustee.

> *"It is not the court's role to assess the fairness or reasonableness of the trustee's decision."*

Claiming superannuation and conflicts

There are a number of positions where a conflict of interest may arise in the payment of a death benefit, including:

– an eligible beneficiary and the executor of the estate;
– an eligible beneficiary and the trustee (or director of a corporate trustee) of the superannuation fund;
– the trustee of the superannuation fund and the executor of the estate; and
– a combination of the above.

McIntosh v McIntosh,[10] *Brine v Carter*[11] and *Burgess v Burgess*[12] provide authority that an executor or administrator of the estate is in a position of conflict where they intend to claim the superannuation death benefit for themselves. Further, the executor/administrator must at least apply to the trustee of the superannuation fund to have the death benefit paid to the estate.

Brine v Carter does suggest that, where there is more than one executor/administrator, provided one makes an application for the superannuation on behalf of the estate, this may be enough to absolve the others from making a claim personally.

McIntosh v McIntosh

In *McIntosh v McIntosh*, the deceased died with no will, spouse, children or other dependants. His assets at the time of death were worth approximately $80,000, plus $450,000 of benefits in retail superannuation funds.

The deceased was survived by both his parents, who, under the rules of intestacy in Queensland, were the beneficiaries of his estate in equal shares. The parents had an acrimonious relationship even though they had been divorced for over 30 years.

The deceased's mother applied for and was appointed administrator of his estate.

Following her appointment as administrator, the deceased's mother applied to the retail superannuation funds for the deceased's superannuation death benefit to be paid directly to her on the basis that she was in an interdependency relationship with the deceased.

The trustees of the three retail superannuation funds accepted her claim and paid all of the deceased's superannuation death benefit ($450,000) to her.

This substantially impacted on the benefit that was to be received by the deceased's father who would only get approximately $40,000 from the estate, compared to $266,000 if the superannuation death benefit was paid to the estate. Consequently, the deceased's father disputed the mother's right to receive the payment of the superannuation death benefit directly.

To resolve the issue, the deceased's mother applied to the Supreme Court for a direction that she did not have to account to the estate for the superannuation death benefit.

The deceased's father argued that the deceased's mother should have to account for the superannuation death benefit to the estate for the following reasons:

– the deceased's mother was appointed as the administrator of the estate by the court and therefore had an obligation to gather in the assets of the estate;
– she also had a fiduciary obligation which required her to act honestly and in good faith for the benefit of the beneficiaries of the estate and not to allow a conflict of personal interest and duty to occur; and
– by applying for the superannuation death benefit personally, the deceased's mother breached both of the above duties.

Atkinson J agreed with the deceased's father and ordered that the deceased's mother account to the estate for the superannuation death benefit, as:[13]

> "The failure of the applicant to apply for payment to herself as legal personal representative was in breach of her fiduciary duty to act in the best interests of the estate, for which she may be held liable to the court."

In arriving at this conclusion, Atkinson J relied on the following:[14]

> "The method of the appointment is an important distinction. An administrator is appointed by the Court whereas the 'appointment of an executor is the act of the testator exercising testamentary choice'."

There is an exception to the general rule that no one who has fiduciary duties is allowed to enter into engagements in which the fiduciary has or may have a personal interest conflicting with the interests of those whom the fiduciary is bound to protect. The exception is described more precisely by Hope JA in *Mordecai v Mordecai*:[15]

> "That exception is where a testator or settlor, with knowledge of the facts, imposes on a trustee a duty which is inconsistent with a pre-existing interest or duty which he has in another capacity. In that situation the trustee is not thereby debarred from accepting the trust or from performing the duties which are imposed under it."

The exception does not, however, extend to allowing a trustee, by the trustee's own act, voluntarily to put himself or herself into a new position of conflict.[16]

Although there is an exception to the fiduciary's obligation to avoid conflicts, Atkinson J held that it does not apply where the person administering the estate is appointed by the court. This is because the deceased did not, with full knowledge of the issues, impliedly authorise the conflict by appointing his mother as his executor under a will:[17]

> "An administrator of an intestate estate has a duty to apply for payment of the superannuation funds to the estate. The administrator has no proprietary right to the funds but has standing to compel the trustees of the fund to exercise their discretion to pay out the funds."

If the mother did not have a personal conflict, she would have, as administrator, applied for the superannuation death benefit to be paid to the estate.

Brine v Carter: beyond McIntosh v McIntosh

The conflict issue that forms the basis of the decision in *McIntosh v McIntosh* has been explored with regard to how it applies to executors appointed under a will in the South Australian case of *Brine v Carter.*[18]

In *Brine v Carter*, Professor Brine died with two superannuation accounts with UniSuper, an indexed pension which automatically reverted to Ms Carter, and a flexi pension. He appointed his three children and his de facto partner Ms Carter as his executors.

Ms Carter applied for the death benefit to be paid to her. Ms Carter had previously made representations to the other three executors on multiple occasions that the estate was not an eligible beneficiary of either of the pension accounts and had failed to disclose the extent of the indexed pension.

After making their own enquiries, the deceased's children discovered that they could claim the death benefit on behalf of the estate, and they proceeded to lodge a competing claim with the superannuation fund trustee on behalf of the estate in respect to the flexi pension balance. The trustee decided to pay the balance to Ms Carter.

The other executors sought an order requiring (among other things) that Ms Carter account to the estate for the superannuation benefit she received, due to the conflict of interest caused by her being an executor of Professor Brine's estate.

Blue J found:

- Ms Carter as the executor was in a position of conflict in relation to Professor Brine's superannuation benefits;
- the mere fact that she was appointed as an executor did not mean she was authorised to act in that position of conflict in relation to the superannuation benefits;
- as the other executors acted on behalf of the estate in claiming the superannuation benefits from UniSuper, they consented to Ms Carter claiming the death benefit despite the conflict; and
- Ms Carter was not liable to account to the estate for the benefit.

With regard to the other executors making their own application:[19]

> "By their conduct, the [children executors] consented to Ms Carter … pursuing her own interests by claiming payment of the benefit in her personal capacity without resigning as an executor."

Therefore, despite Ms Carter acting in a conflict of interest, that conflict had not caused the benefit she received:[20]

> "[The superannuation fund] gave no consideration to the exercise of its discretion until it had received the competing contentions from Ms Carter on the one hand and the other three executors on behalf of the estate on the other hand. In these circumstances, there was no connection between Ms Carter's breach of duty and the benefit she received.
>
> Nevertheless, if no competing contention had been advanced on behalf of or in favour of the estate, equity would not have enquired into the prospect that the discretion would have exercised in favour of the estate and Ms Cater would have been liable to account."

This case is in some ways consistent with, and in some ways expands, the decision in *McIntosh*.

Burgess v Burgess

In *Burgess v Burgess,*[21] the Western Australian courts weighed into this issue.

Mr Burgess died with no will, two minor children, and interests in four retail/industry superannuation funds.

His wife applied to be the administrator of his estate, which was split between her and their children under the intestacy rules.

Mrs Burgess applied for the four superannuation interests to be paid to her. One was paid to her before she became the administrator, one was paid to her after, one was paid to the estate, and the fourth had not been paid.

The court decided:

- Mrs Burgess could keep the one paid to her before she became the administrator;
- Mrs Burgess had to pay the one that was paid to her after she became the administrator to Mr Burgess' estate; and
- the fourth fund must pay the superannuation to Mr Burgess' estate.

The court made the orders reluctantly, accepting that Mrs Burgess had dealt with the superannuation for the benefit of her and her children (she had used it to buy a house for the family to live in) and was not engaging in any inappropriate conduct. However, the law was clear and if Mr Burgess had intended for Mrs Burgess to receive his superannuation, he could have made either a binding death benefit nomination or a will leaving it to her.

Trustee and eligible beneficiary

Katz v Grossman,[22] *Ioppolo & Hesford v Conti*[23] and *Re Marsella; Marsella v Wareham (No. 2)* are all examples of the trustee of the fund deciding to pay the death benefit to themselves.

In *Katz v Grossman*, the judgment only deals with the question of whether the deceased's daughter had been properly appointed as trustee of the fund, and therefore whether her decisions were valid. The court does not discuss the trustee's position of conflict — possibly because it was not raised in argument.

In *Ioppolo & Hesford v Conti*,[24] the deceased and her second husband were both the trustees and members of an SMSF. Prior to her death, the deceased had signed several non-binding and binding death benefit nominations directing that her superannuation death benefit be paid to her husband, but these had lapsed when she died. However, in her will (made both before and after the nominations), the deceased directed that her superannuation death benefit be paid to her children.

On death, her husband was left as the sole trustee of the SMSF. He subsequently changed the trustee of the SMSF to a company of which he was the sole director and shareholder. Presumably, this was to ensure that the requirements of s 17A SISA93 would continue to be complied with once the deceased's death benefit was paid.

Following the change of trustee, the deceased's husband exercised his power as the sole director of the corporate trustee to pay the deceased's superannuation death benefit to himself, not to the deceased's children.

The deceased's children challenged this decision on the following grounds:

1. the deed required the deceased's LPR to be appointed as trustee of the SMSF because the deed required the fund to remain an SMSF; and
2. the trustee did not exercise its discretion in good faith.

The second argument failed for the following reasons:

- the deceased's husband had acted prudently, including taking advice on his obligations in relation to paying the death benefit;
- the fact that the deceased had directed the superannuation death benefit to her children under the will was not consistent with all of the binding death benefit nominations made, therefore her intentions were equivocal; and
- no evidence was adduced by the children in asserting bad faith, other than to draw a mere inference of conflict given the outcome of the decision.

The decision of *Ioppolo & Hesford v Conti* can be compared with the facts and decision of *Re Marsella; Marsella v Wareham (No. 2)* where there was clear evidence that the trustee in that case had failed to:

- seek proper advice about her obligations as a trustee; and
- recognise all eligible beneficiaries.

In *Re Marsella; Marsella v Wareham (No. 2)*, McMillan J commented that the fact the surviving trustee had been appointed by the deceased:[25]

> "As submitted by the defendants, it can be accepted that in appointing the first defendant as trustee, the fund was established by the deceased as tolerating a degree of conflict between the first defendant's duties as trustee and interest as a dependant. In this regard, the rule against conflicts of duty and interest may have been modified."

However, the conflict extended beyond the appointment as trustee due to the personal acrimony between the parties:

> "… the first defendant's position of conflict extended beyond that created by her appointment as trustee, to the significant personal acrimony between her and the plaintiff. This conflict appears to have commenced upon the deceased's death, and as such, it would not have been considered by the deceased at the time of establishing the fund. In that context, there was a heightened risk that the first defendant would not bring a rationale mind to her duties as trustee."

Where a trustee has been appointed by virtue of being the executor appointed under a will, this conflict is not modified[26] and a more express consent to the conflict (such as a clause in the will) is needed to forgive an executor or intended beneficiary in a position of conflict.

This means that, where it is the deceased's intention that their intended beneficiary should also act in a role that will place them in conflict (like executor or trustee), the deceased, while alive, should expressly forgive that conflict.

As suggested in *Burgess v Burgess*,[27] a properly executed will and binding death benefit nomination can remove the conflict that a deceased's family members may find themselves in.

If a binding death benefit nomination is going to be the answer to avoid the conflict, care needs to be taken in its preparation, particularly when dealing with SMSFs.

After reviewing the issues raised in this article, a number of questions arise, including:

- Can an executor or a superannuation death benefit beneficiary act as trustee of the fund?
- Is the answer different where there is a binding death benefit nomination in their favour?
- Is the answer different where they are exercising discretion as trustee and not paying themselves personally?
- Is the answer different where they are exercising discretion as trustee and paying themselves personally?

Of course, when considering binding death benefit nominations, it is necessary to consider the transfer balance cap rules. The transfer balance cap rules are beyond the scope of this article but, from an estate planning strategy, some clients may not wish to "lock in" the death benefit decision by making a binding death benefit nomination. In these cases, it will be important for advisers to consider alternative strategies and methods in which clients can avoid their families having a dispute over the superannuation death benefit after their death.

Binding death benefit nominations

A binding death benefit nomination allows a member to pre-make the death benefit payment decision, therefore removing the ability of the trustee to determine who will receive the death benefit.

In addition to specifying who can receive the death benefit, it is possible for a binding death benefit nomination to also specify how the beneficiary is to receive the death benefit (subject to the trust deed).

Section 59 SISA93 and reg 6.17A SISR94 allow the trust deed of a superannuation fund to be structured such that a member can make a nomination that is absolutely binding on the trustee in relation to how their death benefit is to be paid. However, the provisions in the SISA93 and the SISR94 regarding binding death benefit nominations only apply to retail and industry superannuation funds and not to SMSFs.[28] As a result, there are slightly different considerations for each type of fund.

Binding death benefit nominations and retail/ industry superannuation funds

The SISA93 and the SISR94 only allow a superannuation trust deed to contain the provisions enabling binding death benefit nominations — they do not give the beneficiary the power to make a nomination that is binding on the trustee. For a member to be able to make a binding death benefit nomination, the trust deed for the superannuation fund must be appropriately worded. Therefore, it is essential before making a binding death benefit nomination that the trust deed provisions are carefully considered.

Also, any process specified in the trust deed must be followed. For example, if the deed contains a form that must be used, that form must be used. If the trustee must acknowledge the nomination, there must be evidence that the trustee has issued an acknowledgment.

For a number of years, we have seen cases[29] where the validity of binding death benefit nominations is tested, and this continues to be a battleground for disputes given the substantial wealth in superannuation.

In addition to the trust deed requirements, there are quite a number of technical requirements for a binding death benefit nomination to be effective for retail and industry superannuation funds (set out in regs 6.17A and 6.17B SISR94). In summary, these are:

- the trustee must give sufficient information to the member so that the member understands their right to make a binding death benefit nomination;
- the nominees must be dependants of the member or the member's LPR;
- the proportion that is payable to each nominee must be certain or readily ascertainable;
- the nomination must be in writing and signed by the member in the presence of two witnesses who are over 18 and not mentioned in the nomination; and
- the trustee must advise the member each year that the member has made a binding death benefit nomination, who the nominated beneficiaries are, and when the nomination lapses.

The trustee also has an obligation to clarify a nomination if the nomination is not sufficiently clear to allow the trustee to pay a benefit.

Recent case law has raised concerns regarding the complicated drafting of ss 58 and 59 SISA93 and reg 6.17A SISR94.[30] The cases were of the view that the current drafting gave rise to "ambiguities, uncertainties and potentially unintended consequences" and recommended urgent reform of these provisions.[31]

It is also now common practice for public offer superannuation funds to offer members the option of making a non-lapsing binding death benefit nomination. APRA, as the regulator of public offer superannuation funds, has also confirmed in Prudential Practice Guide SPG 280 that the trust deeds for those funds can allow members to make non-lapsing death benefit nominations. However, how these provisions interact with the SISA93 requirements is still not clear and there continues to be questions as to whether it is actually possible to making a valid non-lapsing binding death benefit nomination in a public offer superannuation fund.[32]

We have also seen a number of highly unusual and concerning provisions in trust deeds for public offer superannuation funds which give the trustee the power to invalidate a non-lapsing binding death benefit nomination at their discretion. As a result, it is critical that you understand the trust deed provisions you are working with and ensure that you are aware of the risks of working with those provisions and consequences should the nomination not be binding on the trustee.

Binding death benefit nominations and SMSFs

As the legislative provisions have no bearing on the binding death benefit nomination process in SMSFs, the provisions of the trust deed are paramount.

The process specified in the trust deed must be followed precisely. Where the process is not followed precisely (or it cannot be proved that it was followed precisely), the nomination will not be binding on the trustee and it is highly likely, given the prevalence of estate litigation, that this will be the subject of a challenge.

As binding death benefit nominations in SMSFs are purely a trust deed concept, they are not subject to the maximum three-year validity that applies to binding death benefit nominations for retail and industry superannuation funds (see reg 6.17A(7) SISR94, SMSFD 2008/3, *Ioppolo v Conti*,[33] *Munro v Munro*,[34] and *Cantor Management Services P/L v Booth*[35]). Therefore, unless there is a restriction in the SMSF trust deed, it is possible to make a non-lapsing binding death benefit nomination in an SMSF.

Compliance with the SISA93 and the SISR94

By far the most common issue that arises in SMSF trust deeds, including trust deeds from extremely reputable and experienced providers, is where the binding death benefit nomination provisions require the binding death benefit nomination to comply with the requirements of the SISA93 or the SISR94.

In the authors' experience, these provisions usually present in one of two forms:

1. the definition of "binding death benefit nomination" in the trust deed refers to a binding death benefit nomination "made in accordance with" or "binding under" s 59(1A) SISA93; and
2. the operative clause in the trust deed requires the binding death benefit nomination to comply with s 59(1A) SISA93 or reg 6.17A SISR94 (or both) for the trustee to be bound.

As mentioned earlier, neither the SISA93 nor the SISR94 provisions relating to binding death benefit nominations apply to SMSFs. Therefore, the trustee of the SMSF will not be bound by the binding death benefit nomination where the trust deed requires the binding death benefit nomination to comply with, or be binding under, the SISA93 or the SISR94.

This is contrasted with a provision that does not require compliance with s 59(1A) or reg 6.17A but merely imports the technical requirements set out in those provisions into the trust deed. This issue was the subject of the dispute in *Donovan v Donovan*.[36]

In this case, the deceased (Mr Donovan) was a member of the SMSF and a director of the trustee company. The operative provision that allowed the member to make a binding death benefit nomination was cl 11.4(b) of the trust deed, which provided as follows:

> "A member may make a binding death benefit nomination in the form required to satisfy the Statutory Requirements."

The trust deed provided as follows:

- "Statutory Requirements" was defined widely to include "any law … which must be satisfied by a superannuation fund in order to qualify for income tax concessions …"; and
- where a member had made a valid binding death benefit nomination, the trustee must pay the death benefit to the nominated LPR or dependant of the member.

The deceased purported to make a nomination by letter to the trustee which specified that he wanted his benefits paid to his LPR for inclusion in his estate assets.

The deceased's second wife and a child of the deceased's first marriage, who were the deceased's executors, were disputing whether this was a valid binding death benefit nomination that had to be followed by the trustee.

The second wife argued that the nomination was binding on the trustee. However, the deceased's children argued that the nomination was not binding for two reasons:

1. the language used was not sufficient to convey a binding intention. The nomination merely indicated that the deceased "wished" for his death benefit to be paid in a particular way, not required or directed; and
2. the nomination was not sufficient to comply with the requirements of the "Statutory Requirements".

In addition to these issues, Fryberg J raised the issue of the "approved form", but neither party pursued this issue and, in any event, it was irrelevant to the end result.

Fryberg J dealt with the second issue first and held that the reference to "Statutory Requirements" for the purposes of the binding death benefit nomination provision was a reference to the formalities in reg 6.17A(6) SISR94, because to read the clause in the trust deed in any other way would render the provision meaningless.

The formalities in the SISR94 required the nomination to be in writing, witnessed by two persons, and contain a signing declaration from the witnesses in relation to the signing of the nomination.

The letter written by the deceased to the trustee clearly did not comply with the requirements of reg 6.17A. As a result, the nomination was not binding on the trustee.

Further, the judge ordered that the costs of the dispute be paid from the estate on an indemnity basis.

This position was affirmed by:

- the Queensland Supreme Court in *Munro* v *Munro*,[37] where it was held that a binding death benefit nomination in relation to benefits in an SMSF does not have to comply with the requirements in the SISA93 and the SISR94 (unless the trust deed requires that); and
- the Full Court of the Supreme Court of South Australia in *Cantor Management Services P/L v Booth*,[38] where it was held that the trustee of an SMSF is not bound by a binding death benefit nomination made in accordance with the SISA93 and the SISR94; it is the trust deed that governs the requirements for a binding death benefit nomination in an SMSF.

However, *Wooster v Morris*[39] demonstrates that practitioners must think beyond the binding death benefit nomination when advising on superannuation death benefits. This case involved a challenge to the validity of the binding death benefit nomination. The judgment does not examine this issue as the binding death benefit nomination was found to be valid by a special referee before the hearing. However, the case demonstrates that. even where there is a binding death benefit nomination, it is critical to ensure that the correct person will be running the superannuation fund in the event of the death of a member. This issue is discussed in detail below.

Another concerning issue is the manner in which practitioners initially respond to a dispute where there is challenge to the superannuation death benefit. Quite often, where there is a binding death benefit nomination, practitioners are very quick to write a response to the claimant notifying them of the binding death benefit nomination and the fact that the death benefit has been paid in accordance with that nomination.

We understand the reasons for this, as it is usually a quick way to dismiss the dispute. However, such a statement must not be made lightly and should only be made after a thorough review of the binding death benefit nomination and the trust deed. If such a statement is made and the binding death benefit nomination is not in fact "binding", the actions of the trustee in paying the death benefit could be subject to challenge.

Binding death benefit nominations — common mistakes in the planning phase

Following from the decisions of *Donovan v Donovan* and *Munro v Munro*, there are other avenues in which the validity of a binding death benefit nomination may be challenged.

This section outlines common issues that can affect the validity of a binding death benefit nomination.

Fund rules

The most critical step when making a binding death benefit nomination is determining the current rules of the fund. Unfortunately, this step is often overlooked, with most people just assuming that the latest deed sets out the current rules of the fund without undertaking a detailed review of the trustee and trust deed history of the fund.

To ensure that a binding death benefit nomination is valid, it is critical that a detailed review of both the trustee and trust deed history of the fund is carried out. If there is an error or gap in the history (which is often the case), this could impact on the validity of the binding death benefit nomination.

In *Perry v Nicholson*,[40] the deceased's adult child, Ms Perry, was challenging her father's binding death benefit nomination, which provided that all of his death benefit would be paid to his de facto spouse, Ms Nicholson. Ms Perry argued that the binding death benefit nomination was invalid because of some technical imperfections in a change of trustee almost two years before the binding death benefit nomination was signed.

Fortunately for Ms Nicholson (and the deceased's accountant), the court upheld the effectiveness of the change of trustee even though the documents prepared by the accountant to change the trustee did not strictly comply with the requirements in the trust deed.

The lack of care in the earlier change of trustee resulted in the court case which would have involved substantial costs.

Had the court applied the stricter approach from previous cases, the change of trustee may well have been invalid, which could have then resulted in the binding death benefit nomination being ineffective. This was the outcome in *Moss Super Pty Ltd v Hayne*,[41] where the court found that an earlier resignation signed by the trustee rendered a later change of trustee ineffective, unravelling the deceased's expressed estate planning intentions.

Approved form

There are a number of common trust deeds in circulation that require the binding death benefit nomination to be made in the "approved form".

Usually, this requires the member to use the specific form set out in the schedule to the particular trust deed. In the grand scheme of things, this is a fairly basic condition to satisfy, but it is surprising how many times it is not.

In most of these situations, the reasons why this requirement has been overlooked are uncertain. However, the most compelling reason seems to be that the specified form did not have sufficient flexibility to cater for the practitioner's drafting style (for example, it was not possible to make cascading nominations).

Unfortunately, where the "approved form" is not used, it is irrelevant how well the alternative form is drafted as it will not be binding on the trustee.

As mentioned many times in this article, the provisions of the trust deed are of paramount importance. Where they are not complied with, there is no room for movement. Unlike in the world of drafting a will, there is no such thing as substantial compliance or testamentary intention. Therefore, if the trust deed requires a certain form to be used, that is the only form in which a binding death benefit nomination can be made and be binding on the trustee.

An even bigger problem is caused by trust deeds that require the binding death benefit nomination to be made in the form "approved" by the trustee. These trust deeds do not usually include a default or pre-approved form and it is therefore up to the trustee to decide at the time what the "approved form" is. As a result, the trustee must have taken an active step to "approve" a form before a nomination can be binding on the trustee.

Even where this step is taken by the trustee, such provisions are at high risk of a challenge. This is because, if put to proof, the parties will need to produce evidence that the trustee "approved" a form and that the form of the binding death benefit nomination used was in fact the "approved form".

Eligible beneficiaries

Another common mistake is that the binding death benefit nomination nominates a beneficiary that is either:

- not an eligible recipient for the purposes of the SISR94; or
- an eligible recipient for the purposes of the SISR94 but the trust deed provisions (in particular, the definitions) are inexplicably narrow.

A common example that arises is where a person makes a binding death benefit nomination in favour of their de facto spouse, but the trust deed defines a "spouse", for the purposes of the "dependant" definition and the binding death benefit nomination clause, to only include a married spouse. In this case, the binding death benefit nomination to the de facto would not be valid as they are not a permitted beneficiary under the trust deed.

In one prominent superannuation trust deed, a binding death benefit nomination can only be made to a dependant and not to the estate. Therefore, it is critical that the terms of the trust deed, including every relevant definition, are carefully considered when making a binding death benefit nomination to ensure that it is valid.

Also, it is critical that the binding death benefit nomination correctly refers to the intended beneficiary. As the power to make binding death benefit nominations for SMSFs is solely based on the provisions of the trust deed, the courts have insisted on strict compliance with the requirements of the trust deed when determining the validity of binding death benefit nominations.

In the recent Queensland Supreme Court case of *Munro v Munro*,[42] the binding death benefit nomination was found to be invalid, allowing the trustees of the SMSF to distribute the deceased's death benefit other than as set out in the nomination. The court held that the binding death benefit nomination was not valid as it did not comply with the requirements in the trust deed. The court emphasised that the binding death benefit nomination would only be binding if it strictly complied with all of the requirements of the trust deed. In this case, the nomination was to the "Trustee of Deceased Estate" rather than to the deceased's "legal personal representative" as required by the trust deed and the SISA93. The court determined that this was not a nomination of the deceased's "legal personal representative" (as required by the trust deed and the SISA93), as the roles were different.

Eligibility to make a binding death benefit nomination

This issue is a twist on the situation in the section above.

It is dangerous to assume that every member of a superannuation fund is able to make a binding death benefit nomination.

Some SMSF trust deeds allow a "member" to make a binding death benefit nomination, although the definition of "member" did not include a person whose only interest in the SMSF was their pension account. As a result of this drafting oversight, only a person with an accumulation balance in the superannuation fund could make a binding death benefit nomination, and a pension account could not be subject to any effective binding death benefit nomination.

Trustee acknowledgment/receipt

Another common binding death benefit nomination provision requires the binding death benefit nomination to be given to the trustee or the trustee to "acknowledge" or "accept" the binding death benefit nomination for it to be valid and binding on the trustee.

Although this is not a difficult provision to comply with, such provisions are high risk. If there is a dispute, the parties will need to produce evidence that the binding death benefit nomination was given, or that the trustee "acknowledged" or "accepted" the binding death benefit nomination. In the authors' experience, this step is not often completed satisfactorily, or where it has been attended to, the client does not keep adequate records to establish this at the time of payment of the death benefit.

This issue was examined in *Cantor Management Services P/L v Booth.*[43] In this case, the trust deed required the binding death benefit nomination to be "given" to the trustee in order to be binding on the trustee. The court found that the binding death benefit nomination was given to the trustee as it was being held at the registered office of the corporate trustee, even though the sole director of the corporate trustee was not aware of its existence.

This was a fortunate result for the nominated beneficiaries as the parties gave no thought to the technical requirement for the binding death benefit nomination to be "given" to the trustee.

Also, clauses requiring the trustee to accept or acknowledge a binding death benefit nomination presents a problem where the trustees/members have separated and one of the members wishes to make a new binding death benefit nomination. As the nomination has to be accepted or acknowledged by the trustee, the ex-spouse must consent to the new binding death benefit nomination for it to be valid. As you can imagine, this can be rather difficult.

Information to members

A similar issue arises where the trust deed requires the trustee to provide information to the member before they can make, or before the trustee can accept, a binding death benefit nomination. The following is an example of such a clause:

> **Information to Member:** Before the Trustee accepts a Binding Death Nomination, the Trustee must give the Member a statement that …

Required compliance

Another critical mistake is where the binding death benefit nomination clause and the death benefit provisions in the trust deed do not work together.

Usually, the problem arises because the death benefit provisions do not "require" the trustee to pay the death benefit in accordance with the binding death benefit nomination made by the member. The following is an example from a well-known trust deed:

> Where this Deed provides for the payment of a Benefit on the death of a Member, the Trustee **may** pay or apply the Benefit to or for the benefit of the Nominated Dependants …

This clause provides the trustee with a choice to follow the binding death benefit nomination or to pay the death benefit in accordance with the trustee's discretionary power. As a result, for the binding death benefit nomination to be "binding", this clause needs to be amended.

Also, do not be surprised to see trust deeds where the death benefit provisions do not even refer to the binding death benefit nomination. In this case, depending on the exact wording of the binding death benefit nomination clause, it is likely that the binding death benefit nomination will not remove the trustee's discretion in relation to the payment of the death benefit.

Can an attorney make a binding death benefit nomination for a member?

Recent comments in a decision of the Western Australia State Administration Tribunal in *SM*[44] have questioned whether a binding nomination is a testamentary disposition. If this is the case, binding nominations will not be able to be made by an attorney on behalf of a member.

If the comments in the decision are correct, this will have two impacts on the current state of the law:

1. the decision in *Re Narumon Pty Ltd*[45] in terms of whether an attorney can make or renew a binding nomination could be determined incorrect by a later decision; and
2. the approach to preparing binding death benefit nominations must change to ensure that they meet the formal requirements of a will under the legislation in each state and territory.

In *SM*, the tribunal undertook an assessment of the case law relied on by Bowskill J in *Re Narumon* and distinguished those decisions from the decisions of *Bird v Perpetual Executors and Trustees Association of Australia Ltd*[46] and *Re Bubnich; Marian v Bubnich*.[47]

Those cases referred to involved a combination of nominations for life insurance, life insurance held in a pension scheme, and pension schemes. *Bird v Perpetual Executors and Trustees Association of Australia Ltd* involved a deed that purported to give an amount of money in consideration of accommodation provided to the deceased during his life.

The tribunal in *SM* did not undertake an analysis or comment on whether a member of a superannuation fund had an absolute and indefeasible entitlement to a death benefit.

The discussion in *McFadden v Public Trustee for Victoria*[48] of a contributory life assurance and pension scheme and *Re Application by Police Association of South Australia*[49] of a group life policy determine that those schemes are schemes in which the deceased did not have absolute and indefeasible entitlement.

Instead, the schemes were viewed as a binding contract between the member and the fund for "the creation of a trust of future property in certain events [reaching preservation age or death in the context of a superannuation fund] …".

The ability of the member to make a nomination under the rules of the fund (as determined by the trust deed) is a right of the member in the nature of a power of appointment to be made inter vivos under the terms of the trust deed. In the authors' opinion, this is analogous to the concept of a binding death benefit nomination under a trust deed for an SMSF.

Based on this analysis, it is likely that an attorney does have the power to make a binding death benefit nomination on behalf of a member (in Queensland at least), although this will be subject to the particular trust deed and the terms of appointment of the attorney.

Whether the Queensland position will be adopted in other states and territories will ultimately depend on the courts' analysis of the legislation governing powers of attorney in each jurisdiction. However, the current case law in the authors' view provides a good foundation to argue that an attorney can make a binding death benefit nomination on behalf of the member.

Control of the fund after death

The issue of the "control" of the superannuation death benefit decision is deeply embedded in the minds of most estate practitioners.

The importance of who controls the superannuation fund and who has the discretion as to how the superannuation death benefit is paid was highlighted by *Katz v Grossman*.[50]

In this case, Daniel Katz brought an action against his sister Linda Grossman and her husband Peter Grossman claiming an interest in their father's SMSF. The key facts of this case were:

- the deceased and his late wife were individual trustees of their SMSF;
- the deceased's wife died in 1998 and the deceased appointed his daughter Linda as an additional trustee of the fund;
- when the deceased died in 2003, Linda appointed her husband Peter as a co-trustee;
- the deceased had made a non-binding death benefit nomination of beneficiary in which he indicated that he wanted his superannuation benefit to be divided equally between Daniel and Linda;
- Linda and Peter refused to follow the deceased's non-binding death benefit nomination and decided to pay the entire benefit of approximately $1,000,000 to Linda; and
- Daniel challenged the appointment of Linda and Peter as trustees of the fund.

The court held that both Linda and Peter were validly appointed as trustees and, as a result, they were entitled to exercise the powers of the trustee. This included the discretionary power to pay the death benefit in accordance with the trust deed and the SISR94.

Following this case, practitioners generally paid a lot more attention to binding death benefit nominations and who had the power to control the superannuation fund where there was no binding death benefit nomination to prevent such abuses from occurring.

Despite this, not as much focus has been given to who controls the superannuation death benefit where the superannuation death benefit decision is locked in, either by way of binding death benefit nomination, reversionary pension or specific trust deed provision. This is most likely due to complacency resulting from the knowledge that the trustee has to comply with a pre-made decision.

Although the thought process behind this is logical, it does not necessarily prevent a dispute. The Victorian Supreme Court case of *Wooster v Morris*[51] is a prime example of the potential issues that can arise where the trustee chooses not to comply with the trust deed.

In this case, the deceased had made a binding death benefit nomination for the benefits in his SMSF in favour of his two daughters from his first marriage, who were also the executors of his estate. At the time of his death, the deceased's second wife was the surviving member and trustee of the SMSF.

The second wife disputed the validity of the binding death benefit nomination and had obtained legal advice that the nomination was not binding as it was not delivered to her in her capacity as a co-trustee as required by the trust deed. The second wife, as the surviving trustee and the controller of the SMSF, therefore decided to pay the superannuation death benefit to herself.

As a result, the daughters had to commence proceedings to obtain an order that the nomination was valid and binding on the trustee, and to direct the second wife to account for the superannuation death benefit to them.

The judgment does not contain a detailed consideration of the reasoning as to why the binding death benefit nomination was valid. However, the daughters were successful. The court also ordered that the daughters' costs be paid by the second wife and the new corporate trustee of the SMSF, and that the deceased's superannuation death benefit was not to be diminished by the costs order.

This case demonstrates how critical it is to deal with the control of the SMSF in all situations, including where the trustee's discretion is removed. Our clients will not thank us for the work we do if they have to go to court to enforce their right to receive the superannuation death benefit under a binding death benefit nomination, reversionary pension or a specific trust deed provision.

Broadly speaking, the issue with control of SMSFs can be broken down into two categories:

1. SMSFs with individual trustees; and
2. SMSFs with corporate trustees.

Appointment of LPR

Where there are individual trustees, it is critical that the terms of the trust deed are reviewed to determine how a replacement trustee is appointed in the event of the death of a trustee and member. This is because:

- the deceased will cease automatically to be a trustee on their death; and

– control of the SMSF will then rest with the remaining individual trustees and the person who has the power to appoint new trustees.

Where a member dies, s 17A(3)(a) SISA93 provides that the deceased's LPR must be appointed as a trustee (or a director of a corporate trustee) of the fund within six months of the member's death in order to satisfy the basic conditions to remain an SMSF while the deceased still has member benefits in the SMSF. If this is not done, the SMSF ceases to be a complying SMSF and can be made non-compliant by the ATO.

However, s 17A does not automatically appoint the LPR as a trustee (or a director of a corporate trustee) of the SMSF. This is a common misconception.

The importance of reviewing the SMSF trust deed to determine who has the power to appoint trustees was addressed in *Ioppolo & Hesford v Conti*.[52] Master Sanderson J reviewed the requirements of s 17A and held that:[53]

> "Section17A(3) allows for the appointment of an executor as a trustee of the fund but does not in its terms require such an appointment."

Therefore, in the absence of any express clause in the trust deed, the court found that the surviving trustee was not required to appoint her LPR as a trustee, and therefore, the surviving trustee's exercise of powers was valid.

This position has been confirmed recently in *Dawson v Dawson*[54] in which the court held that the appointment of an attorney as trustee of the fund is a personal appointment and does not cease on the death of the member. Therefore, there is no automatic or compulsory removal of the attorney and appointment of the executor under s 17A SISA93.

The control of an SMSF on the death of the member needs to be considered in light of the following:

– whether the LPR needs to be appointed and, if they are appointed, whether any issue of conflict arises; and
– the provisions in the trust deed for appointing trustees.

The provisions in SMSF trust deeds for appointing trustees are many and varied. The most common trust deed provision for appointing trustees is a clause that requires the determination of a majority of members. Although this provision may be sufficient for everyday operation, it can be the source of problems when it comes time to appoint the LPR as a trustee.

In a typical two-member SMSF, the consent of the surviving member (generally the surviving spouse) would be required in order to have the LPR appointed as a trustee. This may be a problem where the interests of the continuing trustee/member and the LPR are not aligned (as in *Ioppolo & Hesford v Conti*).

Conclusion

While this article does not address all of the issues with regard to superannuation death benefits, it does provide a useful insight into the breadth of issues that must be considered when you are engaged to advise on superannuation death benefit payments or claims.

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A Matter of Trusts

by Edward Morcombe, Sladen Legal

When a declaration of trust is dutiable: part 2

In this two-part article, we explore two recent cases that provide guidance on when a declaration of trust will be a dutiable transaction.

In part 1 of this two-part article, we introduced the concept of acknowledgments of existing trust and the decision of *Chief Commissioner of State Revenue v Benidorm Pty Ltd*[1] (*Benidorm* decision), where it was found that the relevant declaration of trust was not dutiable because, first, the declaration had no legal effect and merely acknowledged an existing position and, second, as it did not constitute a transaction, a mere acknowledgment of existing trust was not a dutiable declaration of trust under s 8 of the *Duties Act 1997* (NSW).

Part 2 of this article reviews the decision in *Chief Commissioner of State Revenue (WA) v Rojoda Pty Ltd*[2] (*Rojoda* decision) in order to draw out key comparisons between the *Benidorm* and the *Rojoda* decisions, and summarises the key questions that advisers should be asking when considering the potential duty implications of declarations of trust.

Rojoda decision

A similar argument to that made by Benidorm Pty Ltd (Benidorm) was unsuccessful in the *Rojoda* decision in the context of partnership interests.

The *Rojoda* decision was based on s 11 of the *Duties Act 2008* (WA), which provides:

> "(1) … any of the following is a ***dutiable transaction*** —
>
> …
>
> (c) a declaration of trust over dutiable property …"

Section 9 of the *Duties Act 2008* (WA) defines "declaration of trust", in nearly identical terms to s 8(3) of the *Duties Act 1997* (NSW), to mean:

> "… any declaration (other than by a will) that any identified property vested or to be vested in the person making the declaration is or is to be held in trust for the person or persons, or the purpose or purposes, mentioned in the declaration although the beneficial owner of the property, or the person entitled to appoint the property, may not have joined in or assented to the declaration;"

Facts

The Scolaro family ran a business of property ownership and investment through two partnerships (the partnerships). The partnerships held several freehold titles (the titles). Following the death of Mr Scolaro, the titles were held solely by Mrs Scolaro (the legal owner). Following the dissolution of the partnerships but prior to the partnerships being wound up, two deeds (the deeds) were entered into by the legal owner and other former partners with interests in the partnerships providing that the titles were to be held on trust for the former partners of the dissolved partnerships in fixed shares according to their partnership interests. The deeds appointed Rojoda Pty Ltd (Rojoda) as trustee of the titles, to whom legal ownership of the titles would be transferred, and stated that the beneficial ownership of the titles "remained unchanged" as a result of the execution of the deeds.[3]

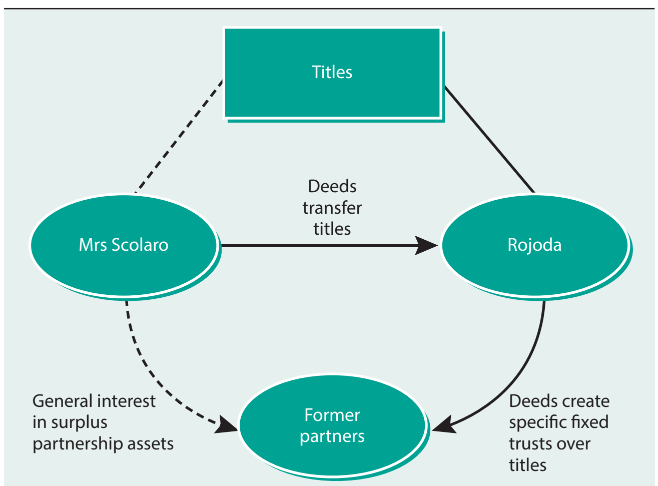
The Commissioner of State Revenue imposed duty on the deeds on the basis that they were declarations of trust that changed the nature of the former partners' interests in the titles. The taxpayer, Rojoda, argued that, since all of the partnerships' property interests had been held on fixed trust for the former partners in proportion to their partnership interests since the partnerships were dissolved, the deeds merely confirmed that existing position and were not dutiable transactions.[4]

Decision

The court found that, while the former partners in whose favour the deeds were made did have existing equitable interests in the titles, the nature of and rights under those interests (not being interests in any specific asset(s)) were significantly different from the rights under the fixed trusts created by the deeds. The deeds extinguished the existing partnership interests and created new rights and were therefore dutiable events (see Figure 1).

It did not matter that the "practical reality"[5] was that, after the liabilities of the dissolved partnerships were discharged (regardless of whether such liabilities were certain to be discharged by current assets or would require property to

Figure 1. Declaration of trust structure in the Rojoda decision



be realised), the titles would then be held on fixed trust for the former partners according to their partnership interests. The deeds, in effect, skipped over a stage in the winding-up of the partnerships — the satisfaction of the partnerships' liabilities by allocation of their assets — and gave the former partners an immediate interest in the titles rather than an expectancy in the surplus of the partnerships' assets once the partnerships were fully wound up.

Therefore, the court found that the nature of the former partners' interests in the titles had changed, there was a transaction, and, as the deeds fell within the statutory definition of "declaration of trust", they were dutiable.

While not stated directly by the court, if the deeds had not been entered into, and there had been "true"[6] transfers of interests in the titles to the respective former partners in proportion to their interests in the partnerships following discharge of all liabilities and the finalisation of the partnerships' winding-up, it is likely that the transfers could have been made with only a nominal duty liability.[7]

Comparisons

There are at least two factual differences that are worth teasing out in order to reconcile the *Rojoda* decision and the *Benidorm* decision. They also illustrate useful indicia for determining whether a document is effecting a transaction or merely acknowledging an existing position.

How did the declaration interact with the interests of third parties?

Compare the position of potential creditors of the partnerships in the *Rojoda* decision to that of the potential creditors of Mr Robinson's estate in the *Benidorm* decision. In the *Rojoda* decision, the deeds vested the beneficial interests in the titles in the former partners prior to the liabilities of the partnerships being discharged. Regardless of whether there were in fact any creditors, or whether the partnerships had adequate cash to satisfy liabilities without realising real property, this was a material change in the position of third parties with potential interests in the titles.

In the *Benidorm* decision, the court also noted that the potential existence of creditors of Mr Robinson's estate, and their potential interests in the property, was an important consideration in distinguishing the position of Benidorm holding the property on trust for Mr Stubbs in his capacity as executor as compared to his capacity as beneficiary.[8] As the second declaration of trust only confirmed the vesting of the property in Mr Stubbs in his capacity as executor, any potential interests of third parties in the estate of Mr Robinson were unaffected. Unlike the facts in the *Rojoda* decision, the second declaration of trust did not skip over the administration of the estate by vesting the beneficial interest in the property immediately in Mr Stubbs as beneficiary.

Could the operation of a specific legislative provision be pointed to with certainty?

Benidorm was able to rely on a specific legislative provision whose effect (in conjunction with Mr Robinson's will) was that Mr Robinson's interest in the property "shall pass and become vested" in Mr Stubbs in his capacity as executor "upon the grant of probate of the will".[9] It was unambiguous that this had already occurred at the time of the second declaration of trust.

Rojoda, on the other hand, could not point to a specific legislative provision whose effect was to have already created the specific beneficial interests in the titles that the deeds purported to merely confirm. The court accepted that, under the *Partnership Act 1895* (WA) and general principles of partnership law, "every partner is entitled … to have the surplus assets"[10] of the partnership returned to them according to their interests in the partnership on completion of the winding-up. While they protected the rights of the former partners, these provisions and principles did not operate automatically to have vested the titles on fixed trusts for the former partners by the time the deeds were executed. The requirement for further action to be taken before the beneficial interests would vest in the former partners may be contrasted to the immediate vesting of the beneficial interest in the property in Mr Stubbs as Mr Robinson's executor on the granting of probate of his will.

Takeaways

As duties legislation varies from state to state, so will the relevant test for whether a declaration of trust is a dutiable transaction.[11] The provisions of the relevant legislation should be read closely when considering declarations of trust, noting that the statutory definition of a dutiable declaration of trust may be broader than what would be considered a declaration of trust under the general law.

Based on the *Benidorm* and the *Rojoda* decisions, for jurisdictions where duties legislation has been adopted that taxes transactions rather than instruments, a declaration of trust that merely confirms or acknowledges an existing trust should not be a transaction and therefore should not be dutiable.

This does not, however, resolve the difficulty of determining whether a declaration is creating or altering legal rights or merely confirming an existing trust. Therefore, consider the following questions prior to entering into declarations of trust:

– Is the document bringing into existence a trust relationship that would not otherwise exist?
– Is the document purporting to bring into existence a contingent trust relationship at some point in the future?
– Is the document confirming the existence of an implied trust by creating an express trust?
– Is the document making an existing trust enforceable in a way that it would not otherwise be enforceable?
– Is the document at all altering the rights and obligations between parties within an existing trust relationship?
– Could the document affect the legal rights of third parties in the subject property?
– Is it difficult to point to a specific legislative provision whose operation you are confirming?
– Are you seeking to confirm the general operation of common law principles?

If the answer to any of these questions is yes, or the answer is not clear, there is a risk that the relevant state tax authority may take a view that the execution of the documents amounts to a dutiable transaction and is liable to stamp duty.

In that case, or in any event, consider whether the document is required or whether the existence of the trust relationship could be evidenced in other ways. For example, if a bank requires evidence of a trust for finance purposes, or a court for evidentiary purposes, the existence of the trust may potentially be established by secondary evidence, such as financial statements or by statements from relevant parties (eg affidavits from the trustee and/or beneficiary).

As shown in this two-part article, great care should be taken before executing a declaration of trust, even if it is merely to confirm an existing trust.

Important note: In the first part of this article, it was noted that the Chief Commissioner had advised that they would be seeking special leave to appeal the *Benidorm* decision to the High Court. That application for special leave was refused by the High Court on 12 April 2021.

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7 As a transfer of partnership property to retiring partners following the partnerships' dissolution under s 78 of the *Duties Act 2008* (WA).

8 [2020] NSWCA 285 at [29].

9 S 44 of the *Probate and Administration Act 1898* (NSW).

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Superannuation

by Daniel Butler, CTA, and Shaun Backhaus, DBA Lawyers

SMSFs – can all income be NALI?

Broadly, SMSF trustees may assume that, in any related party dealing, NALI will apply unless they can prove otherwise.

Overview

One key criticism of LCR 2019/D3 (the draft LCR) is the breadth of the ATO's view in relation to the "nexus" required between the scheme and the loss, outgoing or expense (expense) that can constitute non-arm's length income (NALI) under s 295-550 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97).

The ATO's view is that, where an expense is incurred by a fund that is less than an arm's length amount, all of a fund's ordinary and statutory income is NALI, which (after relevant expenses) is taxed at 45%.

Extrapolating this to a "general expense" incurred by an SMSF, the ATO takes the view that, where a direct nexus to a particular source/asset is missing, there is instead a nexus to all income of the fund, regardless of the source of that income or whether any asset produces that income or gain.

While the draft LCR confirms that a non-arm's length expense (NALE) causes the income from that particular year to be NALI, this ATO view also leads to the conclusion that all future income (including net capital gains) on all assets held by the fund at that particular time would also be NALI.

For example, a $100 reduction in an accounting cost for a widely diversified mum and dad SMSF with an average fund balance of $1.3m would expose all future income and all future capital gains on all assets then held by that fund to NALI.

On 4 December 2019, The Tax Institute lodged a detailed submission on "Non-arm's length income and expenses — LCR 2019/D3 and PCG 2019/D6" to the ATO adopting a different construction of the wording in s 295-550(1) ITAA97. The Institute's view is examined below and contrasted to the ATO's view. (Note that PCG 2019/D6 was finalised as PCG 2020/5 and is discussed below.)

In preparing this article, we wish to acknowledge The Tax Institute's NALI submission for raising this "nexus" issue.

What nexus?

Section 295-550(1) ITAA97 contains a nexus requirement in paras (b) and (c) that, if *as a result of a scheme* the parties to which were not dealing with each other at arm's length in relation to the scheme, one or more of the following applies:

> "(a) …
>
> (b) *in gaining or producing the income*, the entity incurs a loss, outgoing or expenditure of an amount that is less than the amount of a loss, outgoing or expenditure that the entity might have been expected to incur if those parties had been dealing with each other at arm's length in relation to the scheme;
>
> (c) *in gaining or producing the income*, the entity does not incur a loss, outgoing or expenditure that the entity might have been expected to incur if those parties had been dealing with each other at arm's length in relation to the scheme." (emphasis added)

Clause 2.38 of the explanatory memorandum (the 2019 EM) that introduced the *Treasury Laws Amendment (2018 Superannuation Measures No. 1) Act 2019* (Cth) (NALE Act) states:

> "Where there is a scheme that produced non-arm's length income by applying non-arm's length expenses, there must also be a sufficient nexus between the expense/s and the income, that is, the expenditure must have been incurred 'in' gaining or producing the relevant income. This reflects the analysis that must be undertaken in determining whether an expense is deductible under section 8-1, or can be included in the entity's cost base for the transaction if the expense is of a capital nature (see below)."

This nexus point is not critically examined in the draft LCR. Rather, the ATO readily accepts that a nexus is easily established. For example, para 17 of LCR 2019/D3 states:

> "Non-arm's length expenditure incurred to acquire an asset (including associated financing costs) will have a sufficient nexus to all ordinary or statutory income derived by the complying superannuation fund in respect of that asset. This includes any capital gain derived on the disposal of the asset (see Example 1 of this Ruling)."

Broadly, the draft LCR suggests that NALI will arise if there is a nexus between the acquisition of an asset and any eventual capital gain derived when the fund incurs an expense less than the arm's length amount.

Background to NALE being introduced

The introduction of the NALE Act was largely due to the growth of low interest loans in relation to limited recourse borrowing arrangements (LRBAs).

The *Superannuation Taxation Integrity Measures* consultation paper was issued on 11 January 2018 (the consultation paper), together with exposure draft legislation and an exposure draft EM. The consultation paper stated:

> "28. The current NALI rules ensure that income derived from related party transactions does not receive concessional tax treatment if it is higher than could be derived on commercial terms. However, the rules do not currently take into account *fund expenditure* incurred that would normally apply in a commercial transaction, which reduce non-arm's length income e.g. where interest is not paid on the loan from a related party, meaning the fund's

net income is higher than it would have been in a commercial transaction.

29. The proposed amendment would include these expenses, meaning that these arrangements with higher net income will not receive concessional tax treatment."

Examples 2 and 3 in the consultation paper involve low interest LRBAs. There is no reference to, or example of, a general expense or lower professional fee giving rise to NALI.

The following paragraphs are extracted from the exposure draft EM of January 2018:

"1.16 The legislation requires the *identification of a specific amount* of ordinary or statutory income that is NALI. That is, the existence of an amount of NALI does not necessarily 'taint' all of a superannuation entity's income; it is necessary to specify the scheme in relation to which the NALI was derived."

"1.23 The framework for the ordinary and statutory NALI rules remains the same:

- there must be a scheme;
- the party or parties must not be dealing with each other at arm's length by incurring less (or nil) expenditure than would otherwise be expected if the parties were dealing with each other on an arm's length basis in relation to the scheme; and
- the *expense must be identifiable as a specific amount* (including a nil amount), *as must the income* gained or produced." (emphasis added)

Example 1.1 of the exposure draft EM of January 2018 also relates to an LRBA. The circumstances in this example involve an LRBA with no interest, no repayments, 100% gearing and repayment of principal required at the end of the 25-year loan term.

Broadly, the SMSF industry had not contemplated that the proposed NALI changes would result in a general expense tainting all (of an SMSF's) ordinary and statutory income. As noted, for a considerable period, it was envisaged that an expense such as a lower interest rate in respect of rental income related to an LRBA could give rise to NALI. This was on the basis that a superannuation fund is permitted under s 67A of the *Superannuation Industry (Supervision) Act 1993* (Cth) to borrow to acquire a single acquirable asset. Thus, with LRBAs, there is a sufficient nexus with the lower expense and the specific asset producing that income.

PCG 2020/5 (dated 1 June 2020) confirmed the ATO's position that a general expense would taint all ordinary and statutory income. The following paragraphs from PCG 2020/5 best explain the background to the ATO's revised view:

"6. As a result of consultation feedback received on LCR 2018/D10, the ATO has provided clarification on particular issues in LCR 2019/D3. One of these issues concerned when non-arm's length expenditure will have a sufficient nexus with income derived by the complying superannuation fund for the NALI provisions to apply. In particular, the Commissioner has set out the preliminary view that certain non-arm's length expenditure incurred by a complying superannuation fund may have a sufficient nexus to all ordinary and/or statutory income derived by the fund for that income to be NALI (for example, fees for accounting services) … This can be contrasted to non-arm's length expenditure that has a more direct nexus to particular ordinary or statutory income derived by the fund (for example, expenditure relating to the acquisition of an income-producing asset).

7. The ATO recognises that trustees of complying superannuation funds may not have realised that the amendments will apply to non-arm's length expenditure of a general nature that has a sufficient nexus to all ordinary and/or statutory income derived by the fund in an income year, noting that it was not explicitly stated in LCR 2018/D10. It is also recognised that the amendments apply in relation to the 2018-19 and later income years which may result in all income derived by a fund during the 2018-19, 2019-20 and 2020-21 income years being classified as NALI where it has incurred non-arm's length expenditure of a general nature.

8. A number of comments were received in respect of LCR 2019/D3 and all these comments are being considered in the finalisation of that draft Ruling.

9. Pending the finalisation of LCR 2019/D3, the ATO considers it is appropriate to apply the transitional compliance approach outlined in paragraphs 10 and 11 of this Guideline."

Thus, the SMSF industry was not expecting NALE to taint all ordinary and statutory income when the consultation paper was issued in January 2018 with exposure draft legislation and the exposure draft EM. The SMSF industry was put on notice of this broad view when LCR 2019/D3 issued on 2 October 2019.

As noted above in paras 6 to 9 of PCG 2020/5, the ATO's broader view resulted in considerable controversy from certain sectors of the SMSF industry. The ATO confirmed in PCG 2020/5 that the ATO had decided that no compliance resources would be applied for the period of 1 July 2018 to 30 June 2021. However, as noted below, this period was extended on 24 March 2021 to cover the 2021-22 financial year.

The NALI/NALE legislative changes in late 2019

The NALE Act was, on receiving royal assent, finalised as law on 2 October 2019, with retroactive powers from 1 July 2018. Moreover, the changes are expressed to apply to schemes regardless of when they were entered into. For example, an SMSF that acquired an asset for less than market value in 2000 could be exposed today to NALI.

We will now examine the impact of NALE where an asset is acquired below market value, and where an asset is acquired at market value.

Assets acquired below market value: is there a nexus?

Example 1 of LCR 2019/D3 involves Armin selling commercial property with a market value of $800,000 for $200,000 to his SMSF. According to the draft LCR, all of the income and capital gains from that property is NALI.

However, what is not taken into consideration in this example is the application of the CGT market substitution rule and the

ATO's long-established practice of treating a transfer of an asset below market value as a contribution in accordance with TR 2010/1 (the ATO's tax ruling on superannuation contributions).

Where the CGT market value substitution rule in s 112-20 ITAA97 applies, the member transferring the asset to the fund below market value is deemed to have received the market value of the asset that exceeds any consideration received as capital proceeds in accordance with s 116-30 ITAA97. Therefore, Armin would typically be treated by the ATO as having made a non-concessional contribution (NCC) equal to the difference between the sale price ($200,000) and the asset's market value ($800,000), ie a $600,000 contribution. This approach is consistent with the ATO view reflected in TR 2010/1.

Note that, if a member exceeds their NCC cap, they will be subject to the excess contribution system, which may potentially expose them to tax at a rate of 47% unless they elect to release the excess amount of NCCs, plus 85% of the associated earnings on the excess NCC amount, in which case the member will then pay tax on 100% of their associated earnings.

There is no guidance in the draft LCR about what takes precedence — the contributions regime or NALI — to avoid any potential "double jeopardy". Indeed, the recognition of an NCC reflects market value consideration for the asset. This is the view of the High Court in *Cook v Benson* in relation to contributions made by a member who was made bankrupt:[1]

> "… the first respondent made contributions in return for the undertaking by the trustees of the funds of obligations to pay death, retirement or other related benefits, to him or his nominees, in accordance with the rules of the respective funds. He obtained consideration in money's worth in return for the payments."

If the ATO seeks to change its long-established practice of treating an asset acquired below market value other than as a contribution, the ATO should revise TR 2010/1 and communicate its revised position to the tax industry.

Further, while the 2019 EM is not law and should only be referred to where there is ambiguity in the law, the commentary in the 2019 EM and the examples referred to[2] all relate to a specific asset or category of income. There does not appear to be any commentary or example in the 2019 EM that refers to a general expense tainting all of a fund's income.

In summary, the current ATO view results in a potential "double jeopardy" by applying the NALI provisions and also treating the same amount as a contribution under TR 2010/1. If the ATO construction of the NALE Act is correct, we would hope that the ATO's contribution ruling is revised accordingly.

Assets acquired for market value: is there a nexus to all income?

The Tax Institute's 4 December 2019 submission submits that, if a lower revenue expense is incurred by an SMSF in relation to the acquisition of an asset at market value, only the ordinary income should be assessed as NALI. Consequently, NALI should only apply to any net capital gain (statutory income) when that asset is eventually sold if there is a relevant nexus. The Institute's submission queries whether there is any relevant nexus when an arm's length price is paid and the capital gain is solely from capital appreciation of that asset.

In other words, a capital gain generally arises from capital appreciation over time and not "as a result" of the lower revenue expense, ie the lower revenue expense was not incurred in relation to "gaining or producing the [statutory] income" under s 295-550(1)(b) or (c) ITAA97.

Example 4 of LCR 2019/D3 provides the example of Kellie's SMSF. This example highlights a situation where both the net rental income and any net capital gain from the eventual disposal of a commercial property funded by a non-arm's length LRBA is NALE (where the SMSF borrows 100% of the purchase price, an interest rate of 1.5% pa applies, and repayments are made annually over a 25-year term). However, Kellie's SMSF paid the market value of $2m for this property.

It is important to note here that many SMSFs are passive investors and benefit from long-term capital appreciation of assets. In this type of case, why should Kellie's SMSF have its capital gain exposed to NALI if it incurred a lower revenue expense?

The capital gain in this situation generally remains the same, regardless of lower expenses such as discounted service fees or interest rates on a related party LRBA. Thus, the Institute's submission argues that there is not a sufficient and relevant nexus between the lower revenue expense and the subsequent capital gain that may eventually be realised on disposal.

Indeed, the capital gain in relation to many SMSF investments, including property, shares and many other investments, arises from the original contract price and any capital appreciation subsequently received.

For example, consider an SMSF that holds an investment property for 20 years and experiences a 400% increase in value over that time. In the final year prior to sale, the SMSF trustee, who is a builder, does some free services to better position the property for sale, enabling the fund to realise the best sale price. On the ATO's reasoning, the total capital gain achieved over the past 20 years would be NALI, despite there being no connection between the capital appreciation from the prior 19 or so years accrued before the builder provided free services. As discussed below, the ATO argues that there is no flexibility to pro rata or apportion this gain for NALI purposes.

The Tax Institute's submission also argues that there is a need to ensure an appropriate nexus between an expense and the income that is tainted. In particular, a lower revenue expense can taint ordinary income and a lower capital expense can taint a capital gain (ie statutory income). The Institute's submission, for instance, readily accepts that, in a case such as Kellie's SMSF (example 4 of LCR 2019/D3), there is a relevant nexus between NALE and the future capital gain on the eventual sale of the property, if the fund would not have been able to acquire that property but for the non-arm's length loan being provided. This approach is in line with the ATO's analysis in TD 2016/16 (which is a public ruling that predates the NALE Act) on how the ATO applies NALI to a non-arm's length LRBA. Paragraphs 4 and 5 of TD 2016/16 provide:

> "4. Having identified a hypothetical borrowing arrangement between the SMSF and the lender the terms of which are on an arm's length basis, it is then necessary to establish whether it is reasonable to conclude that the SMSF could have and would have entered into the hypothetical borrowing arrangement.
>
> 5. Where it is reasonable to conclude that the SMSF could not have, or would not have entered into the hypothetical borrowing arrangement, the SMSF will have derived more ordinary or statutory income under the scheme than it might have been expected to derive under the scheme with the hypothetical borrowing arrangement. In this instance, the ordinary or statutory income derived under the scheme is NALI."

As mentioned above, assuming that Kellie's SMSF could have acquired the property that is the subject of the LRBA without the non-arm's length LRBA, The Tax Institute's view is that the capital gain on disposal of that asset lacks the relevant nexus to the expense.

Should ordinary or statutory income be apportioned?

The question of apportionment of value caused by different acts/events also needs to be considered. Referring again to the above example, capital appreciation of a residential property by 400% may be tainted in the final (20th) year of disposal by free services provided by the builder, who is an SMSF trustee/member — and this would appear to be most unfair and brutal. Assume further that planning approval via an external consultant was obtained, which also resulted in considerable capital appreciation. This increase in the value of the property due to the planning approval should not be tainted by NALI. The overall increase in value should at least be apportioned between the free services provided by the builder (which is also treated as a contribution by the ATO under TR 2010/1) and the increase in value that relates to the planning approval.

As noted above, the ATO has for many years treated free services that added value to an asset as a contribution (eg free services provided by an SMSF member have been treated as an NCC reflective of the value of the services provided[3]). If an NCC was recognised for these free services, this should neutralise any need for the ATO to apply NALI.

It is recommended that the ATO review and revise TR 2010/1 in view of its construction of NALI.

PCG 2020/5: general expenses

Following the controversy arising from the substantial broadening of the NALE provisions to cover lower general expenses (ie NALE that taints all ordinary and statutory income of a fund), the ATO sought to provide a practical concession to industry to adjust to this much wider tax net.

The following are the key paragraphs from the revised PCG 2020/5 that issued on 9 April 2021:

> "10. The ATO will not allocate compliance resources to determine whether the NALI provisions apply to a complying superannuation fund for the 2018-19; 2019-20, 2020-21 and 2021-22 income years where the fund incurred non-arm's length expenditure (as described in paragraphs 9 to 12 of LCR 2019/D3) of a general nature that has a sufficient nexus to all ordinary and/or statutory income derived by the fund in those respective income years (for example, non-arm's length expenditure on accounting services). This transitional compliance approach only applies to general expenditure that is incurred on or before 30 June 2022.
>
> 11. This transitional compliance approach does not apply where the fund incurred non-arm's length expenditure that directly related to the fund deriving particular ordinary or statutory income."

On 24 March 2021, the ATO Assistant Commissioner, Mr Justin Micale, announced a 12-month extension to the period covered by PCG 2020/5 so that it also covers the 2021-22 financial year; thus, the revised PCG 2020/5 that issued on 9 April 2021 now covers the 2018-19, 2019-20, 2020-21 and 2021-22 financial years.

Mr Micale said that, given the complexity and level of interest in this issue, the ATO will be seeking independent, specialist advice from the public advice and guidance panel before finalising the draft LCR. Therefore, the ATO will not be applying compliance resources for the period of 1 July 2018 to 30 June 2022 where the NALI provisions apply to all of the ordinary and statutory income of a fund simply because it incurs NALE of a general nature.

Mr Micale confirmed that it is important to recognise that the ATO's transitional compliance approach does not apply in other circumstances where the fund incurs NALE that relates directly to particular income.

Conclusion

The NALE changes have proved to be extremely controversial. The legislation was enacted on 2 October 2019, and LCR 2019/D3 is still to be finalised (at a guess, this could possibly take 6 to 9 months; say, late 2021 or early 2022). It appears that the initial intent of the exposure draft legislation has taken on a far broader application, given the ATO's views in relation to how a general expense can taint all income (ordinary and statutory). Specifically, the interpretation that a sufficient nexus is very easily established even if that nexus is remote and tenuous (as illustrated above by the examples of the property held for 20 years and the $100 accounting fee discount tainting all of the fund's income).

Bearing in mind that the evidential burden falls on the taxpayer and the current expansive and pro-revenue construction of the NALI provisions being espoused by the ATO, SMSF trustees need to take great care to ensure that they have sufficient and appropriate evidence to defend themselves against NALI claims. Broadly, SMSF trustees may assume that, in any related party dealing, NALI will apply unless they can prove otherwise given the ATO may issue an assessment and place the burden on the SMSF trustee to prove that it is excessive.

Certainly, this is not a fair system and urgent action and reform are needed. Considerable uncertainty exists with the application of NALE and NALI until the ruling is finalised.

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An earlier version of this article was presented at The Tax Institute's 2021 Superannuation Intensive Series held on 24 to 25 March 2021.

References

1 [2003] HCA 36 at [36] per Gleeson CJ, Gummow, Hayne and Heydon JJ.

2 For example, paras 2.17, 2.19 to 2.21, 2.35, 2.39, 2.41, 2.44 to 2.50, and examples 2.1 and 2.2.

3 See TR 2010/1 and the ATO National Tax Liaison Group Superannuation Technical minutes of March 2013.

Alternative Assets Insights

by Cherie Mulyono, CTA, PwC

NSW build-to-rent land tax and stamp duty reforms

Recent land tax and duty reforms in NSW will remove some of the tax barriers to institutional investment in the build-to-rent market.

Build-to-rent (BTR) as an asset class offers an attractive alternative to traditional home ownership for occupants. With rising house prices, purchasers are being priced out of the market, and for those who choose or have no choice but to rent, the current Australian rental system has shortcomings for long-term renters. Depending on the type of development, BTR properties can allow occupants lifestyle benefits that are synonymous with home ownership (such as design and decor selection), longer-term stability, and ease of dealing as a result of more centralised or institutional corporate ownership rather than individual investors whose use of the property may be impacted by changes in personal circumstances.

However, there are taxation barriers for the institutional investment into, and provision of, rental services in Australia. Recently, some states have taken steps towards removing some of the land tax and stamp duty costs to investment.[1] Notably, the New South Wales Government has recently undertaken reforms to alleviate some of the state tax challenges for BTR to be viable as an asset class, including:

- a 50% land value discount for the purposes of calculating land tax for NSW developers who invest in eligible BTR schemes for the next 20 years (until 31 December 2039) (the land tax concession);
- a refund or an exemption from the 2% surcharge land tax for foreign persons; and
- a refund or an exemption from the 8% surcharge purchaser duty for foreign purchasers.

These BTR reforms were enacted on 11 August 2020, pursuant to the State Revenue Legislation Amendment (COVID-19 Housing Response) Bill 2020 (NSW), which amended the *Land Tax Management Act 1956* (NSW) (LTM Act), the *Land Tax Act 1956* (NSW) (Land Tax Act), and the *Duties Act 1997* (NSW) (Duties Act).

This article sets out the key NSW eligibility requirements for the BTR reforms and considers some practical concerns.

Land tax concession

In NSW, land tax is generally imposed at rates of up to 2% on the taxable value of land.[2] To the extent that the parcel of land is eligible for BTR, for assessing land tax, the taxable value of the parcel is to be reduced by 50%, provided the relevant conditions are satisfied.

To be eligible for this reduction, an application must be made pursuant to s 9E of the LTM Act.[3] Relevantly, the 50% reduction to land value for a parcel of land applies if:[4]

- a building is situated on the land, and construction of the building commenced on or after 1 July 2020;
- the "labour force requirement" is met; and
- the Chief Commissioner of Revenue NSW (Chief Commissioner) is satisfied that the building is being used and occupied for a BTR property in accordance with guidelines which were approved and published by the Treasurer on 16 February 2021 (the guidelines).

Construction of building commenced on or after 1 July 2020

For most projects, whether the requirement that construction of the building commenced on or after 1 July 2020 is met should be clear. However, given the long lead time for some projects of this nature, there is a practical question regarding what constitutes "construction of the building". This is not defined in the LTM Act and there is not yet guidance from the Chief Commissioner. However, this could arguably exclude preparatory land works (eg clearing, levelling etc), but would likely include pouring foundations or excavation for an underground carpark.

Labour force requirement

The labour force requirement will be met if the Chief Commissioner is satisfied that a significant proportion of the labour force hours spent on the construction of the building involves, or involved, work performed by persons whom the Chief Commissioner considers belong to any one or more of the following classes of worker:

- apprentices or trainees;
- long-term unemployed workers;
- workers requiring upskilling;
- workers with barriers to employment (such as persons with a disability);
- Aboriginal jobseekers; and
- graduates.

Further clarity is required around the number or percentage of hours to satisfy the "significant proportion" criteria and the documents required to evidence the relevant class of worker. From a practical perspective, there is a question as to whether the developer would have sufficient oversight, as the industry often involves various contractors and sub-contractors throughout the construction phase of a project.

Guidelines: building used and occupied for a BTR property

Pursuant to s 9E of the LTM Act, the guidelines provide guidance in forming a view as to whether a particular building is being used and occupied for a BTR property for the purposes of the land tax concession.[5]

Relevantly, the following conditions must be satisfied:

- **planning requirements:** all requirements of the relevant development consents must be complied with;
- **building requirements:** the buildings on a parcel of land must contain at least 50 self-contained dwellings used specifically for the purposes of BTR:
  - where a BTR adjacent site is consolidated with a land parcel that already qualifies for the concession, the additional dwellings do not have to meet the 50-dwelling threshold; and
  - if only part of the adjacent site that is consolidated is being used and occupied for a BTR property, the concession may be proportionately reduced (see below);

  BTR properties must comply with the relevant affordable housing policies under the *Environmental Planning and Assessment Act 1979* (NSW); and

  BTR dwellings must be made available to the general public, without restriction, apart from restrictions necessary to ensure public health and safety, to promote announced government policy, or to ensure that dwellings designated for affordable or social housing are used for that purpose;
- **ownership structure:** BTR dwellings and land must be held within a unified ownership structure (which can include a group of entities holding joint ownership), and must not be held in such a way as to constitute a de facto subdivision or divided ownership of the land, or is otherwise contrary to the intent of s 9E(9) of the LTM Act to restrict subdivision or division of the land;
- **management structure:** BTR dwellings must be managed by a single management entity, with on-site access to management for tenants;[6] and
- the management entity can be different to the landholder (ie the landholder may outsource the provision of the management services, provided the services are delivered by a single entity); and
- **lease conditions:** each tenant must be provided a range of lease term choices, including a genuine option to enter into a fixed-term lease of at least three years.[7]

Although the guidelines refer to the above as determinative factors (ie "must" be satisfied), the Chief Commissioner does have discretion and can have regard to other factors that they consider relevant.

Proportionate reduction in land values

If the Chief Commissioner is satisfied that only part of a parcel of land is being used and occupied for a BTR property, the percentage reduction in land value is to be proportionately decreased in accordance with the guidelines.[8] When determining the appropriate decrease to the concession, the Chief Commissioner can determine the proportion of the land being used for BTR property and may have regard to factors as the Chief Commissioner considers appropriate, including the floor space allocated for BTR purposes compared with the total floor space of the property.[9]

It is noted that a parcel of land may still be considered wholly used and occupied for a BTR property where part of the land is used not for dwellings but is nonetheless used for the purpose of the BTR business (eg reasonable accommodation for on-site management and facilities).[10]

Surcharge land tax

Currently, a foreign person[11] that owns residential land[12] is subject to surcharge land tax at a rate of 2% on the taxable value as assessed under the LTM Act.[13]

Refund

An Australian corporation[14] is entitled to a refund of surcharge land tax paid in respect of residential land owned at midnight on 31 December in a year (the taxing date) commencing from midnight on 31 December 2020 and ending on midnight on 31 December 2039, if the Chief Commissioner is satisfied that:

- a building that is taken to be BTR property under s 9E of the LTM Act has been constructed on the land concerned by the corporation or a related body corporate (whether before or after the taxing date);[15] and
- the corporation is entitled under s 9E of the LTM Act to a reduction in the value of land.[16]

Surcharge land tax for a land tax year may be refunded only if an application for the refund is made:[17]

- within 12 months after the owner of the land concerned became entitled to the refund; and
- not later than 10 years after the land tax year concerned.

Exemption

Rather than requiring payment and a refund of surcharge land tax, the Chief Commissioner may approve a foreign person as an exempt person for particular land if the Chief Commissioner is of the opinion that the person is likely to become entitled to a refund of the full amount of surcharge land tax payable by the person in respect of the land for a land tax year.[18] Relevantly, a foreign person may be approved as an exempt person for land for a land tax year, noting that:[19]

- an approval may be given for one or more land tax years (and can be given for a land tax year before or after the end of the land tax year);
- the Chief Commissioner may give an approval subject to conditions (which can be varied by way of notice); and
- an approval can be revoked by the Chief Commissioner (by way of notice) and this revocation can be backdated.

Surcharge purchaser duty

A foreign person[20] (which includes a foreign corporation) that directly acquires residential-related land[21] is subject to surcharge purchaser duty at 8%.[22] This is in addition to the usual stamp duty rates of up to 5.5% (or 7% for premium residential land). A BTR surcharge purchaser duty refund and exemption may be available only for an agreement for the sale or transfer of residential-related property.

It is important to be aware that this exemption does not apply to other surcharge duty transactions referred to in s 104L(1)(b) of the Duties Act (eg declaration of trust over residential-related property, surrender of an interest in residential land etc).[23] Further, a foreign person that indirectly acquires residential land (eg through an acquisition of 50% or more in a private company or private unit trust that is a landholder) is subject to surcharge landholder duty at 8% of the unencumbered value of the residential land holdings directly or indirectly held by the relevant landholder.[24] The refund and exemption provisions discussed below do not appear to extend to surcharge landholder duty, resulting in an inequity between direct acquisitions of residential-related land and indirect acquisitions of residential land (eg through a share or unit acquisition).[25]

Refund

An Australian corporation[26] that is the transferee under a transfer of residential-related property is entitled to a refund of surcharge purchaser duty paid by the transferee that is chargeable on the transfer if the Chief Commissioner is satisfied that:[27]

- the transfer was entered into on or after 1 July 2020 (other than a transfer made in conformity with an agreement for sale or transfer entered into before 1 July 2020);
- a building that is taken to be BTR property under s 9E of the LTM Act has been constructed on the land concerned by the transferee or a related body corporate after completion of the transfer to the transferee; and
- the corporation has become entitled under s 9E of the LTM Act to a reduction in the value of land.

Surcharge purchaser duty may be refunded under this section only if an application for the refund is made:[28]

- within 12 months after the owner of the land concerned first became entitled under s 9E of the LTM Act to a reduction in the value of the land; and
- no later than 10 years after completion of the transfer of the residential-related property to the Australian corporation.

Exemption

Similarly to the land tax surcharge, the Chief Commissioner may approve a person as an exempt transferee for a particular transfer or class of transfers if the Chief Commissioner is of the opinion that the person is likely to become entitled to a refund of the full amount of surcharge purchaser duty chargeable on a transfer to which the approval applies.[29] Relevantly, a foreign person may be approved as an exempt transferee for a transfer of residential-related land, noting that:[30]

- the Chief Commissioner may give an approval subject to conditions (which can be varied by way of notice);
- an approval remains in force until it is revoked and can be revoked by the Chief Commissioner (by notice);
- the revocation of an approval can be backdated to extend to a transfer in respect of which liability for surcharge purchaser duty would (but for the approval) have arisen before the revocation is notified (an exempted transfer);
- if the revocation of an approval is backdated to extend to an exempted transfer, surcharge purchaser duty is payable and is to be assessed or reassessed as if the approval had never applied to the transfer and as if liability for duty arose when revocation of the approval was notified (meaning that penalties and interest can apply).

Revocation for subdivision within 15 years

There are revocation and reassessment provisions where subdivision occurs or the ownership of the land is divided within 15 years.

Land tax concession

If, after the land tax concession first applies to reduce the land value of a parcel of land, the land is subdivided or the ownership of the land is otherwise divided:[31]

- the person liable to land tax must, within one month, inform the Chief Commissioner of the subdivision or division;
- liability for land tax in respect of the following years is to be reassessed as if the concession had not applied:
  - the year in which the land is subdivided or the ownership of the land is otherwise divided; and
  - each preceding year in which a person's liability to pay land tax was assessed in accordance with s 9E of the LTM Act, but not more than 15 preceding years; and
- the subdivision or division is taken to be a tax default for the purposes of Pt 5 of the *Taxation Administration Act 1996* (NSW) (TAA), and interest and penalties may apply.

Surcharge land tax

A similar revocation to that described above applies to refunds or exemptions from surcharge land tax if, within 15 years after a refund or an exemption from surcharge land tax first applies, the land concerned is subdivided or the ownership of the land is otherwise divided.[32]

Surcharge purchaser duty

If, after a refund from surcharge purchaser duty has been paid in relation to a transfer, and the land is subdivided or the ownership of the land is otherwise divided within 15 years of that payment:

- the entitlement to the refund is terminated;
- that termination is backdated to extend to the transfer in respect of which liability for surcharge purchaser duty would have arisen (but for the exemption); and
- surcharge purchaser duty is payable and is to be assessed or reassessed as if the refund had never applied, and as if liability for duty arose when the land was subdivided or the ownership was otherwise divided.

If, after a surcharge purchaser duty exemption is applied in relation to a transfer, the land is subdivided or the ownership of the land is otherwise divided within 15 years of the application:[33]

- the approval of the relevant person as an exempt transferee is revoked;
- that revocation of an approval is backdated to extend to the transfer in respect of which liability for surcharge

purchaser duty would have arisen (but for the approval); and
- surcharge purchaser duty is payable and is to be assessed or reassessed as if the approval had never applied to the transfer, and as if liability for duty arose when the land was subdivided or the ownership of the land was otherwise divided.

Reassessment for more than five years

For the purposes of s 9(3)(c) of the TAA, any reassessment for either land tax, surcharge land tax or surcharge purchaser duty is authorised to be made more than five years after the initial assessment.[34]

Application process

Currently, only an expression of interest (including name, contact details, title particulars, and the proposed number of dwellings) can be lodged online with Revenue NSW. The expression of interest is not an application for the BTR land tax concession, and Revenue NSW advises that it is currently in the process of streamlining the application process and will advise when a formal application will be able to be submitted.[35]

Conclusion

Overall, while the NSW BTR reforms are a welcome step in the right direction, there are still some potential inequities, particularly between surcharge purchaser duty and surcharge landholder duty. Once Revenue NSW commences processing formal applications, it will be interesting to see the practical impact of some of the concerns raised above (such as the labour force requirements), and the interaction of these BTR reforms with the NSW property tax reform proposal.

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References

1 For example, the Queensland Build-to-Rent Pilot Project (see www.treasury.qld.gov.au/programs-and-policies/build-to-rent-pilot-project), and Victoria's discretionary exemptions from foreign surcharge purchaser duty and absentee owner land tax surcharge for BTR (see www.gazette.vic.gov.au/gazette/Gazettes2018/GG2018S450.pdf).

2 Ss 7 and 9 of the LTM Act; and s 3AL, Pt 1 of Sch 13 of the Land Tax Act.

3 S 9E(2)(e) and 9E(8) of the LTM Act.

4 Available at www.revenue.nsw.gov.au/news-media-releases/land-tax-build-to-rent.

5 S 9E(2)(d) and (3) of the LTM Act. See also www.revenue.nsw.gov.au/news-media-releases/land-tax-build-to-rent.

6 Guideline note: dwellings in BTR properties are exempt from the "management structure" requirement if those specific dwellings are made available for use as affordable housing or social housing for a continuous period of 15 years. This is in accordance with s 5CA(4) of the LTM Act which states that the guidelines must include policies to promote the development of new affordable housing and social housing in BTR properties.

7 Guideline note: a landlord would not be in breach of this condition if a tenant who has been provided the option of a fixed-term lease of at least three years opts for a lease of a shorter duration instead.

8 S 9E(7) of the LTM Act.

9 See www.revenue.nsw.gov.au/news-media-releases/land-tax-build-to-rent.

10 See www.revenue.nsw.gov.au/news-media-releases/land-tax-build-to-rent.

11 Pursuant to s 2A of the Land Tax Act, "foreign person" has the same meaning as Ch 2A of the Duties Act.

12 Pursuant to s 2A of the Land Tax Act, "residential land" has the same meaning as Ch 2A of the Duties Act.

13 For residential land owned by the foreign person at midnight on 31 December (from 2017 onwards) under s 5A(2)(b) of the Land Tax Act.

14 S 5CA(10) of the Land Tax Act defines "Australian corporation" to have the same meaning as in the *Corporations Act 2001* (Cth).

15 S 5CA(10) of the Land Tax Act defines "related body corporate" to have the same meaning as in the *Corporations Act 2001* (Cth).

16 S 5CA of the Land Tax Act.

17 S 5CA(8) of the Land Tax Act. Note that the amount of the refund to which an Australian corporation is entitled is the amount that is determined in accordance with an order made by the Treasurer for the purposes of this section and published in the *Gazette* under s 5CA(2) of the Land Tax Act. The amount of the refund may be the full amount of surcharge land tax paid or a lesser amount (as determined in accordance with the order) under s 5CA(3) of the Land Tax Act.

18 S 5CA(4) of the Land Tax Act.

19 S 5CA of the Land Tax Act.

20 S 104J of the Duties Act.

21 S 104K of the Duties Act.

22 Ch 2A of the Duties Act.

23 S 104ZJB(11) of the Duties Act.

24 Pt 2B of Ch 4 of the Duties Act.

25 Unless the Chief Commissioner exercises the just and reasonable discretion under s 163H of the Duties Act.

26 S 104ZJB(10) of the Duties Act defines "Australian corporation" to have the same meaning as in the *Corporations Act 2001* (Cth).

27 S 104ZJB(1) of the Duties Act.

28 S 104ZJB(8) of the Duties Act. Note that the amount of the refund to which an Australian corporation is entitled is the amount that is determined in accordance with an order made by the Treasurer for the purposes of this section and published in the *Gazette* under s 104ZJB(2) of the Duties Act. The amount of the refund may be the full amount of surcharge land tax paid or a lesser amount (as determined in accordance with the order) under s 104ZJB(3) of the Duties Act.

29 S 104ZJB(4) of the Duties Act.

30 S 104ZJB(6) of the Duties Act.

31 S 9E(9) of the LTM Act.

32 S 5CA(7) of the Land Tax Act.

33 S 104ZJB(7) of the Duties Act

34 S 9E(10) of the LTM Act; s 5CA(9) of the Land Tax Act; and s 104ZJB(10) of the Duties Act. Note that, under s 9E(11) of the LTM Act, any land tax reassessment is not a relevant land tax assessment for the purposes of s 35(1)(b) of the *Valuation of Land Act 1916* (NSW) if it is based on the same land value or average value on which the original land tax assessment was based (before the reduction was made).

35 See www.revenue.nsw.gov.au/news-media-releases/land-tax-build-to-rent.

Events Calendar

May/June 2021

STATE/EVENT	DATE	CPD
Online		
2021 Global CTA Tax Webinar – International corporate tax	6/5/21	1.5
Aon Webinar – Don't just insure, be sure: the benefits of insurance advice	17/5/21	0.75
NSW 13th Annual Tax Forum – online	20/5/21	14
New South Wales		
Local Tax Club – Sydney CBD – Part 4: 2021 Year-end tax planning	18/5/21	1.5
Local Tax Club – Parramatta – Part 4: 2021 Year-end tax planning	19/5/21	1.5
NSW 13th Annual Tax Forum	20/5/21	14
Queensland		
Local Tax Club – Brisbane CBD – Part 4: 2021-22 Federal Budget	26/5/21	1.5
2021 Queensland Tax Forum	27/5/21	13
South Australia		
Local Tax Club – Adelaide CBD – Part 4: to be confirmed	25/05/21	1.5
Victoria		
Leading from Trials to Triumph – Melbourne Networking Lunch	7/5/21	1
Local Tax Club – Melbourne – Part 4: PCG on profit allocations	20/5/21	1.5
Local Tax Club – Geelong – Part 4: PCG on profit allocations	21/5/21	1.5
2021 Yarra Valley Tax Retreat	3/6/21	12
Western Australia		
Local Tax Club – Perth CBD – Part 4: 2021 Year-end tax planning	26/5/21	1.5

For more information on upcoming events, visit **taxinstitute.com.au/professional-development**.

Cumulative Index

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Vol 55(10): pages 505 to 582

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Giving back to the profession

The Tax Institute would like to thank the following presenters from our April CPD sessions. All of our presenters are volunteers, and we recognise the time that they have taken to prepare for the paper and/or presentation, and greatly appreciate their contribution to educating tax professionals around Australia.

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