THE JOURNAL FOR MEMBERS OF THE TAX INSTITUTE

Taxation in Australia

VOL 56(2) AUG 2021

The case for reform

The Tax Institute

Why holistic reform of the Australian tax system is fundamental to economic recovery, growth and equity.

R&D tax incentive amendments

Damian Smyth and Andy Nguyen

Corporate tax residence: a hidden risk

Bill Mavropoulos

THE TAX INSTITUTE

Contents

Cover article

104

The case for reform

The Tax Institute

Holistic reform of the Australian tax system is fundamental to economic recovery, growth and equity. This chapter from the *Case for Change* explores why.

Feature articles

111

R&D tax incentive amendments

Damian Smyth, Chief Executive Officer, and Andy Nguyen, Principal, Swanson Reed

119

Corporate tax residence: a hidden risk

Bill Mavropoulos, Partner, VT Advisory

Insights from the Institute

86 President's Report

87 CEO's Report

89 Associate Tax Counsel's Report

Regular columns

85 Tax News – at a glance

91 Tax News – the details

95 Tax Tips

99 Mid Market Focus

103 Higher Education

123 A Matter of Trusts

125 Superannuation

129 Alternative Assets Insights

134 Successful Succession

137 Events Calendar

138 Cumulative Index

Invitation to write

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

For details about submitting articles, please see Guidelines for Publication on our website taxinstitute.com.au, or contact publisher@taxinstitute.com.au.

Tax News – at a glance

by TaxCounsel Pty Ltd

July – what happened in tax?

The following points highlight important federal tax developments that occurred during July 2021. A selection of the developments is considered in more detail in the "Tax News – the details" column on page 91 (at the item number indicated).

Patent box

On 5 July 2021, the Assistant Treasurer announced the release of a discussion paper on the design of the patent box which was announced in the 2021-22 Budget and is to start on 1 July 2022. **See item 1.**

GST: low-value imported goods

Also on 5 July 2021, the Assistant Treasurer announced that the government has asked the Board of Taxation to review the collection of GST on low-value imported goods and to ensure that the system is operating as intended. **See item 2.**

Sharing economy reporting regime

Exposure draft legislation and explanatory material have been released in relation to the government's announcement in the 2019-20 Mid-Year Economic and Fiscal Outlook that a third-party reporting regime for the sharing economy would be introduced. **See item 3.**

Division 7A: benchmark interest rate

For the 2021-22 income year, the Div 7A benchmark interest rate for private companies with a regular 30 June accounting period is 4.52%. **See item 4.**

Division 7A: minimum yearly repayments and COVID-19

The Commissioner, in recognition of the fact that some borrowers under Div 7A complying loan agreements are facing circumstances beyond their control, is allowing an extension of the repayment period for those borrowers who are unable to make their minimum yearly repayment by the end of the lender's 2020-21 income year (generally 30 June). **See item 5.**

Travel and overtime meal allowances

The Commissioner has issued a determination that sets out the amounts that he considers are reasonable (reasonable amounts) for the substantiation exception in Subdiv 900-B ITAA97 for the 2021-22 income year (TD 2021/6). **See item 6.**

Calculation of aggregated turnover

The Commissioner has released a draft determination which considers the question of whether, where an entity is working out its aggregated turnover, the relevant annual turnovers of connected entities or affiliates are determined by reference to the entity's income year (TD 2021/D1). **See item 7.**

FBT: car parking benefits

A final ruling has been issued by the Commissioner that sets out when the provision of car parking is a car parking benefit for the purposes of the *Fringe Benefits Tax Assessment Act 1986* (TR 2021/2). **See item 8.**

Default assessments: onus of proof

The AAT has rejected an individual taxpayer's claims that the Commissioner's amended assessments for four income years made under the default assessment provisions (s 167 ITAA36) were excessive (*Behrndt and FCT* [2021] AATA 1769). **See item 9.**

Temporary full expensing

The Commissioner has released a draft law companion ruling in relation to the temporary full expensing measures that were introduced as part of the tax system response to COVID-19 (LCR 2021/D1). Among other things, LCR 2021/D1 outlines the operation of temporary full expensing, provides views on interpretive issues, explains the interaction of temporary full expensing with instant asset write-off and the backing business investment measure, and explains and illustrates how temporary full expensing applies to small business entities.

President's Report

by Peter Godber, CTA

Recognising our tremendous volunteer efforts

President Peter Godber writes about how our members give so generously of their time.

I mentioned last month how volunteer member contributions keep The Tax Institute vibrant.

With more recent COVID-19 outbreaks and lockdowns, our program for events has once again been under pressure and the agility of the teams of people behind the scenes who do the organising of these events has been re-tested.

The programming of our CPD events requires very significant thought and input from organising or program committees that are made up of members who have expressed interest in being involved in an event, or recurring events. They are fundamentally responsible to make sure that the best topics are addressed, and by the most appropriate speakers. They in turn work with nominated speakers who themselves give enormous time and effort to provide papers and deliver program sessions that live up to the quality that is expected at events of The Tax Institute.

When COVID-19 changes things, we all have to adjust. This is clearly hard for potential attendees. But the potential compromise to a program from events out of our control can be exasperating for the people who put in the effort to deliver the program. Your efforts are always appreciated, and we thank you for the extra time it may take to complete a program, or change it, in order to get it to the market and delivered at the high level of quality we have all come to expect. And a big thank you to all the speakers who make changes in their own schedules in order to deliver their papers at any re-scheduled events.

Recognition of very significant volunteer effort has come with the release of the *Case for Change* paper. It is not lightly said that such a work could not have been possible without the input of hundreds of members who contributed, on a voluntary basis, into the analysis, discussion and documentation of the many wide and varied views that have been entertained in completing this work. Thank you, and hopefully you are proud of what The Tax Institute has achieved with such a large and respected work that will give rise to overdue debate for years to come.

We are further recognising our members and busy professionals in the Tax Adviser of the Year Awards for 2021. In past years, this has been a great celebration of achievement among members, as recognised by peer members. I am sure that 2021 will again produce some great nominees, and good luck to them all. Nominations for the awards are soon closing. I encourage you to put yourself or your peers forward for recognition.

Looking forward

The Tax Institute is now operating on a 30 June financial year end. I can safely say that the year just passed has again seen us successfully operate in very trying and adverse business times.

We are now able to continue to look forward and invest for the future benefit of members, with strategies that involve, in the short-term, the roll-out of a refreshed website that is supported by a new content management system.

Creating new member experiences and engagement around this is very exciting for us. We will focus on engagement with members in many ways, including the creation of communities that are facilitated through new electronic mediums.

Of course, learning and education for members is a key objective of The Tax Institute. We will be better able to deliver this in the many forms modern learning can take as a result of the investment we have now made in new technology.

I'd also like to share the sentiment that our whole team will have expressed to members who have again recently felt the effects of restricted movement under COVID-19 regulations. Although 2020 is behind us, all of its challenges are not. Please stay safe and well, and look after those to whom you are close, both at home and at work.

CEO's Report

by Giles Hurst

Ongoing challenges for our community

A message of support from CEO Giles Hurst as we face renewed challenges from COVID-19.

If adversity is opportunity in disguise, the tax profession has been in no short supply of opportunity lately.

Throughout 2020, our community has been called on to help ensure that small businesses and their many employees could weather the economic storm of COVID-19. It was a long, hard road, but I was thoroughly impressed with the positive attitude and dedication you all brought to that challenge.

And in the end, we made it through. Economically, Australia bounced back quicker than anyone had expected. Your clients were able to stay in business, pay their rent and continue with their livelihoods, in large part thanks to your efforts.

The recent restrictions and lockdowns around the country have reminded us that COVID-19 still poses significant risk to our community. Over and above the impact that this has had on our lives, families and personal situations, this is having a significant effect on the working lives of tax practitioners.

With further COVID-19 support for areas affected by lockdowns announced by the Commonwealth Government in mid-July, many of you will once again be called on to support your clients through difficult circumstances. I know you will step up to this challenge with the same dedication and determination with which you handled the various stimulus measures announced in 2020. The Tax Institute is here to support you through this with resources and clear communication. We are here to help you ensure that your clients receive the correct outcomes and to advocate on your behalf.

We have built the bench strength of our Tax Policy and Advocacy team throughout 2020, and continue to do so this year with the recent appointment of Jeremy Kwok, formerly of the ATO, as Tax Consultant, and Zoe-Marie Beesley, with a Graduate Diploma of Taxation under her belt, as Tax Policy Assistant. They join an already strong team with more than a century of experience between them. This well-equipped and expert crew are poised to support you in any way possible.

I encourage you to reach out to our representatives for support or assistance where you feel we might be able to provide it. Alongside that, keep your eye on your inbox, and on sources like *TaxVine* or this journal, for information on the resources and support we are continually developing and distributing. Communication is a two-way street — please don't hesitate to let us know how we can better support you.

Going forward, your health and safety remain our top priority. We are closely monitoring health guidelines and restrictions around the country, and will communicate any necessary changes to our planned events and activities as required. I'd like to thank you in advance for your cooperation in the event of sudden changes to accommodate safety guidelines. I know you have exercised considerable adaptability and a positive spirit in spades recently and will continue to do so as we move forward.

Our thoughts are with those members, staff, friends and loved ones who are facing uncertainty or challenges from the ongoing COVID-19 situation. The hurdles we overcame in 2020 are not completely gone, although we now approach them a little wiser than before.

The tax community has embraced the challenges brought on by COVID-19. You have put in countless hours and turned your considerable expertise towards some very difficult technical requirements. We have supported you throughout and will continue to do so in the future.

Stay safe and stay sanitised everyone!

THE TAX INSTITUTE

Tax Adviser of the Year Awards 2021

Australia's most prestigious tax awards return!

Chartered Tax Adviser
Tax leaders with outstanding expertise, vision and innovation

Emerging Tax Star
Emerging tax leaders building a successful career in tax

Introducing the RESPECT Awards for 2021:

RESPECT SME
SME tax advisers who have gone above and beyond during COVID-19

RESPECT Corporate
Corporate tax advisers who have gone above and beyond during COVID-19

21 October 2021
MCEC, Melbourne

Nomination date extended 15 August

Nominate Now
taxinstitute.com.au/awards

0325MEM_07/21

Associate Tax Counsel's Report

by Michelle Ma, ATI

State Budgets: a mixed approach to tax reform

The recent state Budgets made some promising steps forward but, overall, demonstrate a mixed approach to tax system improvements and the pursuit of genuine tax reform.

Which states embraced the opportunity for tax reform?

As part of The Tax Institute's commitment to a more efficient, fair and simpler tax system, following each recent state Budget, the Tax Policy and Advocacy team engaged with the relevant state tax committee with a view to starting a conversation, seeking initial thoughts in response to the measures, and identifying opportunities for advocacy.

Table 1 outlines the key tax measures announced in the state Budgets at the date of publication of this journal.

Which states and territories are next?

Tasmania

The Tasmanian Budget is to be delivered on 26 August 2021. Ahead of that date, it has been announced that stamp duty will be waived for purchasers of electric vehicles, an initiative effective from 1 July 2021 and lasting for two years.

ACT

The ACT Budget is to be delivered on 31 August 2021. Similarly, it has already been announced that stamp duty will be abolished on off-the-plan apartments and townhouses valued at $500,000 or less which are purchased on and from 1 July 2021.

Driving the agenda for tax reform

The different approaches of the various state and territory governments demonstrate that there is no unified plan with respect to Australia's tax system. The Tax Institute stands firm in the pursuit for holistic reform of the Australian tax system. We hope that The Case for Change paper which was presented recently to government will prompt further discussions for the future of Australia's tax system.

Table 1. Key tax measures announced in recent state Budgets

	NSW Budget 22 June 2021	Victoria Budget 20 May 2021	South Australia Budget 22 June 2021	Queensland Budget 15 June 2021
Property taxes (including land tax)	– Continued consideration of the proposed property tax reform to replace transfer duty with an annual property tax.[1]	– Increase in the general land tax threshold from $250,000 to $300,000 from 1 January 2022. – Expansion of the vacant residential land tax exemption for newly constructed properties for up to two years. – New windfall gains tax on the land value uplift for rezoned land (to be introduced from 1 July 2022).[2]	– 50% land tax discount for eligible new build-to-rent housing projects (where construction commences from 1 July 2021) until the 2039-40 land tax year. – Increased land tax liability relief for taxpayers negatively impacted by the changed aggregation of land rules.	

cont …

Table 1. Key tax measures announced in recent state Budgets (cont)

	NSW Budget 22 June 2021	Victoria Budget 20 May 2021	South Australia Budget 22 June 2021	Queensland Budget 15 June 2021
Duties	– Electric vehicles under $78,000 are exempt from motor vehicle stamp duty from 1 September 2021.	– Stamp duty "premium" on property transactions with a dutiable value of over $2m.[2] – Land tax rates will increase by 0.25 percentage points for taxable landholdings of over $1.8m, and 0.3 percentage points for taxable landholdings of over $3m. – Temporary stamp duty concessions for new residential properties in the City of Melbourne. – Temporary increase to the threshold for the off-the-plan stamp duty concession.		
Payroll tax	– Temporary reduction in the payroll tax rate from 5.45% to 4.85% has been extended in 2021-22. – Payroll tax-free threshold increased to $1.2m.	– New mental health and wellbeing surcharge from 1 January 2022, payable by employers with total annual Australian wages of $10m or more.[2] – Payroll tax-free threshold increased to $700,000 from 1 July 2021. – Payroll tax rate for regional employers reduced to 1.2125% from 1 July 2021.	– 12-month extension of the payroll tax exemption for wages paid for eligible new trainees and apprentices. – Removal of the payroll tax exemption and associated ex-gratia relief for films produced in South Australia.	12-month extension of the 50% payroll tax rebate for wages paid to apprentices and trainees (to include wages paid in the year ending 30 June 2022).

Notes

1. NSW: Despite early speculation in an initial consultation paper, *The NSW Budget 2020-2021; Buying in NSW, Building a future; Creating jobs and securing our future,* further details of a proposal to replace the current stamp duty and land tax system with an annual property tax regime were not released. The NSW Government has sought further feedback in response to the subsequent consultation paper, *NSW property tax proposal – Progress paper for June 2021, Making home ownership more achievable in NSW.* Links to our submissions are available here and here.
2. Victoria: The Tax Institute has concerns regarding specific measures due to inconsistencies with sound tax policy and the divergence created between Victoria and the remainder of Australia. A link to our submission is available here.
3. Northern Territory: Delivered on 4 May 2021, the Budget focused on infrastructure, job creation (particularly in the tourism and hospitality sectors), and general community support including skills and training programs. There were no significant tax measures.

Tax News – the details

by TaxCounsel Pty Ltd

July – what happened in tax?

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

Government initiatives

1. Patent box

On 5 July 2021, the Assistant Treasurer announced the release of a discussion paper on the design of the patent box which was announced in the 2021-22 Budget and is to start on 1 July 2022.

Under the patent box, income earned from new patents that have been developed in Australia will be taxed at a concessional rate of 17%. Initially, the patent box will apply to the medical and biotechnology sectors.

The Assistant Treasurer said that patent boxes are widely used in other jurisdictions, including the United Kingdom, France, Switzerland and Singapore. By providing internationally competitive tax treatment, the patent box will encourage the retention of Australian-developed inventions in Australia.

The patent box will also encourage research and development in the medical and biotechnology sectors, and complements the substantial support that the government already provides to innovative sectors through the Research and Development Tax Incentive.

2. GST: low-value imported goods

Also on 5 July 2021, the Assistant Treasurer announced that the government has asked the Board of Taxation to review the collection of GST on low-value imported goods and to ensure that the system is operating as intended.

The GST on low-value imported goods was introduced on 1 July 2018, removing the unfair advantage foreign businesses had prior to that. Before that date, goods imported directly by consumers costing $1,000 or less did not attract GST, and only high-value goods with a customs value of over $1,000 were assessed and charged GST at the border.

Australia was one of the first countries in the world to implement a vendor model, requiring suppliers, online platforms and re-deliverers with an Australian GST turnover of $75,000 or more to register, collect and pay GST to the ATO. When announcing this measure in the 2016-17 Budget, the government committed to reviewing the measure after it was operational to ensure that it was consistent with international best practice.

Given the measure has now been in place for several years, with many countries moving in the same direction, the government has requested that the Board consider:

- the effectiveness of the low-value imported goods regime to efficiently collect GST; and
- any relevant international developments and experiences regarding the collection of GST and other consumption taxes.

3. Sharing economy reporting regime

Exposure draft legislation and explanatory material have been released in relation to the government's announcement in the 2019-20 Mid-Year Economic and Fiscal Outlook that a third-party reporting regime for the sharing economy would be introduced.

The reporting regime will require operators of electronic platforms within the sharing economy to report identification and payment information regarding participating sellers to the ATO for data-matching purposes.

It is intended that the reporting regime will apply to transactions that relate to the supply of:

- ride-sourcing and short-term accommodation from 1 July 2022; and
- asset sharing, food delivery, tasking-based services, and other services (except for transactions where only the title or ownership of goods or real property are exchanged, and transactions relating to financial supplies) from 1 July 2023.

The Commissioner's perspective

4. Division 7A: benchmark interest rate

For the 2021-22 income year, the Div 7A benchmark interest rate for private companies with a regular 30 June accounting period is 4.52%. This benchmark interest rate (which is the same as the 2020-21 rate) is relevant to:

- determine whether a loan made in the 2020-21 income year is taken to be a dividend (s 109N(1)(b) of the *Income Tax Assessment Act 1936* (Cth) (ITAA36) and, as applicable, s 109D(1) or 109XB ITAA36); and
- calculate the amount of the minimum yearly repayment for the 2021-22 income year on an amalgamated loan taken to have been made prior to 1 July 2021 (s 109E(5) ITAA36).

5. Division 7A: minimum yearly repayments and COVID-19

The Commissioner, in recognition of the fact that some borrowers under Div 7A complying loan agreements are facing circumstances beyond their control, is allowing an extension of the repayment period for those borrowers who are unable to make their minimum yearly repayment (MYR) by the end of the lender's 2020-21 income year (generally 30 June).

Borrowers can request the extension by completing a streamlined online application. The application will ask the borrower to confirm the shortfall, that the COVID-19 situation has affected them, and that they are unable to pay the MYR

as a result. Where an application is approved, the shortfall will need to be paid by 30 June 2022.

It is open to a borrower to apply to obtain a longer extension of time outside the streamlined process or for relief on the grounds of undue hardship under s 109Q ITAA36.

A similar extension was provided to taxpayers in respect of MYRs for the 2019-20 income year. Where a borrower obtained an extension to pay the 2019-20 MYR shortfall by 30 June 2021 and requires further time to pay the shortfall, it is open to the borrower to apply to obtain a longer extension outside the streamlined process or for relief on the grounds of undue hardship.

6. Travel and overtime meal allowances

The Commissioner has issued a determination that sets out the amounts that he considers are reasonable (reasonable amounts) for the substantiation exception in Subdiv 900-B of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) for the 2021-22 income year (TD 2021/6).

TD 2021/6 relates to claims made by employees for:

– overtime meal expenses: for food and drink when working overtime;
– domestic travel expenses: for accommodation, food and drink, and incidentals when travelling away from home overnight for work (particular reasonable amounts are given for employee truck drivers, office holders covered by the Remuneration Tribunal, and federal members of parliament); and
– overseas travel expenses: for food and drink, and incidentals when travelling overseas for work.

The approach outlined in TD 2021/6 can only be used where the taxpayer receives an allowance to cover the particular expenses that they are claiming, for example, the taxpayer received an accommodation allowance and is claiming accommodation expenses.

The reasonable amounts only provide the maximum amount that can claimed by a taxpayer without being required to substantiate the expenditure. If a taxpayer relies on the reasonable amounts and the ATO checks the taxpayer's income tax return, the taxpayer will still be required to show:

– that the taxpayer spent the money when performing their work duties (for example, when travelling away from home overnight on a work trip);
– how the claim was worked out (for example, a diary was kept);
– that the money was spent by the taxpayer (for example, using a credit card statement or other banking records) and was not reimbursed (for example, a letter from the employer); and
– that the allowance was correctly declared as income.

7. Calculation of aggregated turnover

The Commissioner has released a draft determination which considers the question of whether, where an entity (the tested entity) is working out its aggregated turnover, the relevant annual turnovers of connected entities or affiliates are determined by reference to the entity's income year (TD 2021/D1).

The view expressed in TD 2021/D1 is that, when working out the tested entity's aggregated turnover (under s 328-115 ITAA97), the annual turnovers of:

– connected entities; and
– affiliates,

are calculated for the relevant period that aligns with the tested entity's income year, even if those entities have a different accounting period for tax purposes to the tested entity.

An entity is required to calculate its aggregated turnover based on its income year, whether that ends on 30 June or some other date, for example, where the entity has a substituted accounting period approved by the Commissioner.

An entity's aggregated turnover includes its own annual turnover, as well as the annual turnover of any entity (including a foreign resident) that is connected with it, or is an affiliate of it, at any time during its income year.

Example

TD 2021/D1 gives the following example.

Example

Company A Ltd needs to calculate its aggregated turnover for an income year to determine whether it is eligible to make a loss carry back election. Company A Ltd has a regular income year of 1 July to 30 June.

Company A Ltd identifies Company B Pty Ltd as an entity connected with it at all times during its income year. Company B Pty Ltd has been approved by the Commissioner to adopt a substituted accounting period of 1 January to 31 December.

Company A Ltd calculates its annual turnover for 1 July to 30 June. In accordance with the aggregation rules, Company A Ltd is also required to include Company B Pty Ltd's annual turnover in its aggregated turnover.

Company A Ltd will need to include Company B Pty Ltd's annual turnover for the same 1 July to 30 June period when calculating its aggregated turnover. This is the case even though Company B Pty Ltd has an approved substituted accounting period of 1 January to 31 December.

8. FBT: car parking benefits

A final ruling has been issued by the Commissioner that sets out when the provision of car parking is a car parking benefit for the purposes of the *Fringe Benefits Tax Assessment Act 1986* (Cth) (FBTAA86) (TR 2021/2).

The conditions which must be satisfied before a benefit is a car parking benefit on a particular day are prescribed in s 39A(1) FBTAA86. Some points made in TR 2021/2 in relation to these conditions are noted below.

"in the vicinity of"

One condition prescribed by s 39A(1) is that the work car park is located at or "in the vicinity of" the primary place of employment, on the particular day. This means that the two locations are near, proximate, or close to each other.

When considering the distance between the places, it is the spatial (the physical measured distance between the places) and the geographical separation that is significant. Geographical includes geographical features such as rivers, railway lines, freeways and other physical obstacles which might render a car park and an employee's primary place of employment near or close as the crow flies but not so in terms of the distance of the shortest practicable route between them.

Commercial parking station

Another condition that must be met is that a commercial parking station is located within a one kilometre radius of the work car park used by the employee.

A "commercial parking station", in relation to a particular day, is defined (in s 136(1) FBTAA86) as a commercial car parking facility which (for present purposes):

- is permanent;
- is not on-street parking; and
- has car spaces available in the ordinary course of business to the public for all-day parking on payment of a fee.

The expression "commercial car parking facility" is not defined and takes its ordinary meaning. When considering its ordinary meaning and the statutory context, there must first be a parking facility, such as:

- a purpose-built complex designed for car parking (including parking provided as part of an office or apartment building); or
- an area of land dedicated or adapted to providing car parking (including on-street parking).

A parking facility will be a commercial car parking facility if it is operated by a car parking operator. This includes a parking facility that exists within another complex (such as an office, shopping centre or hospital) where the owner or lessor of that complex outsources the management of the parking facility to a car parking operator.

Where a parking facility is not managed by a car parking operator, it may nevertheless be a commercial car parking facility if it displays other relevant hallmark characteristics.

Permanent

The term "permanent" used in the definition of "commercial parking station" (see above) is not defined. Considering its ordinary meaning and the statutory context, a permanent commercial car parking facility is enduring or lasting as such and not temporary or transient in nature. For example, a parking facility set up for a special event (like a sporting event) would not be permanent. A vacant lot, operated as a commercial car parking facility, could be considered to be a permanent commercial car parking facility even where it is intended that a building will be erected on the site in due course.

TR 2021/2 states that it should be read in conjunction with ch 16 of *Fringe benefits tax — a guide for employers* which provides guidance to help employers calculate the taxable value of a "car parking fringe benefit" and practical examples.

Commencement point

TR 2021/2 replaces TR 96/26 (which was withdrawn on 13 November 2019). Paragraph 81 of TR 96/26 expressed the view that car parking facilities that have a primary purpose other than providing all-day parking (that is, one that usually charges penalty rates significantly higher than the rates chargeable for all-day parking at commercial all-day parking facilities) were not commercial parking stations. That view is not retained in TR 2021/2. In respect of this changed view, TR 2021/2 applies in respect of car parking benefits provided on or after 1 April 2022.

Recent case decision

9. Default assessments: onus of proof

The AAT has rejected an individual taxpayer's claims that the Commissioner's amended assessments for four income years made under the default assessment provisions (s 167 ITAA36) were excessive (*Behrndt and FCT*[1]).

The taxpayer and his business partner were property developers who purchased vacant land through related entities, often using money from third parties. The taxpayer was the development manager and had nothing to do with the financial side of the business which was looked after by his business partner who was a qualified accountant.

The Commissioner determined that income tax returns lodged by the taxpayer did not declare all of the assessable income in the 2009, 2011, 2012 and 2013 income years. Specifically, certain deposits identified in the taxpayer's bank accounts were assessed by the Commissioner as assessable income. Tax shortfalls were identified and amended assessments as to income tax were made pursuant to s 167 ITAA36. Also, notices of assessment of shortfall penalty were made for each of the income years. On 29 December 2015, the taxpayer lodged objections against the notices of amended assessment, the notices of assessment of shortfall penalty, and the imposition of statutory interest charges. On 27 September 2016, the Commissioner made a decision to disallow the objections. The taxpayer applied to the AAT for a review of that decision.

The taxpayer operated numerous bank accounts, including an account in the name of Creative Edge Investments Pty Ltd (Creative Edge). He was a director and shareholder of Creative Edge whose bank account was used by the taxpayer to receive payments from other entities. The Commissioner calculated the taxpayer's actual income based on what he received in those bank accounts. Certain deposits were excluded because they were received from family members, proceeds from the sale of a family home, amounts transferred between accounts, and amounts attributed to other people. Amounts paid from the bank accounts of related third parties with whom there was a loan agreement were also excluded. All other payments to these accounts were treated by the Commissioner as assessable income because they were payments for services that the taxpayer provided. The taxpayer did not dispute that these deposits were received but instead identified deposits that he asserted were not income. These assertions were not supported by satisfactory evidence and hence the taxpayer failed to prove that the amended assessments were excessive.

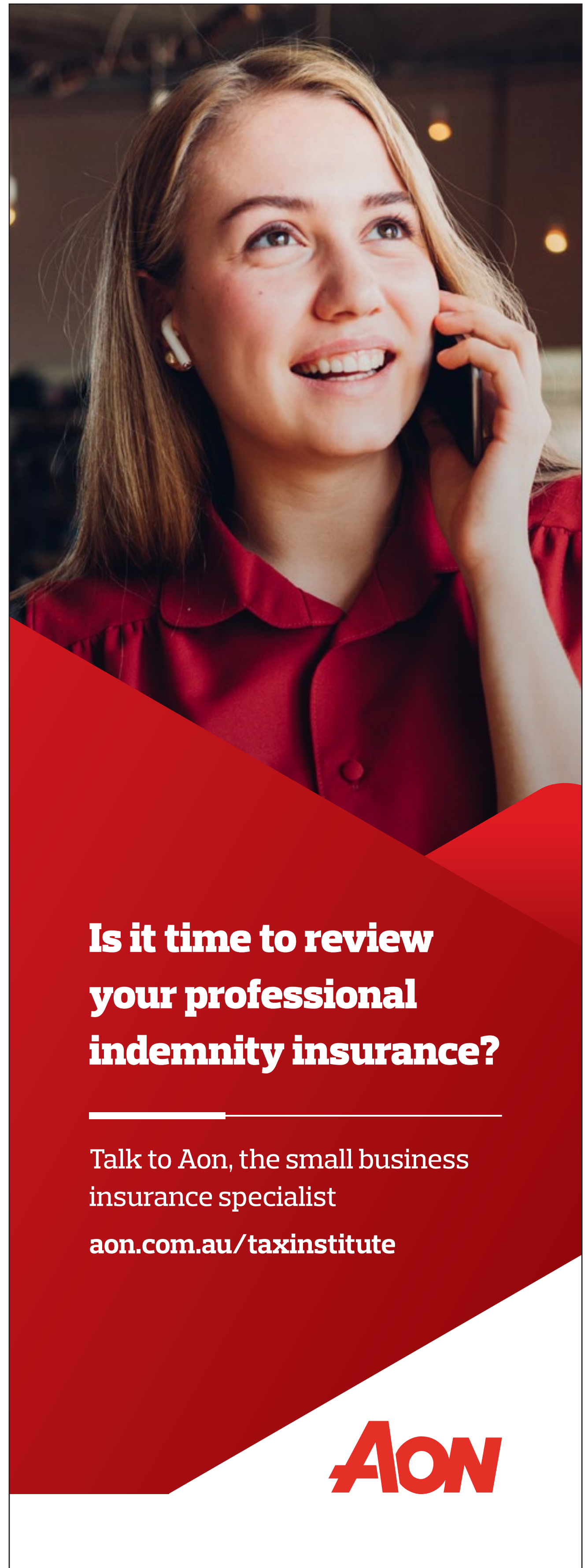
The AAT, in rejecting the taxpayer's application, pointed out that, where the Commissioner makes a default assessment pursuant to s 167, the taxpayer has the onus (under s 14ZZK(b) of the *Taxation Administration Act 1953* (Cth)) of showing that the assessment is excessive. To discharge this onus, the taxpayer must do more than establish that the Commissioner's assessment is wrong; they must prove their actual taxable income for the years in issue. This the taxpayer had failed to do.

In relation to the administrative penalties, the AAT said that the income declared by the taxpayer represented a significant understatement of his assessable income and was therefore false or misleading. The AAT agreed with the finding of the Commissioner that the taxpayer's behaviour was reckless in the sense that it was behaviour that fell significantly short of the standard of care expected of a reasonable person in the same circumstances. The base penalty of 50% of the shortfall amount, being $186,145.30, was appropriate. In these circumstances, the AAT declined to remit the shortfall interest charge.

TaxCounsel Pty Ltd
ACN 117 651 420

Reference

1 [2021] AATA 1769.



Tax Tips

by TaxCounsel Pty Ltd

Granny flats and CGT

The CGT amendments relating to granny flat arrangements are now law and operative.

Background

Amendments to the *Income Tax Assessment Act 1997* (Cth) (ITAA97) that were recently enacted by the *Treasury Laws Amendment (2021 Measures No. 4) Act 2021* provide for the CGT treatment of so-called "granny flat arrangements". The amendments had their ultimate genesis in the 2017 Australian Law Reform Commission report *Elder abuse – a national legal response*[1] which examined, in particular, the prevalence of elder abuse in relation to granny flat arrangements.

The explanatory memorandum[2] explains that a granny flat arrangement has a particular legal meaning, derived from the term "granny flat interest" in social security law. It describes an arrangement rather than a type of accommodation, and it can arise whenever money or other consideration is given in exchange for a right to accommodation for life.

In a typical case, granny flat arrangements occur when an older person transfers some sort of consideration (often title to property or proceeds from the sale of property) to their adult child in exchange for the promise of ongoing care, support and housing. The arrangements can be formal, but more often than not they are informal.

These arrangements can be beneficial to all parties involved. When operating effectively, they can provide benefits to the adult child in the way of property or funds, and benefits to the older person in the way of care, support and housing.

However, the older person tends to be in a more vulnerable position and can suffer serious consequences if circumstances change. Problems can arise as a result of the adult child pre-deceasing the older person, relationship breakdowns between the adult child and their partner, or the adult child becoming bankrupt. Contingencies are often not considered if these types of events happen and this, combined with the common informality of granny flat arrangements, can make it difficult for the older person to establish, assert or enforce their rights under the arrangement.

Perceived tax consequences have often been one barrier to the parties having a formal granny flat arrangement in place. CGT events could arise on entering into, varying or terminating a granny flat arrangement, depending on the circumstances.[3] Informal agreements can make it easier for a taxpayer to argue that there are no formal rights in existence, and therefore no assets that could be subject to CGT.

The Board of Taxation examined these issues and the tax issues that arise from granny flat arrangements and delivered a report to government in November 2019.[4] In response to the Board's report, it was announced in the 2020-21 Federal Budget that a targeted CGT exemption would be introduced for granny flat arrangements that provide accommodation for older Australians or people with disabilities where there is a formal written agreement in place. The amendments considered in this article were introduced to give effect to that announcement.

Commencement

The amending Act provides that the commencing date for the CGT granny flat provisions is the first 1 July after the amending Act received royal assent.[5] The date of royal assent was 30 June 2021 which means that the amendments commenced on 1 July 2021.

It is provided more specifically that the amendments apply in relation to events that happen on or after the amendments commenced that would, apart from the amendments, be CGT events. This is the case even if the arrangements the events relate to were entered into before, on or after that commencement.[6]

The structure of the provisions

The CGT granny flat provisions are contained in a new Div 137 ITAA97 which is titled "Granny flat arrangements".[7] The new Division comprises Subdiv 137-A which contains a definition section (s 137-10 ITAA97) and provisions that govern the circumstances in which a CGT event will not happen when a granny flat arrangement is:

- entered into (s 137-15 ITAA97);
- varied (s 137-20 ITAA97); or
- terminated (s 137-25 ITAA97).

Broadly, the effect of the amendments is that a CGT event does not happen on entering into, varying or terminating a granny flat arrangement that satisfies the legislative requirements. Also, the existence of a granny flat interest does not affect the application of the CGT main residence exemption.

Interface with social security

Although, as explained in the explanatory memorandum, the CGT granny flat provisions that have been inserted into the ITAA97 are intended to have an operation in the context of arrangements that are made for social security purposes, it is not a requirement of the CGT granny flat provisions that there be social security considerations for those provisions to apply. The only direct recognition of social security in the CGT granny flat provisions is the reference in s 137-10(2)(a) to "pension age", a term that is defined in s 995-1(1) ITAA97 to have the meaning given by s 23(1) of the *Social Security Act 1991* (Cth).

It would seem, therefore, that the CGT granny flat provisions are to be interpreted and applied according to their terms and that any social security considerations that may arise in a particular case would need to be determined by reference

to the provisions of the *Social Security Act 1991.* If that is so, great care will need to be taken in the drafting of granny flat agreements, particularly where both CGT and social security issues are involved.

Definitions

Two key expressions in the CGT granny flat provisions are "holds a granny flat interest" and "eligible for a granny flat interest". These expressions are defined.

Holds a granny flat interest

An individual holds a granny flat interest in a dwelling under an arrangement if the individual has a right to occupy the dwelling for life that has been conferred by the arrangement[8] (s 137-10(1)).

The explanatory memorandum explains that the concept of granny flat interest in a dwelling has been drawn from the recognition in the social security law of family arrangements that provide support for older people.

A granny flat interest does not have to relate to properties often referred to as "granny flats" as it is not a description of the type of property. An individual can have a granny flat interest in a wide range of properties, such as a family home or a family's rental property or holiday home.

Dwelling

The concept of a "dwelling" for the purposes of the definition of "granny flat interest" takes the defined meaning that it has in s 118-115 ITAA97 for the purposes of the CGT main residence exemption.[9] It generally captures a unit of accommodation, such as a residential home, and includes the land beneath the home. In the CGT granny flat provisions, the word refers to the dwelling that the individual has the right to occupy because of the granny flat interest.

While the term "dwelling" refers to the unit of accommodation, adjacent land and structures that fall within the CGT main residence exemption by virtue of s 118-120 ITAA97 are also included as part of the term "dwelling" for the purposes of the CGT granny flat provisions, as a granny flat interest could exist in relation to these components as well (s 137-10(3)).

Eligible for a granny flat interest

The other concept that is defined in the CGT granny flat provisions is of an individual being "eligible for a granny flat interest" at a particular time. An individual will be so eligible if the individual:

- has reached pension age at or before that time; or
- has a disability that means they need assistance to carry out most day-to-day activities and this is likely to continue for at least 12 months after that time (s 137-10(2)).

Pension age is the same age threshold that is used when determining eligibility for the age pension.[9] Sections 23(5A), (5B), (5C) and (5D) of the *Social Security Act 1991* provide the thresholds for pension age.[9] The explanatory memorandum points out that those who are above pension age are the ones most likely to require the care and support that the CGT granny flat provisions are aimed at encouraging.

The word "disability" is not defined and, so, takes its ordinary meaning. "Disability" is relevantly defined in the *Macquarie Dictionary* as "1 lack of competent power, strength, or physical or mental ability; incapacity". The individual needs to have an ongoing disability that causes them to require assistance when carrying out most day-to-day activities. The explanatory memorandum states that, while an individual does not need to be eligible for the disability support pension to meet this threshold, generally an individual who is eligible would meet this threshold. It is not intended that an individual be able to access the exemption because of short-term injuries that have a quick recovery time.

It will be noted that, in the case of a disability, the definition applies to test eligibility at the time of entering into or varying the arrangement. This means that the ability to recover from a disability is not an impediment to accessing the CGT granny flat provisions. The ability to undertake employment while having the disability is also not an impediment.

The operative provision: creation

A CGT event does not happen to the extent that it relates to *creating* a granny flat interest in a dwelling under an arrangement by entering into the arrangement at a particular time (the "start time"), if:

1. the individual who holds, or who is to hold, the granny flat interest under the arrangement is eligible for a granny flat interest at the start time;
2. another individual either holds an ownership interest in the dwelling at the start time or agrees, under the arrangement, to acquire an ownership interest in a dwelling that is to be the dwelling in which the first-mentioned individual is to hold the granny flat interest;
3. at the start time, both individuals are parties to the arrangement;
4. the arrangement is in writing and indicates an intention for the parties to the arrangement to be legally bound by it; and
5. the arrangement is not of a commercial nature (s 137-15).

Parties to a granny flat arrangement need not own the dwelling where the granny flat interest is to be held at the time of entering into the arrangement. Parties are able to enter into an arrangement and agree that one party will acquire a dwelling where the other party is to hold their granny flat interest at a future time.

An individual who is to hold a granny flat interest can enter into a granny flat arrangement with any party. For example, the individual can enter into such arrangements with their family, family friends, or members of their cultural community. The individual who does own, or is to own, the dwelling, needs to be a party to the arrangement.

It will be noted that the CGT event does not happen only to the extent that it relates to the creation of a granny flat interest. The exemption does not extend to other CGT events that may happen as part of the broader process of putting in place a granny flat arrangement, but do not relate to the creation of a granny flat interest.

Example (from explanatory memorandum)

Carl is eligible for a granny flat interest and enters into a formal granny flat arrangement with his daughter Sandra. Under the arrangement, Sandra agrees to build an attached flat on her property for Carl to live in. Carl agrees to pay $500,000 to Sandra to finance the build, which he obtains from selling shares in his investment portfolio.

Under the exemption, the CGT event D1 (creating contractual or other rights) that would otherwise have arisen from the creation of Carl's right to occupy the flat on Sandra's property, will not happen and Sandra will have no CGT liability resulting from the creation of the right.

However, the exemption will not apply to any CGT consequences from the sale of Carl's shares as, although proceeds from the sale are to be used to finance the building of the attached flat, the sale is not considered sufficiently related to the creation of the granny flat interest.

There is an issue as to whether the requirement that the arrangement be in writing means that the written agreement must reflect all of the terms, so that there would not be any scope for other provisions being implied.

In relation to the arrangement, the explanatory memorandum points out that there is no requirement that a granny flat arrangement must take a particular form or include specific terms. This allows parties flexibility to ensure that an arrangement can be entered into with terms that best suit their circumstances and avoids unnecessary requirements that might be a barrier to entering into such arrangements. However, it is expected that a formal arrangement would deal with basic matters such as who the parties to the arrangement are, the circumstances in which the arrangement could be varied or terminated, and what happens on variation or termination.

In relation to the fifth requirement that the arrangement is not of a commercial nature, the explanatory memorandum states that the commerciality of an arrangement would need to be determined on a case-by-case basis, considering the terms of the arrangement and the circumstances of each case. An arrangement requiring the holder of the granny flat interest to pay rent at a market rate to occupy the accommodation could be an indicator that the arrangement is of a commercial nature. On the other hand, if the individual who holds the granny flat interest merely contributes to the costs of running the household that they are living in, this could be more in the nature of a reimbursement of household expenses and suggest that the arrangement is not of a commercial nature.

The amount of any consideration for the granny flat interest and how it is worked out could also be a factor in determining whether the granny flat arrangement is of a commercial nature.

Example (from explanatory memorandum)

Alice has a granny flat interest in part of a home owned by her brother, Jeremy. In addition to the right to accommodation, the agreement also provides for Alice to pay a monthly amount to Jeremy. The payments are a contribution to the costs associated with running the household, being rates, electricity, cleaning and food. The amount Alice agrees to pay is a share of household costs and not rent. The amount is lower than the amount Jeremy would be able to obtain under an arm's length rental agreement made on the open market.

The arrangement would unlikely be considered commercial in nature. The payments are intended to reimburse Jeremy for the reasonable costs he incurs in providing Alice with accommodation and food.

The operative provision: variation

A CGT event does not happen, to the extent that it relates to creating or varying a granny flat interest in a dwelling under an arrangement by varying the arrangement at a particular time (the "variation time"), if:

1. the individual who holds, or who is to hold, the granny flat interest under the arrangement (as varied) is eligible for a granny flat interest at the variation time;
2. another individual either: (a) holds an ownership interest in the dwelling at the variation time; or (b) agrees, under the arrangement (as varied), to acquire an ownership interest in a dwelling that is to be the dwelling in which the first-mentioned individual is to hold the granny flat interest;
3. at the variation time, both individuals are parties to the arrangement (as varied);
4. the arrangement (as varied) is in writing and indicates an intention for the parties to the arrangement to be legally bound by it; and
5. the arrangement (as varied) is not of a commercial nature (s 137-20).

The operative provision: termination

A CGT event does not happen, to the extent that it relates to terminating a granny flat interest in a dwelling under an arrangement by terminating the arrangement, if either s 137-15 (creation of a granny flat interest) applied so that a CGT event did not happen when the arrangement was entered into or s 137-20 (variation of granny flat arrangement) applied so that a CGT event did not happen when the arrangement was varied.

Observations

It is to be hoped that the Commissioner issues practical guidance material to assist practitioners who are called on to advise in relation to granny flat arrangements or to draft complying agreements. Ideally, Services Australia should have input in the formulation of any such material.

At a practical level, when drafting any agreement for a granny flat arrangement, there should be a statement of intent as to what the agreement is intended to achieve.

TaxCounsel Pty Ltd

References

1 Australian Law Reform Commission, *Elder abuse – a national legal response*, ALRC Report 131, May 2017.

2 To the Treasury Laws Amendment (2021 Measures No. 4) Bill 2021. References to the explanatory memorandum in this article are references to this explanatory memorandum.

3 The typical CGT event would be CGT event D1 (s 104-35 ITAA97). For a determination in which the operation of CGT event D1 is considered, see TD 2018/15.

4 The Board of Taxation, *Review of granny flat arrangements*, November 2019.

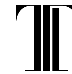
5 See item 4 of the table in s 2 of the *Treasury Laws Amendment (2021 Measures No. 4) Act 2021*.

6 S 137-10 of the *Income Tax (Transitional Provisions) Act 1997* (Cth).

7 These are referred to in this article as the "CGT granny flat provisions".

8 The word "arrangement" in s 137-10(1) ITAA97 and in the other operative provisions is asterisked so that it takes its meaning from the Dictionary to the ITAA97, except so far as a contrary intention appears. The Dictionary definition of arrangement embraces "any arrangement, agreement, understanding, promise or undertaking, whether express or implied, and whether or not enforceable (or intended to be enforceable) by legal proceedings". There is a contrary intention to this definition applying in an unlimited way in relation to the CGT granny flat provisions because, for example, only binding written arrangements that create rights are relevant for the purposes of those provisions.

9 See s 995-1(1) ITAA97.



THE TAX INSTITUTE

2021 National Infrastructure Conference

The only conference focused entirely on tax issues affecting infrastructure

Program highlights include;

- 24+ expert presenters
- Flexibility to attend face-to-face or online
- Unbeatable networking opportunities

10–11 November 2021
Crown Sydney | Online
12 CPD hours

Register now
taxinstitute.com.au/2021NIC

0779NAT_07/21

Mid Market Focus

by Lauren Whelan, FTI, HLB Mann Judd

Are software charges subject to royalty withholding tax?

The recently published TR 2021/D4 outlines the circumstances in which receipts from the licensing and distribution of software will be royalties.

On 25 June 2021, the Commissioner of Taxation published TR 2021/D4 which outlines the Commissioner's views on whether receipts from the distribution and licensing of software should be regarded as royalties. TR 2021/D4 has replaced TR 93/12, which was withdrawn with effect from 25 June 2021. As TR 93/12 was heavily relied on to determine withholding tax obligations for cross-border software arrangements, TR 2021/D4 will require multinationals and their advisers to re-focus on whether these arrangements are caught under the definition of a "royalty". This article addresses the following important questions when considering whether software charges qualify as royalties:

– How are cross-border royalties taxed in Australia?
– What is the domestic law definition of royalties?
– How do the Commissioner's views differ between TR 93/12 and TR 2021/D4?
– Do software support services qualify as royalties?
– If caught under Australian domestic law, how does the definition in the OECD model[1] impact this?

How are cross-border royalties taxed in Australia?

Section 128B(2B) of the *Income Tax Assessment Act 1936* (Cth) (ITAA36) requires Australian businesses to deduct withholding tax from royalty payments made to non-residents. Withholding tax at the rate of 30% is imposed on royalty payments under s 7 of *Income Tax (Dividends, Interest and Royalties Withholding Tax) Act 1974* (Cth). However, this may be reduced by the relevant international tax treaty. The withholding tax liability is imposed on the non-resident but is collected from the payer under s 12-280 of Sch 1 to the *Taxation Administration Act 1953* (Cth).

Where a withholding tax obligation exists but is not paid, the Australian taxpayer is denied a tax deduction for the royalty payment until the withholding tax has been paid to the Commissioner under s 26-25 of the *Income Tax Assessment Act 1997* (Cth). Income subject to withholding tax is then excluded from the assessable income of the non-resident under s 128D ITAA36.

What is the domestic law definition of royalties?

The Australian domestic law definition of a "royalty" in relation to software includes any amount paid or credited as consideration for:[2]

"(a) the use of, or the right to use, any copyright, patent, design or model, plan, secret formula or process, trade mark, or other like property or right;

(b) the use of, or the right to use, any industrial, commercial or scientific equipment;

(c) the supply of scientific, technical, industrial or commercial knowledge or information;

(d) the supply of any assistance that is ancillary and subsidiary to, and is furnished as a means of enabling the application or enjoyment of, any such property or right as is mentioned in paragraph (a), any such equipment as is mentioned in paragraph (b) or any such knowledge or information as is mentioned in paragraph (c);"

However, it also includes a royalty in the ordinary sense.[3] Given the inclusivity of the definition and the heavy reliance on the previous guidance provided by the Commissioner in TR 93/12, taxpayers and their advisers should review its replacement, TR 2021/D4, to determine whether their cross-border software arrangements fall within the definition of a royalty. It should be noted that the proposed retrospective start date of the new ruling is not intended to prevent the application of TR 93/12 prior to its withdrawal "to the extent that it has been relied upon".

How do the Commissioner's views differ between TR 93/12 and TR 2021/D4?

The significant difference between TR 93/12 and TR 2021/D4 (highlighted in Table 1) is that the supply of software distribution rights may now attract royalties. Australian software distributors often relied on the fact that they did not have access to, or the right to modify, the source code to avoid being caught as a royalty. However, the Commissioner's revised opinion in TR 2021/D4 will require further analysis.

While Table 1 is helpful in establishing whether a payment for software is a royalty, often the supply of software, services and know-how is not priced separately. Both TR 93/12 and TR 2021/D4 establish that, where the supply is mixed and no separate consideration is attributable to the various supplies, a notional allocation is required to be made based on the difference in market value of a similar software product without such transfer of know-how and/or service and the contract price.

Do software support services qualify as royalties?

Often contracts for the supply of software include the provision for ongoing assistance, such as training, bug-fixing, maintenance and help desk support. In TR 93/12, paras 43

Table 1. Comparison of TR 93/12 and TR 2021/D4

Payments for …	TR 93/12 (old interpretation)	TR 2021/D4 (new interpretation)
A licence for the simple use of the software by an end-user, without permitting the use of the copyright.	Not a royalty per para 27.	Not a royalty per para 6(a) and example 3 (paras 14 to 18).
The grant of distribution rights from the software developer to an intermediary distributor to allow sub-licensing to an end-user.	Not a royalty per para 29.	Possibly a royalty. If the distributor becomes the owner, or can use the copyright in the software, it will be deemed to be a royalty per paras 5(a) and 6(b). The right to reproduce the software is an example where the distributor has acquired the right to use the copyright. See example 1 (paras 8 to 10). Per para 6(a), if the software developer still has the exclusive right of the copyright in the software, such a payment would not be a royalty. However, this somewhat contradicts example 4 (paras 19 to 24), where the Commissioner deems the payment for distribution rights of software as a royalty despite the end-user and the distributor's lack of right to reproduce or modify the software. The point of difference may be that, in example 4, the distributor has the right to specify the terms of software use by end-users. It is on this basis that the Commissioner argues that there is a grant of right to use the copyright in the software. This major departure from TR 93/12 suggests that, despite a local distributor not having the right to reproduce or modify the software, and not owning or otherwise controlling the server or the website, the payments for the right to distribute could still be deemed to be a royalty. Furthermore, the Commissioner suggests in example 5 (paras 25 to 30) that the payments made by distributors for the right to sub-license the use of the software to customers is a royalty because it would be acting in a copyright owner's capacity.
The sale of goods where the hardware and a copy of the software for simple use is sold to an end-user in an integrated form.	Not a royalty per paras 4(c) and 34.	Not a royalty per para 6(d). Example 6 (paras 31 to 33) provides that the distribution right to retail computer games would not be considered a royalty because the retailer is not involved with the use of the copyright.
The transfer of all rights relating to the copyright in the software.	Not a royalty per paras 4(a) and 23 to 25.	Not a royalty per paras 6(c) and 82 to 83.
The software where some or all of the underlying source code of the program or significant algorithms is provided.	A royalty per para 39. It is considered that, prima facie, there is a supply of technical knowledge or information or know-how about the program which comes within para (c) of the "royalty" definition in s 6(1) ITAA36.	A royalty per para 5(b). As explained in example 2 (paras 11 to 13), this is because the provision of the source code imparts unpublished technical information or know-how about the software.
The supply of know-how.[4]	A royalty per para 40 (whether in the subject matter or the program itself).	A royalty per para 5(b) as it falls within para (c) of the "royalty" definition in s 6(1) ITAA36. Examples include payments for the supply of the source code relating to software per example 2.
The provision of services to enable the application or enjoyment of the software, where not relating to basic use.	A royalty per para 44 and example 2 in para 46.	A royalty per para 5(c). Example 7 suggests that assistance provided by a software developer to help a user in updating or modifying the software itself is directly related to the right to reproduce and modify the software. On this basis, the payment for these services comes within para (d) of the "royalty" definition in s 6(1) ITAA36.
The provision of services in the modification or creation of the software.	Not a royalty per paras 4(d) and 41.	Not a royalty per paras 6(e) and 94. Despite the payment for services to assist an end-user in learning how to modify software being considered as a royalty, the payment for services provided to modify or create the software would not.

to 46 established that the payment for these services are not royalties, and this is reiterated in paras 96 to 98 of TR 2021/D4.

However, as discussed in Table 1, in example 7 of TR 2021/D4, support services to allow a user to modify the software would be royalties. Similarly, there can be a grey area between the supply of know-how and the provision of services. Paragraphs 92 to 94 of TR 2021/D4 echo para 41 of TR 93/12 in that the characteristics of a contract for services, and the elements that distinguish it from a contract for the supply of know-how, are discussed in paras 25 to 36 of IT 2660. Because of the wide variety of contracts that may be entered into, the issue of whether a contract for the provision of custom software is or is not a contract for services will depend on the particular terms of the agreement. In cases where the essence of the contract is the provision of services for the modification or creation of software, it is accepted that the receipts are not royalties for the purposes of the ITAA36.

Similar to the supply of software and know-how, para 42 of TR 93/12 required an apportionment of consideration where the contract provides for both the supply of know-how and the provision of services. Paragraph 95 of TR 2021/D4 still requires apportionment. However, unlike TR 93/12, it does not refer to TA 2018/2 (regarding the mischaracterisation of activities or payments in connection with intangible assets).

If caught under Australian domestic law, how does the definition in the OECD model impact this?

If an arrangement is caught under Australian domestic law, taxpayers and their advisers may also wish to ensure that it meets the definition of a royalty under the relevant international tax treaty. The OECD *Model tax convention on income and on capital*[1] (the OECD model) and its related commentaries should be reviewed to interpret whether the royalty meets the definition according to the treaty. This article considers whether payments for the consideration of the following would be subject to royalty withholding tax under the OECD model:

- the supply of a software licence;
- the supply of software with the ability to make minor modifications to the source code; and
- services specifically as they relate to the provision of "know-how".

Supply of software licence

Article 12(2) of the OECD model states that royalties are:

> "… payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience."

The commentary to art 12 in para. 13.1 suggests that payments for the supply of a software licence will represent a royalty where the licence allows the licensee to reproduce and redistribute the software and/or modify and publicly display the program, as this would signify a right to use the copyright of the software. However, para 14.4 clarifies that payments for the right to distribute the software, without the right to exploit any right in the software copyrights, would not be considered as royalties.

Similarly, para 16 in the commentary to art 12 suggests that payments for "the transfer of rights that constitute a distinct and specific property … are likely to be business profits within Article 7 or a capital gain within Article 13 rather than royalties within Article 12". The OECD's examples of how software can constitute a distinct and specific property can include the exclusive right to use in a limited geographic area or in a limited period of time.

While there are some differences between the Commissioner's most recent views in TR 2021/D4 and the OECD model, they are largely are aligned.

Supply of software with ability to make minor modifications to the source code

While the consideration for the right to customise software may be considered a royalty in TR 2021/D4, the OECD commentary to art 12 in para 14.4 suggests that the right to minor customisation for the purposes of its installation would not be considered a royalty. Similarly, para 14 in the OECD commentary to art 12 also states that the acquisition of software and rights limited to those necessary to enable the user to operate the program would not be considered a royalty, but subject to art 7. However, care will be needed where relying on this to ensure that customisation of the code is minor.

Services specifically as they relate to the provision of "know-how"

As explained in para 11 of the commentary to art 12 of the OECD model, payments made as consideration for information concerning industrial, commercial or scientific experience refers to the concept of "know-how". Paragraph 11.4 suggests that payments for purely technical assistance and after-sale services would not be considered know-how, but rather a provision of services. Paragraph 11.3 distinguishes the provision of know-how and services in that:

> "… the supplier undertakes to perform services which may require the use, by that supplier, of special knowledge, skill and expertise, but not the transfer of such special knowledge, skill or expertise to the other party."

In practice, services that are provided in connection with the development of software do not involve transferring such special knowledge, skill or expertise, but rather using a supplier's special knowledge, skill or expertise to perform services so that they may meet their obligations under the contract. Accordingly, these services would not be subject to royalty withholding tax under the treaty. Again, the OECD and the Commissioner's views as expressed in TR 2021/D4 are mostly aligned.

In summary

There are notable differences between the Commissioner's views as expressed in TR 2021/D4 and TR 93/12, in particular, the treatment of rights to distribute software which may now capture arrangements that were previously not subject to royalty withholding tax. As the OECD's definition of "royalty" as it applies to software arrangements is more

limited than the Commissioner's, taxpayers may wish to rely on the relief provided by Australia's tax treaties. Nevertheless, taxpayers should analyse the implications that TR 2021/ D4 may have on their cross-border software arrangements and seek advice from the Commissioner as it relates to their circumstances.

Lauren Whelan, FTI
Director – Tax Consulting
HLB Mann Judd

References

1 OECD, *Model tax convention on income and on capital*, November 2017.

2 See paras (a) to (d) of the definition of "royalty or royalties" in s 6(1) ITAA36.

3 For this reason, if a payment is contractually described as a royalty, it is likely that it will be taxed by the Commissioner as such (according to para 49 of TR 2021/D4).

4 Both TR 93/12 and TR 2021/D4 refer to paras 19 to 21 of IT 2660 for examples of know-how. IT 2660 refers to "undivulged technical knowledge, information, experience or technique that is necessary for the industrial reproduction of a product or process. Examples of this would include technical data, samples or patterns, or details of processing or production methods".

To become a master of your craft, you need to learn and evolve.

Are you ready to take a significant step to master your career in tax? Enrol into Study Period 3 before 1 October for the early bird discount.

Enrol now
taxinstitute.com.au/education

THE TAX INSTITUTE

Higher Education

Higher Education

Understanding the facts and the client's ultimate goals

The Dux of Advanced Superannuation in study period 2, 2020 shares the most valuable aspect of studying this subject in the Graduate Diploma of Applied Tax Law program.

Helen Cameron, Accountant & Tax Adviser, Ulton, Queensland

Please provide a brief background of your career in tax

After teaching high school in Far North Queensland for two years, I worked as an accountant for Drake & Murphy in Brisbane, then spent six months in London before taking on the role of manager at Moore Stephens HF in Melbourne. After returning to Brisbane, I ran my own accounting practice for nearly 15 years before joining Ulton's new Brisbane office in July 2018.

What have you taken away as the most valuable aspect of studying Advanced Superannuation?

The importance of understanding both the facts and what the clients' ultimate goals are. If one fact changes, this can change the whole advice. Also, there is usually more than one way to achieve what the client wants; it is about finding the best way for their specific circumstances.

What are your areas of new confidence?

My areas of new confidence include how to research and reference legislation and cases properly, and how to structure a letter of advice to a client.

Why did you undertake this specific subject?

I have always had an interest in superannuation, so it was great to have this subject as an option to fill the gaps in my knowledge.

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

I have two more subjects left to complete as part of the Graduate Diploma of Applied Tax Law (GDATL), then hopefully it will be on to the home renovations.

Do you have any tips for managing study and work?

I think the main challenge everyone faces when juggling work, study and home life is a lack of time. However, as my mother always says, "you have all the time there is", which is absolutely true — the main thing is how you manage the time you have. In terms of study, my tip is to start early and work consistently through the program. The Tax Institute provides plenty of resources, so definitely take advantage of these.

What advice do you have for other tax professionals considering the GDATL program?

Do it! The program does take a lot of time and effort but will be worth it in the long run.

The case for reform

by The Tax Institute

Between widespread bushfires, floods and the COVID-19 pandemic, Australia has experienced unprecedented events that have shaken the economy since 2019. However, the risks to the economy have been brewing for some time and the lack of microeconomic reform has never been so evident as is now being shown. To propel Australia forward, government needs to generate revenue, support economic growth and job creation, and improve equity for future generations. Holistic reform of the Australian tax system is fundamental to these goals. The Tax Institute launched *The Case for Change* in July 2021, the result of a year's effort from hundreds of members and others. It is the platform for discussion on the future of Australia's tax system. Extracts from *The Case for Change* will be published in coming months. This month, we publish the first chapter, "The case for reform".

Recovering from the events of 2020

Between 2019 and 2021, Australia experienced unprecedented events that shook the economy and adversely impacted the lives of many Australians and businesses. The widespread bushfires, floods and the COVID-19 pandemic have had a shattering effect, not to mention other global issues which have also, directly or indirectly, affected the Australian economy and our relations with other nations. In addition, while the worst of some of these events is over, others persist, and the impact of all is long-lasting. The economic and social fallout from these events, including the devastating loss of lives, destruction of property and infrastructure, closure of businesses and job cuts following strict lockdowns, and shrinking household spending, plunged the Australian economy into a recession for the first time in 30 years.

The government was swift in its responses to provide support to individuals and businesses affected by these crises. The temporary stimulus measures ranging from the cash flow boost to JobKeeper and JobMaker, among others, have been critical in ensuring that many businesses stay afloat through these trying times.

Now, to propel Australia forward from this recession, the government must look beyond temporary measures, and invest in long-term solutions to address the current economic crisis and the aftermath of 2019 to 2021. Australia needs solutions that will:

- generate revenue to support ongoing government expenditure;
- support economic growth and create jobs; and
- improve equity for the generations to come who will continue to bear the brunt of the economic fallout of 2019 to 2021.

Tax reform – a key part of the solution

Holistic reform of the Australian tax system is fundamental to achieving any of these objectives:[1]

> "The tax system serves an important role in funding the quality public services that benefit individual members of the community as well as the economy more broadly. Through its design it can have an important impact on the growth rate and allocation of resources in the economy."

Over the past few decades, the taxation and superannuation systems have played an important role in supporting and strengthening the resilience of the Australian economy and fiscal position. This is particularly evident when compared to other countries during other periods of severe economic downturn, such as, for example, the GFC of 2008-09 (the only major economic shock Australia has experienced since the introduction of the GST, other than the COVID-19 pandemic).

However, our ability to weather the storm in the past may provide a false sense of security and it would be remiss of the government to rest on its laurels now. Today, Australia is facing different economic challenges than in the past. The emerging economic and social implications of the bushfires, floods and the COVID-19 pandemic have placed greater pressure on budgets at all levels of government. These events have tested the capability and durability of the tax system to support the recovery, and further growth, of Australia's economy.

We now have unimaginable levels of debt at the state and federal level. Even taking into account the current record low interest rates, at a very minimum, the principal on these debts eventually must be repaid.

For the tax system to support Australia in bringing its debt back under control over the long term, revenue must be raised from efficient and sustainable tax bases. As demonstrated throughout *The Case for Change* paper, the vast majority of revenue collected currently comes from unsustainable sources. Sweeping reform of the entire tax system is vital and must begin now so that we can implement the right structures to drive Australia towards economic prosperity.

Moreover, when assessing the long-term impacts of the pandemic, an important variable is the impact of halted migration (and tourism), which is expected to be reflected in a corresponding reduction in GDP. Lower net immigration in 2019-20 and 2020-21 due to restrictions on international travel is likely to permanently reduce Australia's population compared to pre-COVID-19 assumptions. This is expected to cause a flow-on decline in household consumption and therefore GST revenue over the longer term.[2] Similarly, a lower number of temporary visitors affects not only the tourism and related sectors, but also translates to lower education exports, healthcare, as well as flow-on effects to retail, trade and other sectors.

Rebalancing the tax mix

Australia's low tax revenue

Australia has relatively low tax revenue as a percentage of GDP compared to other OECD countries. In 2018, Australia had a tax revenue as a percentage of GDP of 26.7%, while the OECD average was 33.9% and common comparative countries such as New Zealand and the UK were both 32.9%, and Canada was 33.2%.[3]

Over-reliance on income tax

Despite the aforementioned *comparatively* lower rates of tax, the mix of taxes in Australia has largely been unchanged for approximately 60 years, with a significant reliance on income taxes, including company tax.[4] In 2017-18, 51.3% of tax collected was from personal income tax.[5] More than two-thirds of Australia's tax receipts come through personal and corporate income taxes — which is approximately twice the OECD average. Most other advanced economies have placed a considerably higher reliance on the taxation of consumption (or value-added) taxes.[6]

The introduction of the GST was a critical addition to the Australian tax mix. Specifically, the GST introduced to the existing tax mix a broader tax base than the previous narrow sales tax base. However, Australia's tax mix is still highly skewed towards direct taxes on individuals and corporations. According to the ABS, in 2018-19, taxes on income, profits and capital gains accounted for 60.5% of total tax revenue, while the GST accounted for a mere 11.6%.[8]

While income tax revenue is significantly higher than the OECD average, GST revenue is relatively low compared to other OECD countries, in which VAT comprises, on average, 20% of total tax revenue. Further, concessions and exemptions that are available within the Australian GST regime are broader, relative to other OECD countries.[9] In 2018-19, the GST collected was $65.1b and GST concessions cost $26.4b. According to the ATO, the GST tax gap for that year amounted to $5.8b.[10] Together, these figures indicate that almost half the potential revenue from the GST, as it currently applies, is not being collected. The GST tax gap is largely attributable to overclaimed deductions and the cash economy. However, it can be seen that an incredibly large amount of revenue has been forgone by virtue of concessions and other forms of reliefs from GST.

The Henry and Thodey reviews agreed with the OECD assessment that consumption is 'one of the most efficient and sustainable tax bases available to governments' and that 'empirical evidence indicates that a broad-based tax on consumption is one of the least damaging taxes to economic growth'.[11] This is because taxing consumption does not distort economic growth, but rather encourages investment and saving since it does not tax the normal return to capital.

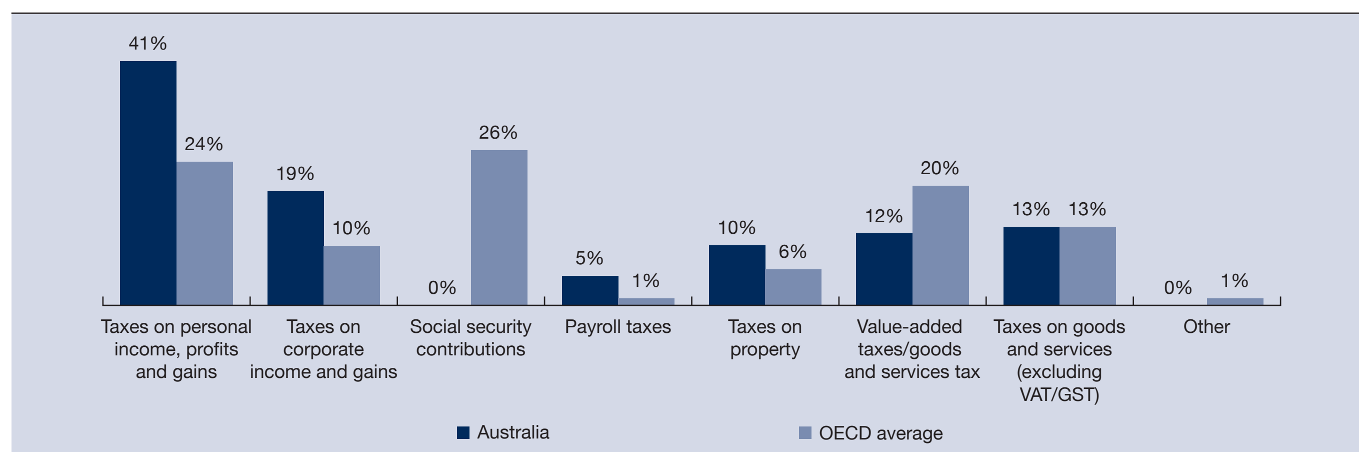
Increasing reliance on the GST as a source of revenue is an important strategy to rectify some of the fundamental issues associated with Australia's current tax mix. If increased productivity and workforce participation remain at the forefront of the agenda (as they should), it is unsustainable and counterintuitive to rely on personal income taxes, particularly as Australia's ageing population moves into retirement. Further, heavy reliance on corporate taxes is less conducive to economic growth.

On the other hand, with some necessary reforms, the GST has the potential to be a comparatively stable and reliable revenue stream. The current relative volatility of the GST can be attributed, in part, to the broad range of exemptions to the regime.

In addition to encouraging productivity and workforce participation by shifting reliance from income taxes, improvements to the GST can alleviate reliance on even more volatile, distortionary and inefficient revenue streams that are imposed at the state level, such as stamp duties and insurance levies.

Another benefit to greater reliance on the GST is the reduced scope for significant tax planning and potential tax avoidance. The availability of unilateral choices within the income tax system lends itself to tax planning in a manner which does not readily translate in a consumption tax system, particularly where both sides to a transaction are required to report consistent information to the ATO.

Figure 1. Tax structure of Australia compared with OECD average (2018)



Source: OECD, *Revenue statistics 2020 – Australia,* OECD Publishing.[7]

Overall, there are a range of reasons demonstrating the importance of not only undertaking a comprehensive review of the existing GST regime, but also taking action to rebalance the tax mix with a shift away from income taxes towards a greater reliance on consumption tax.

A tax system must support, not impede, the economy

A tax system is designed to raise the money that governments need to provide the services demanded by society. This means that imposts by governments can take many forms, be it user charges or traditional revenue raising.

A *good* tax system not only raises the right amount of revenue, but is also conscious of the impact that taxes have on economic activity. A tax system that causes the least possible impediment to economic growth and productivity[12] is to be preferred to one that has no regard for the impact on economic activity. Tax systems are traditionally gauged on the basis of three accepted fundamental principles: efficiency, equity and simplicity.

Efficiency

The OECD[13] seeks to rank various taxes according to the relative harm they might inflict on economic growth. The conclusion, in terms of efficiency and efficacy, is that the most harmful type of taxes for economic growth are corporate taxes, followed by personal income taxes, and then consumption taxes, with recurrent taxes on immovable residential property being the least harmful. Accordingly, taxes on immovable residential land impose the lowest cost on economic growth. This conclusion is similar to that recently described in the report commissioned by the New South Wales Government into federal financial relations (the Thodey report).[14] That report notes that land tax is efficient and one that could be more broadly based is to be preferred as a substitute for the highly inefficient stamp duty.

Further, while the Thodey report notes the relative efficiency of the GST (in particular, when compared to income and corporate taxes), it also notes that there are major risks to its resilience[15] and that it has failed to be the growth tax it was designed to be because of the relatively narrow base. That is, the proportion of household expenditure that is subject to GST is shrinking[16] and this trend is likely to continue with demographic changes as well as technological change.

It is also well documented that Australia has a comparatively high reliance on corporate taxes compared to other jurisdictions. In the OECD's *Revenue statistics 2020*,[17] Australia ranks fourth highest when it comes to the proportion of tax raised from companies (the first three countries are Chile, Colombia and Mexico). Australia ranks equal second highest on the proportion of revenue from personal income tax and third lowest on consumption taxes. One must ask, are we so significantly out of step for any good reason? Do we know something that other countries don't, or have we been left behind? Noting that our national productivity growth has been extraordinarily low over the last 20 years, we should ask, to what extent is this attributable to the current mix of taxes? How much is the current tax system impeding productivity and economic growth? Why must we continue to restrict our growth and opportunities with a system that fails to tax the right activities in a balanced and sensible way?

To many, the solution is obvious.

The right mix of taxes would reduce reliance on the known inefficient taxes and increase the proportion of revenue raised by efficient taxes. This is true economic reform — reform which enhances productivity and creates employment.

Equity

While a shift away from taxing income to relying more on consumption taxes and a land-based tax may be desirable from an efficiency point of view, it is important to factor in fairness.

Equity and fairness lead to a more cohesive society. A system that is fair, and can be explained and perceived as fair, improves confidence that tax is being paid appropriately by the right contributors. The focus in recent years about multinational corporates not paying 'the right amount of tax' illustrates this. The ATO reports that, in fact, one-third of companies listed on the ASX actually make real economic loss in any one year or that significant accumulated losses are legitimately applied against otherwise taxable incomes. Media reports often overlook this fact, creating the misleading impression that one-third of corporates do not pay any tax.[18] The truth is that the corporates are often fully compliant with the law and pay what is due in most cases.[19] However, what the law requires to be paid and how that amount should be determined have not kept pace with community expectations. Politicians (some of whom were apparently 'outraged' by certain behaviours) are those responsible for ensuring that the legislation keeps pace with those changing expectations.

Accordingly, it is important that tax laws are consistent with community expectations of fairness. That it has apparently ceased to be so is a failure of successive governments to invest in ongoing maintenance of the system. While apparently somewhat mundane, it is clear what happens when that maintenance is neglected. In fact, the only 'maintenance' seems to be to introduce highly technical and complicated laws that are narrowly based and merely add to the community's lack of understanding and, ultimately, lack of trust in the tax system.

Australia prides itself on being a society of equals where everyone gets a 'fair go'. It is unsurprising, therefore, that a system that maintains an appropriate level of progressiveness on income (and wealth distribution) will gain acceptance and support from the community. The importance of ensuring that the social security (ie transfer) system is playing its part in maintaining that fairness is critical and should not be overlooked in any debate regarding the fairness of the system.

However, when considering the appropriate fairness settings in a tax and transfer system, not all taxes are as equitable as they may superficially seem. The International Monetary Fund, in its work "Tax policy for developing countries", said:[20]

> "Another concern in the choice between taxing income and taxing consumption involves their relative impact on equity. Taxing consumption has traditionally been thought to be inherently more regressive (that is, harder on the poor than the rich) than taxing

> income. Doubt has been cast on this belief as well. Theoretical and practical considerations suggest that the equity concerns about the traditional form of taxing consumption are probably overstated and that, for developing countries, attempts to address these concerns by such initiatives as graduated consumption taxes would be ineffective and administratively impractical."

As noted in a *Taxation in Australia* journal article from 2020,[21] what superficially can seem regressive might actually be progressive. Thus, the differential treatment of food, depending on whether or not it is classified as a pre-prepared meal, may actually mean that lower socio-economic sections of society are spending a higher proportion of their income on GST than was previously understood, and that some higher socio-economic sections of society may not be paying GST on what may be considered 'luxury' items.

A tax reform process must include better education of the real impact of taxes on different sections of society and expose for debate what is truly progressive and what is not. For example, recent work by Treasury suggests that there seems to be no convincing correlation between payroll tax and the employment decision, though we acknowledge that there are competing views.[22]

Such education and debate must also address the real incidence of taxes: the way in which certain taxes impact not only the 'payers' of the tax, but also the consumers, employers, employees and other businesses that interact with the payers.

Perhaps one of the starkest discussions that ran as a theme across a number of The Tax Summit: Project Reform sessions was the impact of the interaction of the tax and transfer system on working parents and the high effective marginal tax rates that they — usually working mothers — face. This is one of the most unfair features of our current system and could fall under the heading of 'gender equity' in our tax system. Primary carers can face a net *cost* of working an additional day once effective marginal tax rates are added to the cost of childcare itself. This should be regarded as one of the most fundamental failures of our system. This will be expanded on in future articles published in this journal. The fact that it seems to be acknowledged but little is done about it is a further indictment on the way in which society and our politicians respond to such failures. It is the role of bodies like The Tax Institute to prosecute the changes necessary to rectify this shameful situation.

Also raised during The Tax Summit: Project Reform discourse was intergenerational equity. This is an important issue, not only because inequities exist between different age groups at different times — and there may be good reason for that — but also because little work seems to have been done and minimal debate has occurred about what taxes are borne and what benefits are received over the course of a lifetime. Further, this issue is exacerbated by the fact that there is a risk of that equation changing through policy decisions that may not have regard to the longitudinal impact. Thorough research is necessary to have an informed debate about the right tax settings across a lifetime and to ensure that certainty is built into those settings.

Finally, equity must also consider the treatment of different types of income earned — known as 'horizontal equity'. Often what is called out in this part of the debate is the differing treatment of the taxation of savings and the taxation of labour income. While valid, the debate on horizontal equity should be widened to include the taxation of the same income in the hands of different entities and whether that is an appropriate setting. Currently, small business income is taxed in a variety of ways depending on whether the chosen business vehicle is a sole trader, partnership, limited partnership, trust or company. Such differences create complexity and leave open significant planning opportunities which undermines confidence in the equity of the tax system.

Simplicity

The third main feature of a good tax system is simplicity.

Simplicity generally promotes cost efficiency, which provides an environment for greater investment and builds trust in the system.

The complexity of the current system is reflected in the multiple laws and the detailed rules which are often overlaid on already complex rules. While the Board of Taxation recommended, and the government implemented, a significant reduction in the size of the tax laws in the mid-2000s, the laws have since grown again and now exceed 10,000 pages.

Complexity reduces the ease of doing business and deters both domestic and foreign direct investment.

The most telling statistic of the complexity in the Australian tax system is the estimated cost of meeting obligations to register, calculate and pay tax liabilities. The estimated compliance costs of some $40b per annum[23] is a dead weight cost on business and Australians. It represents more than 10 times the cost of running the ATO. It represents significant red tape and is a drag on economic activity. That means reduced economic welfare for Australians through lower investment, resulting in fewer employment opportunities.

Additionally, a complex system reduces the level of trust in the system and is connected to perceptions of unfairness in the system. Because the system is complex and seems impenetrable — other than to the *cognoscenti* — it has the appearance of being capable of manipulation by those fortunate enough to be advised by that *cognoscenti*, irrespective of the truth of that.

A feature of simplicity (and one that is often called out separately) is the sustainability and stability of a system. A system designed with these features is flexible and minimises the need for constant tinkering. Fewer changes foster certainty, confidence and trust. We have seen what happens when a system is not designed for the long term or is designed in a way that is inflexible to changing economic or societal circumstances and imperatives — it has resulted in our current inefficient, inequitable and complex tax system.

Another perspective of certainty is that a system should be clearly understood by society, which requires a level of transparency. However, other aspects are equally important — the need for our system to be integrated into

other systems, given the openness of our economy and the considerable trade and flow of capital, as well as being positioned to create the best kind of jobs. Or, to express it as the Prime Minister did in 2020 — it's about creating investment and jobs.

> *"The estimated compliance costs of some $40b per annum is a dead weight cost on business and Australians. It represents more than 10 times the cost of running the ATO."*

How does the current system measure up?

Efficiency

Various reports have pointed out that Australia relies on a number of high economic cost taxes. At a state level, examples include the various duties, whether on real property or other transfer (eg cars) duties, and insurance duties. At a federal level, there is a high reliance on income taxes. All of these taxes have an 'excess marginal burden' or the value destroyed for the dollar of revenue raised. The Thodey report sets this out most recently but it has been a theme of previous tax reviews, including the Henry review[24] in 2009.

Equity

The incidence of high effective marginal tax rates on some sections of society has been referred to above and discussed during the course of The Tax Summit: Project Reform event series in 2020, backed up by the work done by Associate Professor Ann Kayis-Kumar (UNSW), Professor Miranda Stewart (University of Melbourne) and others, and reflected in publications by the Grattan Institute, among others.

Importantly, this work shows how the tax system does not sit alone but interacts with other systems (transfer/social security). People often forget that these systems were once highly integrated, with many transfer benefits being delivered through the tax system. This is less so today and may well be part of the reason for what is now a very disjointed and incoherent system.

Similarly, the retirement system must not only integrate with other parts of the tax and transfer system, but it must also satisfy community expectations of fairness and equity. There was considerable (and perhaps surprising) agreement among experts in this area during the course of The Tax Summit: Project Reform event series that the current design of the taxation of superannuation is far too generous. The fact that the taxation is levied at concessional rates on contributions and income of the funds during the accumulation phase for members, yet fund income and benefits during the retirement phase are exempt, means that concessions are significant and their affordability in the context of the whole system is questionable.

The government's recent *Retirement income review* noted:[25]

> "Contributions and earnings tax concessions together were estimated to cost a total of $41.55 billion in revenue forgone terms in 2018-19 (Chart 4A-6). Of this, $18.3 billion was employer contributions tax concessions (both compulsory and salary sacrifice) and $22.1 billion was earnings tax concessions. Only $1.1 billion was personal contributions tax concessions, reflecting that less than 10 per cent of personal contributions are concessional."

To some extent, the tax concessions drive the complexity in the design of the tax rules as integrity measures are built in.

Simplicity

The sheer size of the Australian tax law (exceeding 10,000 pages) is often highly intricate, and much of it applies only to a small proportion of the taxpayer population. This has been referred to above as have the other features, which give rise to a poor score for the tax system on these criteria.

The ATO has attempted to 'paper over the complexity' in the system. While there is much to be admired in an administrator proposing to use technology to mitigate the adverse effects of the complexity in the system, it means that the general population will not be aware of the unnecessary complexity that exists in the tax system. Additionally, the way in which ATO guidance is structured and the design of the ATO website mean that, often, further issues of accessibility and complexity are created.

Rather than paper over complexity, it might be better to address the fundamental complexity so that it is not necessary to use some of the revenue collected in simplifying the user experience. If the system is simplified, less will then need to be spent trying to create the appearance of simplicity.

Trust and transparency

The lack of trust manifests itself in many ways. The lack of trust in the efficacy of the system exists because of the complexity. This emanates from a suspicion of large/multinational corporates and high net worth individuals and the perception that, if you can afford to pay for 'smart tax lawyers and accountants', you can avoid paying your fair share of tax — irrespective of the truth.[26]

A lack of trust between the administrator and the taxpayer adds to the compliance costs imposed on taxpayers. Despite that apparent lack of trust between the administrator and taxpayers in relation to particular dealings, there is a valuable commodity in our system: the relatively high(er) trust in the ATO as administrator, which helps foster the relatively high levels of voluntary compliance that Australia enjoys. This issue will be explored further in future articles published in this journal.

Levels of reform

The system as a whole

Considering the whole system, reform is about the choice of taxes, taking into account the principles above. It is also about the mix of taxes.

Putting aside single tax solutions for the reasons outlined above, we are left with choosing which taxes to put into the mix and what weighting should be given to each of those taxes. Obviously, land tax and consumption taxes should be given greater weight than is currently the case as they are the more efficient taxes. However, we are unlikely to move away

from some form of tax on income and profits/gains, so it is important that they too be in the mix.

The balance could be shifted away from taxes on income and profits/gains which are less economically efficient in favour of GST and land tax. Other taxes can be designed so they are more economically efficient. Payroll tax is a clear example that falls into this category. Similarly, income tax could be made more efficient through changes to thresholds and rates.

Some of the smaller, nuisance taxes could easily be repealed. Some of the insurance duties which impact adversely on behaviour could similarly be abolished. Similarly, the excise regime on alcohol could either be scrapped or rationalised and a step in this direction was seen in the 2021-22 Federal Budget.

The superannuation tax rules could be rewritten in a way that is able to be applied by the average practitioner and comprehensible to the majority of superannuation fund members. It is unlikely that most politicians would be able to describe the intricate and complex superannuation rules that they have created in any level of detail.

These and other examples are explored in further detail throughout *The Case for Change* paper and future articles.

Whatever choices are made, a clear eye will need to be kept on the impact on various sections of the community to ensure that any impacts are considered and dealt with appropriately.

The design of the system

As we consider various aspects of the system at a more granular level (as future journal articles will), the question becomes how to design each of the taxes so that they have the greatest effect with the least economic impost.

This is more challenging, and vested interests will inevitably attempt to ensure that the system continues to work for them. This is evident from the anomalies in the way the current system works that provide perceived benefits for some.

The work that The Tax Institute's volunteers have done and much of the discussion throughout The Tax Summit: Project Reform event series in 2020 was focused on this. The range of matters that *The Case for Change* covers is a testament to the extensive contribution from so many.

Of course, the views that are finally expressed are those of The Tax Institute. Reasonable minds can differ on what is the best solution to a problem.

The Tax Institute

References

1 Australia's Future Tax System Review Panel, Australia's future tax system, report to the Treasurer (Henry review), Part one - Overview, 23 December 2009, p. vii. Available at https://treasury.gov.au/sites/default/files/2019-10/afts_final_report_part_1_consolidated.pdf.

2 PBO, *Structural trends in GST*, report no. 02/2020, Commonwealth of Australia, 2020, p. 4.

3 OECD, *Revenue statistics 2020*, OECD Publishing, 2020, p. 23. Available at https://doi.org/10.1787/8625f8e5-en.

4 M Stewart, A Moore, P Whiteford and RQ Grafton, *A stocktake of the tax system and directions for reform: five years after the Henry review*, Tax and Transfer Policy Institute, 2015, p. 30.

5 ATO, *Taxation statistics 2017-18 snapshot*, chart 3, 2020. Available at www.ato.gov.au/About-ATO/Research-andstatistics/In-detail/Taxation-statistics/Taxation-statistics-2017-18/?anchor=alltaxreturns#alltaxreturns.

6 OECD, *Revenue statistics 2020 – Australia*, OECD Publishing, 2020, p. 1. Available at www.oecd.org/tax/revenuestatistics-australia.pdf.

7 OECD, *Revenue statistics 2020 – Australia*, OECD Publishing, 2020, p. 2. Available at www.oecd.org/tax/revenuestatistics-australia.pdf.

8 ABS, *Taxation revenue, Australia*. Statistics about taxation revenue collected by the various levels of government in Australia, catalogue no. 5506.0. Available at www.abs.gov.au/statistics/economy/government/taxation-revenue-australia/latest-release#key-statistics.

9 OECD, *Choosing a broad base – low rate approach to taxation*, OECD Tax Policy Studies, No. 19, OECD Publishing, Paris, 2010. Available at www.oecd-ilibrary.org/docserver/9789264091320-en.pdf?expires=1622624951&id=id&accname=ocid41018480&checksum=C37D3AFFEF42FFD4364A4EE7213CCCFC.

10 ATO, *Goods and services tax gap*. Available at www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/Goods-and-services-tax-gap/.

11 Henry review, Part one – Overview, p. 51.

12 R Deutsch, "Tax reform in the roaring 20s: some ideas from The Tax Institute", (2020) 55(2) *Taxation in Australia* 69.

13 OECD, *Tax policy reform and economic growth,* OECD Publishing, 2010. Available at read.oecd-ilibrary.org/taxation/tax-policy-reform-and-economic-growth_9789264091085-en#page4.

14 NSW Treasury, *NSW review of federal financial relations: supporting the road to recovery, final report* (Thodey report), August 2020, p. 33 (quoting J Nassios, J Madden, J Giesecke, J Dixon, N Tran, P Dixon, M Rimmer, P Adams and J Freebairn, *The economic impact and efficiency of state and federal taxes in Australia, CoPS/IMPACT working paper G-289*, April 2019. Available at www.copsmodels.com/ftp/workpapr/g-289.pdf).

15 Thodey report, p. 32.

16 PBO, *Structural trends in GST*, report no. 02/2020, Commonwealth of Australia, 2020.

17 OECD, *Revenue statistics 2020*, OECD Publishing, Paris, 2020. Available at www.oecd-ilibrary.org/taxation/revenuestatistics-2020_8625f8e5-en.

18 N Khadem, "ATO data reveals one third of large companies pay no tax", *ABC News*, updated 2 January 2020. Available at www.abc.net.au/news/2019-12-12/ato-corporate-tax-transparency-data-companies-no-tax-paid/11789048?nw=0.

19 The "Tax gap" reports from the ATO bear this out.

20 International Monetary Fund, "Tax policy for developing countries", *Economic issues no. 27*, March 2001. Available at www.imf.org/external/pubs/ft/issues/issues27.

21 A Mills, "Tax reform: selected issues", (2020) 55(2) *Taxation in Australia* 71.

22 B Ralston, *Does payroll tax affect firm behaviour?*, Treasury working paper, April 2018. Available at treasury.gov.au/sites/default/files/2019-03/p2018-t280988-1.pdf.

23 *Re:think – Tax discussion paper*, Commonwealth of Australia, March 2015, p. 171.

24 Henry review. Available at treasury.gov.au/review/the-australias-future-tax-system-review/final-report.

25 Treasury, *Retirement income review, final report*, July 2020, p. 381. Available at treasury.gov.au/publication/p2020-100554.

26 ATO, *Australian tax gaps – overview.* Available at www.ato.gov.au/about-ato/research-and-statistics/in-detail/tax-gap/australian-tax-gaps-overview/?anchor=Whywemeasurethetaxgap#Whywemeasurethetaxgap.

2021 National Superannuation Conference

New October dates! Attend face-to-face or online.

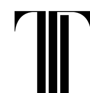
Working in the tax and superannuation space? Join our expert lineup for the latest key updates, hot topics and issues unique to SMSF and large fund sectors. Topics include:

- Implications of NALI/NALE in a plenary panel discussion
- For large funds: mergers, tax governance, foreign issues in emerging markets and Your Future, Your Super
- For SMSFs: SMSF trust deed trips and traps, contributions, the super guarantee and hidden death taxes

Early bird prices close on 3 September

7–8 October 2021
Crown Conference Centre, Melbourne | Online
12 CPD hours

Find out more
taxinstitute.com.au/2021natsuper



THE TAX INSTITUTE

0778NAT_07/21

R&D tax incentive amendments

by Damian Smyth, Chief Executive Officer, and Andy Nguyen, Principal, Swanson Reed

The research and development (R&D) tax incentive is the government's primary mechanism to encourage business R&D. The program is accessed by around 12,000 Australian companies annually who register R&D activities. Since its introduction in the 2012 financial year, the R&D tax incentive has been subjected to ongoing instability from proposed and actual changes in legislation and administration. The latest major legislative amendments to the R&D tax incentive passed in October 2020, within the Treasury Laws Amendment (A Tax Plan For The COVID-19 Economic Recovery) Bill 2020. Changes apply from the 2022 financial year. The amendments impact on the mechanisms for calculation of R&D tax offsets and integrity measures. The eventual passing of these amendments occurred following a tumultuous period during which previous Bills to amend the R&D tax incentive stalled in the Senate. This article details the legislative passage of the amendments, along with an explanation of the changes to the R&D tax incentive.

A decade of instability

Background

The R&D tax incentive operates at an annual cost of almost $3b.[1] The rationale for ongoing public support for the R&D tax incentive is:

- to encourage business R&D that may not have otherwise occurred;
- to generate future tax receipts and economic activity from the successful commercialisation of incentivised R&D; and
- to spill over benefits accruing to the R&D entity and the economy as a whole.

The R&D tax incentive has been partially credited with facilitating Australian "standouts", such as Canva, Atlassian, Dulux and Cochlear. These companies have highlighted how the R&D tax incentive encourages them to continue to conduct R&D activity in Australia, and they have been vocal advocates for program stability.

Most developed countries offer some form of tax incentive for business R&D in their local jurisdictions, and R&D incentives are now a key consideration for companies when determining where to undertake R&D activity. Notably, a report published in March 2021 highlighted that Australia is placed below the OECD average in terms of total government support for business R&D as a percentage of GDP, at a value equivalent to 0.166% of GDP in 2017.[2]

Administrative and legislative framework

Australia's R&D tax incentive program is dually administered by two government agencies:

- AusIndustry (on behalf of Industry Innovation and Science Australia): registers R&D activities disclosed in applications lodged with the agency. AusIndustry has authority to make findings on the eligibility of activities; and
- the Australian Taxation Office: administers R&D tax offset entitlements disclosed in company income tax returns lodged with the agency. The ATO reviews compliance matters such as the substantiation of expenditure and structural tax issues (for example, on whose behalf activities are conducted).

The R&D tax incentive has operated from 1 July 2011, superseding the previous R&D tax concession program which operated from 1985.

Multiple proposed changes to law since FY2011-12 introduction

Australia's R&D tax system has been unstable and perpetually under review. Transition from the R&D tax concession program to the R&D tax incentive (an outcome of Dr Terry Cutler's 2008 innovation review[3]) was itself subject to an elongated passage through parliament. Originally proposed to operate from FY2010-11, when legislated, the R&D tax incentive commenced from FY2011-12.

The R&D tax incentive's brief history has seen constant change proposed by successive Labor and Coalition governments. For example:

- amendments to the R&D tax incentive legislation that were passed as law:
  - a $100m cap on annual expenditure from FY2014-15 (the *Tax Laws Amendment (Research and Development) Act 2015*);
  - a uniform 1.5% reduction in the R&D tax offset rates from FY2016-17;[4] and
  - the recent 2020 amendments discussed in this article from FY2021-22;[5] and
- proposed amendments to the R&D tax incentive legislation that were not passed as law:
  - a proposal for entities with a turnover of greater than $20b being entirely precluded from claiming from FY2013-14 (the Tax Laws Amendment (Research and Development) Bill 2013);
  - a proposed reduction in R&D tax offset rates and other amendments (including an intensity threshold) from FY2018-19 (the Treasury Laws Amendment (Research and Development Incentive) Bill 2018); and
  - a reprisal of the 2018 Bill with modest amendments from FY2019-20 (the Treasury Laws Amendment (Research and Development Tax Incentive) Bill 2019).

Formal review of the program in 2016

The Turnbull Government initiated a comprehensive review of the R&D tax incentive in 2016[6] by Bill Ferris, Dr Alan Finkel and John Fraser, which followed a preceding review by the Centre for International Economics.[7]

The 2016 review sought to improve program effectiveness and integrity, including encouragement of additional R&D spend. The review reported that the R&D tax incentive was not achieving sufficient "additionality", in that it was not encouraging companies to conduct R&D activity that they would not have otherwise conducted.

The 2016 review made significant recommendations, including:

- to retain existing activity and expenditure eligibility criteria, but to publish clearer guidance;
- a premium benefit for expenditure on public research organisations or PhD students;
- a $2m cap on annual cash refunds;
- an intensity threshold for the non-refundable R&D tax offset, whereby R&D benefits only apply to expenditure in excess of 1% to 2% of total business expenses (and if this threshold were introduced, the existing expenditure cap be increased); and
- changes to administration.

Response to these recommendations was mixed, except on the proposed intensity threshold which was widely criticised. Consultation on the intensity threshold noted a number of concerns:

- many claimants would lose their R&D tax benefit altogether, since a large number of companies' R&D expenditure was less than 2% of total business expenses;
- an intensity threshold would make it difficult to determine companies' R&D tax benefits in a timely manner, or to make investment decisions. For example, companies may not be able to determine total business expenses until some time after year end; and
- the threshold would distort outcomes based on the varying nature of businesses. For example, R&D entities with high cost bases (eg manufacturers) may receive a lower incremental tax benefit by investing more in R&D when compared to those with lower cost bases (eg software developers).

The review's findings were published in April 2016, leading to uncertainty as to if, how and when the government may implement the recommendations.

Original introduction to parliament of legislative amendments

The government responded to the 2016 review by introducing legislation in September 2018, that adopted some of the proposed recommendations, including:

- changes to how R&D tax offsets are determined;
- an intensity threshold for the non-refundable R&D tax offset with multiple tiers;
- a cap on refunds; and
- other mechanical and administrative amendments.

The proposed reforms were within the Treasury Laws Amendment (Research and Development Incentive) Bill 2018, widely reducing companies' permanent R&D tax benefits, while also making R&D tax benefits under the non-refundable R&D tax offset less predictable.

In February 2019, a bipartisan Senate Economics Committee recommended[8] that the 2018 Bill should be deferred from consideration until further analysis of its impact had been undertaken, particularly around concerns regarding the proposed intensity threshold.

The government made minor amendments in response to these concerns (simplification of the intensity threshold by one tier) and reintroduced the Treasury Laws Amendment (Research and Development Tax Incentive) Bill 2019. The 2019 Bill would also subsequently stall in the Senate.

Years of prolonged uncertainty

While uncertainty around proposed legislative change was unfolding (including whether the proposed Bills would be enacted retrospectively), the situation was compounded by a widely publicised tightening on the application of existing R&D tax legislation by both AusIndustry and the ATO commencing around February 2017. This period, resulting in heightened compliance activity, was often referred to by the media as the "crackdown".

The crackdown was seemingly in response to the increased budgetary cost of the program, along with identified mischief by some participants which had led to:

- some tax advisers being sanctioned or terminated by professional bodies over poor R&D tax advice and invalid claims; and
- the AAT finding in favour of Innovation Australia in a number of matters regarding disputed eligibility of activities registered under the R&D tax incentive.

However, fallout from the crackdown also saw traditionally accepted interpretations of eligibility no longer accepted, and previously accepted calculations (such as the apportionment of rent expense to R&D based on a ratio of an R&D entity's R&D hours) assessed as ineligible, despite there being no legislative change to the definition of eligible expenditure or activities.

The crackdown phase, spanning 2017 to 2019, is widely considered by stakeholders to be the most challenging period in the history of Australia's R&D tax incentives.

The instability of Australia's R&D tax incentive during this period was particularly concerning since the OECD has concluded that the long-term nature of R&D investments means stable and predictable incentives seem likely to have a stronger impact on business R&D investment.[9]

This period culminated in the December 2019 publication of a further review[10] into the R&D tax incentive by the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) following the agency's consultative inquiry. The ASBFEO recommended that the program be retained as an important incentive for businesses to undertake R&D, but that significant changes to the roles of R&D entities, advisers and regulators were required to improve program administration.

The ASBFEO's report released in 2019 recommended:

- proposals for better administrative integration between AusIndustry and the ATO;
- changes to the process and timing of compliance activity; and
- more accountability and transparency in respect of advice provided by R&D tax advisers.

Eventual passage of the 2020 amendments

A Senate Economics Committee review[11] into the Treasury Laws Amendment (Research and Development Tax Incentive) Bill 2019[12] was subjected to ongoing delays as the government needed to prioritise its response to the pandemic.

The 2019 Bill was proposed to apply from FY2019-20, and the uncertainty of retrospective enactment lingered.

Ahead of the delayed 2020 Budget in October, reports emerged that the government may back down from controversial proposals in the 2019 Bill. Key ministers also indicated a desire to encourage greater business R&D as part of Australia's COVID-19 response.

New proposed amendments to the R&D tax incentive that were announced in the October 2020 Budget came as a pleasant surprise — in contrast to the stalled 2018 and 2019 Bills. In particular:

- the minimum R&D tax benefits already legislated were largely preserved;
- some additional R&D tax benefits not anticipated were presented;
- the proposed cap on refunds did not proceed; and
- the intensity threshold, while still complex, was simplified over earlier Bills.

The explanatory memorandum to the 2020 Bill highlights that:

- the preferred policy option was to implement amendments to the 2019 Bill in order to align with the government's COVID-19 economic recovery measures;
- amendments to the 2019 Bill would better support claimants, helping them to manage the economic impacts of COVID-19, while reducing the complexity of the proposed changes and proceeding with measures to improve the operation of the program; and
- business investment in R&D is central to the development of new products, processes and services that will help make Australia more competitive and create more jobs in the long term.

After years of uncertainty, the Treasury Laws Amendment (A Tax Plan for the COVID-19 Economic Recovery) Bill 2020 passed both Houses in October 2020, commencing from FY2021-22.

Some clear air and a hope for stability

The 2020 amendments have been applauded by stakeholders, particularly when considering previously proposed iterations of the Bill. While the amendments are imperfect and highly complex (eg the intensity threshold and clawback provisions), what has been passed is superior to what was earlier proposed. Moreover, with the likely forthcoming publication of ATO guidance on the 2020 amendments, more clarity on their operation should be attained.

Recent positive developments have also occurred in the administration of the program:

- in November 2019, AusIndustry announced an overhaul of compliance to enhance the program for participants;
- additional and clearer guidance has been published;
- many ASX-listed entities have recently announced positive resolution of R&D tax disputes; and
- anecdotally, companies and R&D tax advisers note that current compliance activity is more balanced than was experienced between 2017 and 2019.

Within the May 2021 Budget, a Board of Taxation review of the R&D tax incentive's administration was announced. Hopefully, any changes proposed will not be adverse or significant.

As this review unfolds, all stakeholders can contribute to stability by seeking to compile and assess claims within the letter and spirit of the law.

Additionally, since the 2020 Bill was unopposed by the opposition, major parties should commit to preserving the stability of the R&D tax incentive to better allow long-term business investment decisions.

TaxVine comments published subsequent to the 2020 Bill's passing declared that the government should stop fiddling with the R&D tax incentive.[13] This sentiment is echoed by most in the R&D tax community, and it is hoped that, following enactment of the 2020 Bill and a better operating environment, a period of stability in the R&D tax incentive may follow.

If the R&D tax incentive could speak, we expect that it would express its own view, as being something akin to the famous Charlie Chaplin quote: "Life could be wonderful if people would leave you alone."

> *"… major parties should commit to preserving the stability of the R&D tax incentive to better allow long-term business investment decisions."*

Detailed examination of the 2020 amendments

R&D tax offset determination prior to changes

The R&D tax incentive operating from FY2011-12 entitles companies to tax offsets for eligible expenditure on registered R&D activities in exchange for tax deductions on the expenditure.

The R&D tax incentive introduced the concept of a notional deduction, since eligible expenditure notionally determines R&D tax offsets, but any entitlement to a tax deduction is foregone. The forfeiture of tax deductions for R&D expenditure is made at item 7, label D (addback of non-capitalised R&D expenditure) in the company tax return.

Prior to the 2020 amendments (up to and including FY2020-21), the legislated offsets were:

– R&D entities with an aggregated turnover of less than $20m: 43.5% refundable R&D tax offset; and
– R&D entities with an aggregated turnover of greater than $20m or that are controlled by exempt entities: 38.5% non-refundable R&D tax offset.

The permanent R&D tax benefit (incentive) received for eligible expenditure is the difference between the tax effect of general tax deductions forfeited and the R&D tax offset entitlement.

The permanent R&D tax benefit legislated prior to the 2020 amendments (in FY2020-21) was:

– R&D entities with an aggregated turnover of less than $20m: 17.5% permanent benefit (43.5% refundable R&D tax offset less 26% corporate tax rate);
– R&D entities with an aggregated turnover of between $20m and $50m or that are controlled by exempt entities: 12.5% permanent benefit (38.5% tax offset less 26% corporate tax rate); and
– R&D entities with an aggregated turnover of greater than $50m or that are controlled by exempt entities: 8.5% permanent benefit (38.5% tax offset less 30% corporate tax rate).

As corporate tax rates reduce for base rate entities between FY2019-20 and FY2020-21, the permanent R&D tax benefit increases, given the R&D tax offset rates are fixed (as outlined in Table 1).

Changes to calculation of R&D tax offsets

Under the 2020 amendments from FY2021-22, there is no change to eligible R&D activities and expenditure. Changes from the 2020 amendments impact on:

– determining the R&D tax offset rates;
– adjustments to R&D tax offsets in cases of recoupment;
– mechanisms for recognising balancing adjustments on R&D assets; and
– administrative processes to enhance integrity and transparency.

The 2020 amendments link R&D tax offset rates to corporate tax rates, now determined based on a fixed margin over tax rates (as opposed to the fixed R&D tax offset rates existing previously).

From FY2021-22, the legislated R&D tax offsets are:

– R&D entities with an aggregated turnover of less than $20m:
  – refundable R&D tax offsets of 18.5% above the corporate tax rate; and
– R&D entities with an aggregated turnover of greater than $20m or that are controlled by exempt entities:
  – non-refundable R&D offset is based on an ascending scale linked to "intensity":
    – 8.5% above the corporate tax rate for R&D expenditure up to 2% intensity; and
    – 16.5% above the corporate tax rate for R&D expenditure above 2% intensity.

The net tax position of R&D entities from FY2021-22 is impacted by changes to both the R&D tax offset and company tax rates, which is illustrated in Table 2.

Determining "intensity" and non-refundable offset

The most controversial element of the 2020 amendments was the intensity threshold that determines non-refundable R&D tax offsets. The proposal was widely criticised by industry during consultation of the 2018 and 2019 Bills, as highlighted earlier in this article.

An effort was made to allay some of the concerns in the 2020 amendments, whereby:

– the minimum level of permanent R&D tax benefit (8.5%) existing prior to the 2020 amendments was preserved at the lowest level of intensity; and
– the number of intensity tiers was simplified from four, to three, to two between the 2018, 2019 and 2020 Bills, respectively.

"Intensity", for the purpose of determining non-refundable R&D tax offsets, is the ratio of notional deductions for R&D

Table 1. Schedule of tax and R&D offset rates (prior to application of 2020 amendments)

	Refundable offset (turnover up to $20m)	**Non-refundable offset** (turnover between $20m and $50m)	**Non-refundable offset** (turnover greater than $50m)
R&D tax offset rate (FY2019-20 and FY2020-21)	43.5%	38.5%	38.5%
Corporate tax rate (FY2019-20)	27.5%	27.5%	30%
Permanent R&D tax benefit (FY2019-20) (R&D tax offset *less* tax rate)	**16%**	**11%**	**8.5%**
Corporate tax rate (FY2020-21)	26%	26%	30%
Permanent R&D tax benefit (FY2020-21) (R&D tax offset – tax rate)	**17.5%**	**12.5%**	**8.5%**
Cash refund when in tax loss (FY2019-20 and FY2020-21)	43.5%	Nil – offset carried forward	Nil – offset carried forward

Table 2. Schedule of tax and R&D offset rates (following application of 2020 amendments)

	Refundable offset (turnover up to $20m)	**Non-refundable offset** (turnover greater than $20m) *up to* 2% intensity	**Non-refundable offset** (turnover greater than $20m) *beyond* 2% intensity
R&D tax offset rate (FY2021-22)	43.5% (25% + 18.5%)	33.5% (25% + 8.5%) or 38.5% (30% + 8.5%)	41.5% (25% +16.5%) or 46.5% (30% +16.5%)
Corporate tax rate (FY2021-22)	25%	25% or 30% for turnover greater than $50m	25% or 30% for turnover greater than $50m
Permanent R&D tax benefit (R&D tax offset *less* tax rate) (FY2021-22)	18.5%	8.5%	16.5%
Cash refund when in tax loss	43.5%	Nil – offset carried forward	Nil – offset carried forward

expenditure as a proportion of an R&D entity's total business expenditure.

Total business expenditure is defined in s 355-115 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) as total expenses for the income year worked out in accordance with:

- accounting principles; or
- if accounting principles do not apply in relation to the R&D entity, commercially accepted principles relating to accounting.

Expenses reported at item 6 in the company tax return (calculation of total profit or loss) are taken to be expenses from an R&D entity's financial statements. The non-refundable R&D tax offset is then determined at varying levels based on R&D expenditure below and above 2% intensity.

Other key points to note in respect of the application of the intensity threshold include:

- based on the principles in the explanatory memorandum to the 2020 Bill, it is likely that the R&D entity's "total expenses" for the purposes of calculating the intensity threshold:
  - do not include capital expenditure;
  - do not include expenses of connected or affiliate entities (unless consolidated);
  - do include depreciation/decline in value expenses; and
  - do include cost of sales;
- notional deductions are always included in total expenses. If notional deductions are not otherwise included in total expenses, a specific provision acts to nevertheless include them. This would impact on the inclusion of capitalised R&D expenditure; and
- s 355-115(3) ITAA97 ensures that amounts are counted in the intensity calculation only once.

Caps on expenditure

The *Tax Laws Amendment (Research and Development) Act 2015* previously implemented a $100m annual cap on notional deductions from FY2014-15. Under the 2020 amendments, this annual cap increases to $150m on notional deductions from FY2021-22. R&D expenditure in excess of this $150m cap is omitted from notional deductions and instead included in general tax deductions.

The 2018 and 2019 Bills had earlier proposed a cap on annual refunds from the refundable R&D tax offset (with an exception for clinical trial expenditure). However, the refund cap did not feature in the final 2020 amendments.

New uniform clawback provision

Since its commencement from FY2011-12, the R&D tax incentive included provisions to reduce R&D tax benefits where expenditure has been recouped or offset:

- where expenditure related to a grant or recoupment by an Australian government agency:
  - a clawback adjustment (R&D recoupment tax) under Subdiv 355-G ITAA97 applied;
  - this rendered a tax of 10% of R&D expenditure related to a grant or recoupment which was not able to be applied against general tax losses; and
- where expenditure related to goods, material or energy used to produce marketable products sold or applied to the entity's own use:
  - a feedstock adjustment applied under Subdiv 355-H ITAA97;
  - the feedstock adjustment is an additional amount included in assessable income calculated as one-third of the lesser of:
    - feedstock input costs; or
    - feedstock revenue.

Clawback and feedstock provisions reduced the permanent R&D tax benefit of recouped R&D expenditure by 10%, a margin that was initially determined simplistically by assuming:

- application of the lower R&D offset rate available during the R&D tax incentive's introduction from FY2011-12 (40% initially, but later legislatively reduced to 38.5%); and
- application of a 30% corporate tax rate.

However, these provisions created an anomaly as claimants of the refundable R&D tax offset received a residual permanent benefit of approximately 5% on recouped R&D expenditure (the difference between the original 45%

refundable R&D offset and the 40% offset that the original provisions were based on). The 2020 amendments seek to address this anomaly by fully reversing the permanent R&D tax benefit on recouped R&D expenditure for all entities.

Within the 2020 Bill, provisions for clawback and feedstock adjustments are consolidated into a unified clawback rule (ss 355-440 and 355-445 ITAA97), whereby recoupment amounts and feedstock adjustments give rise to a clawback amount:

- the clawback recoupment provisions (Subdiv 355-G ITAA97) are replaced with a clawback amount determined under s 355-440(2), which represents the amount of notional deductions that an R&D entity received or is entitled to receive in relation to a recoupment; and
- likewise, previous provisions for feedstock adjustments (Subdiv 355-H ITAA97) are replaced with a clawback amount determined under s 355-445(2), as the lesser of:
  - feedstock revenue received; or
  - notional deductions attributable to the feedstock output.

The clawback amounts determined under ss 355-440 and 355-445 are then applied to a formula specified in ss 355-450(1) to determine an additional amount included in assessable income arising from the clawback amount, as follows:

- aggregate the net of the following:
  - **starting offset**: the total amount of offset calculated under s 355-100 ITAA97 for the offset year; *less*
  - **adjusted offset**: the amount of offset that would be calculated under s 355-100 if the amount of offset were to be reduced by offsets attributable to the clawback amount; *less*
  - **deduction amount**: the clawback amount that is attributable to the offset year, multiplied by the R&D entity's corporate tax rate for the offset year; and
- divide the net of the above three variables by the R&D entity's corporate tax rate for the offset year.

This assessable income amount seeks to compare the R&D tax offsets actually claimed with the amount that would have been claimed under a scenario where notional deductions for R&D expenditure are reduced by clawback amounts. The additional amount of assessable income then reduces the net R&D tax benefit based on the entity's corporate tax rate.

The key changes to the prior clawback and feedstock provisions are:

- linking the clawback and feedstock adjustments to the corporate tax rate fully extinguishes the permanent tax benefit on recouped expenditure for all entities; and
- R&D entities may apply surplus tax losses to assessable income arising from the clawback amounts. Prior to the 2020 amendments, this was not possible for entities claiming expenditure related to a grant, since the R&D recoupment tax applied directly in the calculation statement.

New mechanisms for clawback present greater complexity than previous adjustments. It is hoped that detailed guidance on their implementation is published shortly.

Changes to R&D assets: balancing adjustments

Expenditure for a decline in value of R&D assets is eligible for notional deduction under s 355-305 ITAA97. Mechanisms also operate to incorporate assessable and deductible balancing adjustments within companies' net R&D tax benefit.

Prior to the 2020 amendments, balancing adjustment provisions operated whereby:

- proportional assessable balancing adjustment profit on R&D assets was uplifted by one-third and included in assessable income under s 355-315(3) ITAA97; and
- proportional deductible balancing adjustment loss on R&D assets was included in notional deductions under s 355-315(2) ITAA97.

The explanatory memorandum to the 2020 Bill highlights that, similar to clawbacks for recoupments and feedstock, R&D balancing adjustment provisions relied on approximation.

Within the 2020 Bill, mechanisms for balancing adjustments are amended with varying treatment of assessable and deductible adjustments:

- a clawback or catch-up amount is determined based on whether a balancing adjustment is assessable or deductible; and
- once determined, clawback and catch-up amounts are applied to formulas to determine amounts that are assessable or deductible to the R&D entity.

Changes to the way assessable balancing adjustments on R&D assets are recognised have been incorporated within the 2020 amendments, and are applied using the new uniform clawback provision:

- four different clawback amounts relate to assessable balancing adjustments where R&D assets are wholly or partially used in R&D activities or partnership assets (ss 355-446, 355-447, 355-448 and 355-449 ITAA97);
- the clawback amount seeks to replace previous mechanisms that estimated the R&D tax incentive component of the R&D tax offset to clawback. Determination of the clawback amount reflects the proportional balancing adjustment amount on the R&D asset, capped at the asset's total decline in value (tax cost less its adjusted value); and
- the clawback amount determined is then applied to the formula specified in s 355-450(1) ITAA97 (the same formula that applied to recoupments and feedstock adjustments) to include an additional amount in assessable income to disgorge the R&D tax benefit. The additional assessable income then reduces the R&D tax benefit, based on the corporate tax rate.

Changes to the way deductible balancing adjustments on R&D assets are recognised have been incorporated within the 2020 amendments, and are applied using a new catch-up rule:

- the 2020 amendments introduce a new catch-up rule for R&D assets, providing an additional deduction for deductible balancing adjustments on R&D assets. The catch-up rule mirrors the uniform clawback rule but operates in reverse, providing a deduction in lieu of an

amount of R&D tax offset forgone, rather than including an amount in assessable income;

- as with the clawback amounts for balancing adjustments, four different catch-up amounts relate to deductible balancing adjustments where R&D assets are wholly or partially used in R&D activities or partnership assets (ss 355-465, 355-466, 355-467 and 355-468 ITAA97). The catch-up amounts reflect the amount that an R&D entity can ordinarily deduct for the balancing adjustment;
- the provisions in the point above require determination of the catch-up amount relating to each offset year that a decline in value on the R&D asset was claimed. The decline in value recorded in each offset year as a proportion of the total decline in value on the asset is quantified;
- the catch-up amount determined for a deductible balancing adjustment is then applied to the formula specified in s 355-475(1) ITAA97 which determines the deduction amount based on the sum of the following amounts for each offset year relating to the catch-up amount:
  - aggregate the net of the following:
    - adjusted offset; *less*
    - starting offset; *less*
    - deduction amount; and
  - divide the net of the above three variables by the R&D entity's corporate tax rate for the offset year;
- the additional deduction then reduces taxable income, increasing the R&D tax benefit, based on the corporate tax rate; and
- the additional catch-up deduction is allowed as a deduction but is not a notional deduction and does not contribute towards R&D tax offset entitlement.

New mechanisms for balancing adjustments again present greater complexity than previous provisions, and hopefully detailed guidance on their implementation will be published shortly.

Changes to R&D assets

The capital cost of tangible depreciating assets is ineligible for notional deduction under s 355-225(1)(b) ITAA97. Notional deductions for the decline in value of R&D assets are available to an R&D entity under s 355-310 ITAA97. However, the decline in value of R&D assets using the instant asset write-off under s 328-180 ITAA97 (applying to assets installed up until 31 December 2020) *cannot* be included as a notional deduction under s 355-310.

A recent shift in the principle of not allowing concessional write-off for R&D assets as notional deductions has arisen. R&D assets cannot be deducted under s 328-180 where notional deductions are claimed on the asset. There is, however, no similar exclusion for R&D assets under the temporary full expensing (TFE) provisions in Subdiv 40-BB of the *Income Tax (Transitional Provisions) Act 1997*. This means that the cost of R&D assets qualifying under the TFE provisions (applying to assets installed between 7:30pm AEDT on 6 October 2020 and 30 June 2022) can be included in notional deductions.

Future guidance may be published on applying the TFE provisions to R&D assets, such as apportionment where there is a non-R&D use of the asset.

Other administrative changes

Other administrative changes aimed at enhancing integrity and transparency include the following:

- the definitions of "non-refundable R&D tax offset" and "refundable R&D tax offset" are inserted into the dictionary in Pt IVA of the *Income Tax Assessment Act 1936* (Cth). This will allow the ATO to deny R&D tax offsets linked to a tax avoidance scheme;
- as soon as practicable after a period of two years following the end of a financial year, the Commissioner must publish information about R&D entities, including:
  - the R&D entity's name;
  - the R&D entity's Australian business number, or its Australian company number; and
  - an amount representing the R&D entity's notional deductions claimed;
- the board of Industry Innovation and Science Australia may make determinations in relation to the R&D tax incentive. These determinations are binding on the board and are intended to operate similarly to the Commissioner's rulings. Determinations, however, are not binding on R&D entities; and
- the board's ability to grant an extension of time is capped at three months on the total extension available unless the extension is granted to allow an applicant to wait for the outcome of a separate pending decision (such as examinations or a determination on the eligibility of activities).

Transition to the 2020 amendments applying from FY2021-22

It is anticipated that publication of guidance on the 2020 amendments may be released in the coming months, ahead of commencement from FY2021-22. This may include specific guidance on:

- application of the intensity threshold and determination of total business expenditure;
- application of the new uniform clawback; and
- processes for R&D asset balancing adjustment calculations.

In addition, changes may be required to disclosures in the ATO R&D tax incentive schedule relating to uniform clawback and the non-refundable offset intensity threshold.

AusIndustry has also recently made significant changes to the reporting requirements for FY2021-21 (one year ahead of commencement of the 2020 amendments from FY2021-22). These changes align with the introduction of a new online registration process, and present additional questions seeking to augment the self-assessment registration process. Additional questions in the new registration application include:

- detail surrounding future core activities and the relationship between supporting and core activities;

– disclosure of expenditure per activity;
– disclosure about how an R&D entity researched the state of knowledge prior to an activity commencing to determine that the outcome could not be determined in advance;
– details of evidence kept to substantiate activities; and
– disclosure of whether supporting activities produce a good or service.

It is hoped that, following the availability of this guidance and implementation of the forthcoming changes, a period of stability may be achieved.

Damian Smyth
Chief Executive Officer
Swanson Reed

Andy Nguyen
Principal
Swanson Reed

References

1 Explanatory memorandum to the Treasury Laws Amendment (A Tax Plan for the COVID-19 Economic Recovery) Bill 2020.

2 OECD, *R&D tax incentives: Australia, 2020*, March 2021. Available at www.oecd.org/sti/rd-tax-stats-australia.pdf.

3 T Cutler, *Venturous Australia: building strength in innovation* (Cutler review), August 2008. Available at www.industry.nsw.gov.au/__data/assets/pdf_file/0006/55383/NIS_review_Web3.pdf.

4 *Budget Savings (Omnibus) Act 2016*.

5 *Treasury Laws Amendment (A Tax Plan for the COVID-19 Economic Recovery) Act 2020*.

6 B Ferris, A Finkel and J Fraser, *Review of the R&D tax incentive*, 4 April 2016. Available at www.industry.gov.au/sites/default/files/May%202018/document/pdf/research-and-development-tax-incentive-review-report.pdf?acsf_files_redirect.

7 Centre for International Economics, *R&D tax incentive programme review*, 29 March 2016. Available at www.thecie.com.au/publications-archive/rd-tax-incentive-programme-review.

8 Senate Economics Legislation Committee, *Treasury Laws Amendment (Making Sure Multinationals Pay Their Fair Share of Tax in Australia and Other Measures) Bill 2018 [Provisions]*, February 2019. Available at www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/TLABMultinationalsTax/~/media/Committees/economics_ctte/TLABMultinationalsTax/report.pdf.

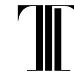
9 OECD, *R&D tax incentives: design and evidence*, 29 February 2016. Available at https://one.oecd.org/document/DSTI/IND/STP(2016)1/en/pdf.

10 Australian Small Business and Family Enterprise Ombudsman, *Review of the R&D tax incentive*, December 2019. Available at www.asbfeo.gov.au/sites/default/files/documents/ASBFEO-RDTI-report.pdf.

11 Economics Legislation Committee, *Treasury Laws Amendment (Research and Development Tax Incentive) Bill 2019 [Provisions]*, October 2020. Available at https://parlinfo.aph.gov.au/parlInfo/download/committees/reportsen/024448/toc_pdf/TreasuryLawsAmendment(ResearchandDevelopmentTaxIncentive)Bill2019[Provisions].pdf;fileType=application%2Fpdf.

12 A follow-up to the Economics Legislation Committee (see ref 8).

13 M von Lucken, "This week in tax", *TaxVine* member newsletter 45, 20 November 2020.



THE TAX INSTITUTE

2021 Tasmanian State Convention

Tasmania's premier event for tax professionals. Now available face-to-face or via online streaming

Program highlights include:

– Trusts: 100A reimbursement agreements; identifying and reducing taxpayer risks
– Primary production land and improvements
– State of the state economic update
– Top 5,000 Program

Early bird prices close on 13 August

9–10 September 2021
Country Club Tasmania | Online
12 CPD hours

Register now
taxinstitute.com.au/2021TAS

0780NAT_07/21

Corporate tax residence: a hidden risk

by Bill Mavropoulos, Partner, VT Advisory

International tax and residence is a complex area. The personal tax residence rules are being revisited in the 2021-22 Federal Budget. Globally, the G20 has floated a 15% tax on multinational corporations. Before practitioners look at these proposed measures, it is useful to perform critical analysis of the current rules around corporate tax residence. This article examines some of the underlying assumptions in respect of corporate tax residence to contextualise and orientate practitioners who are otherwise not familiar with these rules, and poses questions for policymakers in the area.

Introduction

The recent 2021-22 Federal Budget slated changes to simplify the provisions dealing with an individual's tax residence. The rules around corporate tax residence, while also needing simplification, are intrinsically linked to the rules for individuals.

The tax residency of companies is one that has received much analysis over comparatively recent times. The question of corporate tax residence can be said to be almost entirely examined by the courts with reference to companies that are incorporated in foreign jurisdictions. Could this be because, implicitly, domestically incorporated companies are not subject to the same requirements?

This article provides a critical analysis testing this assumption. This analysis involves examining the core legal decision in this space and the legislative evolution contained within para (b) of the definition of "resident or resident of Australia" in s 6(1) of the *Income Tax Assessment Act 1936* (Cth) (ITAA36), with the aim of highlighting a risk that may have been overlooked by practitioners.

Legislative history: the canary in the coal mine

The modern provision that governs Australian tax residency for a company is s 6(1) ITAA36. To understand the meaning of this provision, a practitioner will be aided by tracing back to when it was first enacted. This will also give a practitioner context for when they examine the relevant case law in this area through the task of statutory interpretation.

The definition of "resident" or "resident of Australia" for a company was first enacted by the *Income Tax Assessment Act 1930* (Cth) (the old amending Act) which amended the principal Act, being the *Income Tax Assessment Act 1922-1930* (Cth) (the old principal Act). The relevant part of s 2(i) of the old amending Act inserted the following definition into the old principal Act:

> "(b) a company which is incorporated in Australia, or which, not being incorporated in Australia, carries on business in Australia and has either its central management and control in Australia, or its voting power controlled by shareholders who are residents of Australia;"

Grammatically, where the commas are placed means that this definition makes it clear that a company is a resident where:

- the company is incorporated in Australia,

or

- the company is not incorporated in Australia but carries on business in Australia *and has either*
  - its central management and control in Australia,

  or
  - its voting power controlled by shareholders who are residents of Australia.

This is not a controversial analysis of this definition. However, it should be noted that this is the definition as originally enacted. The current definition is found in the ITAA36, which reads:

> "(b) a company which is incorporated in Australia, or which, not being incorporated in Australia, carries on business in Australia, and has either its central management and control in Australia, or its voting power controlled by shareholders who are residents of Australia."

This definition *appears* to be the same. However, an attentive reader will note an additional comma after the words "carries on business in Australia" that did not appear in the original enactment (this has been shaded over for ease of reference). It is possible to read the passage as follows now:

- the company is incorporated in Australia, *or*
- the company is not incorporated in Australia but carries on business in Australia,

and has either

- its central management and control in Australia, *or*
- its voting power controlled by shareholders who are residents of Australia.

In other words, the requirement to have either central management and control in Australia and/or majority of voting power in Australia *could, under this reading of the text, potentially apply to both companies incorporated in Australia and to companies not incorporated in Australia which carry on business.* This is arguably a grammatically more correct way to read this passage of text. The reason why this is more correct is, under this reading, both types of company have two sub-tests that apply to determine their Australia tax residence. The sub-tests also apply to each type of company equally.

There is no case law where the ATO challenges the residency of domestic companies on this basis, but obiter dictum does exist in the case of foreign incorporated companies which carry on business. In the absence of settled ratio decidendi, this article instead turns to established principles of statutory interpretation for its analysis.

Statutory interpretation: the devil's in the detail

The starting point of a statutory interpretation exercise has been settled by the High Court — it is the text of a provision itself.[1] The most correct grammatical meaning of the text is one in which both domestic and foreign companies are subject to the same tests.

The drafting style of the predecessor enactments, and indeed the ITAA36, is one that was more detailed and complex than the plain English used in the *Income Tax Assessment Act 1997* (Cth) and other broad and principled enactments nowadays. The effect of drafting style can be summarised as follows:[2]

> "Statutes drafted in broad simple language that set a principled framework for a well-known body of law may well be approached with an eye to context, and especially pre-existing law. On the other hand, in legislation that is closely structured and finely worded, the importance of the text may be paramount …"

This does suggest that the text itself should be the more persuasive indicator of meaning, but reference to the context and purpose of the enactment is still relevant.

It is also important that regard to linguistic canons be examined where they are relevant. A potentially relevant espoused canon is reddendo singula singulis. This Latin phrase can be broken up into two parts. The first part refers to two subject-matters, which, in our case, are Australian incorporated companies and those not incorporated in Australia that run businesses here. The second part of the canon matches these subject-matters, in order, to the qualifying conditions in the balance of the provision, being central management and control, as well as majority voting rights of the company. This canon has been applied to former tax provisions that are similar in structure.[3]

At this point, it is appropriate to turn to the purpose of the provision. The seminal or leading modern authority states that the "primary object of statutory construction is to construe the relevant provision so that it is consistent with the language and purpose of all the provisions of the statute".[4] The purpose of the legislation is to levy tax. Interestingly, when one considers the drafting of Australia's double tax agreements, it should be noted that individuals in those agreements are frequently subject to tie-breaker rules but that companies are not subject to those rules. This is coupled with dual residency provisions enacted by parliament that contemplate the situation where a company is a resident of more than one jurisdiction.

In this context, it makes sense that both foreign incorporated companies operating a business in Australia and domestically incorporated companies are subject to the same requirements. This is even more so when considering the domestic laws of foreign jurisdictions contemplating foreign incorporated companies becoming resident for tax purposes using similar rules when no tie-breaker exists. The harmony achieved by ensuring that a company is a tax resident of one jurisdiction is sensible.

The wider context: Bywater case

The leading modern authority examining tax residence for companies that are incorporated in foreign jurisdictions is *Bywater Investments Ltd v FCT*.[5] The first thing to note is that, although this was a unanimous decision, one of the judges reached their decision *by way of different reasons*. It is therefore best to examine the judgment in two parts, the minority decision and the majority decision.

Minority decision

The first reasons examined are those of Gordon J. Her honour states:[6]

> "The definition of 'resident' in s 6(1) of the 1936 Act draws a distinction between companies incorporated in Australia and those incorporated elsewhere. If a company is incorporated in Australia it will be an Australian resident. Parliament has explicitly chosen one formal aspect of a company's existence — incorporation — and deemed that to be determinative of whether a company is a 'resident'."

The reference to parliament explicitly choosing one formal aspect of a company's existence of being determinative appears to be a reference to the explanatory memorandum of the old principal Act which states:[7]

> "The definition of 'resident' would not be complete without a reference to companies. Paragraph (b) therefore causes the definition to apply to companies incorporated in Australia wherever the head office of the control may be situated, and to other companies whose central management and control is in Australia, or whose shareholders controlling the voting power of the company are residents of Australia."

There are three arguments as to why these reasons should be viewed with caution. The first is that they are obiter dictum and do not form binding precedent, given this case relates to a foreign incorporated company carrying on business in Australia and not a company incorporated in Australia with foreign central management and control and a majority voting power of shareholders outside of Australia. The second is that this judgment's reasoning is in the minority and would be less persuasive than a majority reason for decision, especially where the majority leaves open a different construction. Finally, the change to para (b) of the definition of "resident or resident of Australia" in s 6(1) of the *Income Tax Assessment Act 1936* (Cth) (ITAA36) by the addition of a comma changes the way that the provision is to be read. This change would not have been as carefully considered judicially as when the matter in dispute is the residency of a domestically incorporated company.

Majority decision

The majority decision of the court rejected a formulistic approach to determining corporate tax residency. The basis on which the court made its decision was the fact and degree of relevant circumstances. This can best be described by the following passage from the judgment:[8]

> "Finally, in terms of the policy which underlies the statutory concept of corporate residence, the rejection of the appellants' formalistic approach, in favour of the test of fact and degree adopted in *Bullock*[9] and *Esquire Nominees*,[10] is fortified by the approaches adopted in other common law jurisdictions. In *Fundy Settlement v Canada* …,[11] the Supreme Court of Canada applied the same test of residence to a trust as to a company, namely 'where the central management and control of the trust actually takes place'. Accordingly, because the non-resident corporate trustee in that case deferred to the recommendations of Canadian resident beneficiaries in the substantive decisions made regarding the trusts, it was held that the trusts were resident in Canada … Similarly, in *Hertz Corp v Friend*,[12] the Supreme

> Court of the United States held … that, in determining whether a corporation is a 'citizen' for federal jurisdictional purposes, the statutory criterion of 'principal place of business' is:
>
> > 'best read as referring to the place where [the] corporation's officers direct, control, and coordinate the corporation's activities. It is the place that Courts of Appeals have called the corporation's "nerve center". And in practice it should normally be the place where the corporation maintains its headquarters — provided that the headquarters is the actual center of direction, control, and coordination, ie, the "nerve center", and not simply an office where the corporation holds its board meetings (for example, attended by directors and officers who have traveled there for the occasion).'"

Critically, the majority cited with approval, as very compelling, the judgment made by a UK House of Lords case.[13] The reasoning of that case was the irrelevance of the constituent documents of a company which was incorporated in Kenya to the question of tax residence. The parent company was resident in London and was held to have management and control of the Kenyan company, notwithstanding the Kenyan company's constituent documents being sourced in that country. The majority held that it was the facts that really mattered and were decisive in deciding on tax residency.

The inference that is reasonably open from the majority reasons in this case is that the facts and circumstances trump even the constitution of the company. A natural extension of this principle is that perhaps where the company was incorporated, as evidenced by those documents, is also not determinative. Again, the decision gives no binding precedent, much like the minority reasons. Having said this, when presented with the exercise of statutory construction of this particular provision for a company incorporated in Australia, it is the author's view that material risk exists around the question of tax residence for a domestically incorporated company.

"… reliance on binding tax interpretations issued by the ATO to protect the client may be inappropriate in managing tax risk …"

Practitioners should be wary

The ATO is gaining more and more insight into corporate taxpayers and it is sharing data with foreign tax jurisdictions with more sophisticated methods being employed. The advent of technology that allows business commerce to be conducted in an increasingly global environment is a trend that will only continue to increase.

In this context, assumptions that have held for close to a century will inevitably be re-examined by regulators. This can be demonstrated by recent evidence of the ATO reviewing and changing its interpretation on settled tax law positions. For example, income splitting for professional practices.

The task of a tax practitioner is to understand that the implications of tax residency go to the fundamental structure of a corporate group. The consequences of getting this professional judgment wrong can be catastrophic for the client. Given these consequences, reliance on binding tax interpretations issued by the ATO to protect the client may be inappropriate in managing tax risk and advising on a relevant client's tax governance. This is because these binding rulings are subject to more frequent and potentially adverse changes than the legislation itself. Comparatively, because of commercial realities and risks, a structure is sometimes difficult to change quickly.

The courts have not yet decided on a case of residence for a domestically incorporated company. The prudent course of action would be to explain this exposure to a client and obtain some form of acknowledgment from the client that they either wish to make changes or that they decline to do so in writing.

Bill Mavropoulos
Partner
VT Advisory

References

1 *Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue* [2009] HCA 41 at [47].

2 *Australian Competition and Consumer Commission v ACN 099 814 749 Pty Ltd* [2016] FCA 403 at [117], citing *Quikfund (Australia) Pty Ltd v Airmark Consolidators Pty Ltd* [2014] FCAFC 70 at [75].

3 *MP Metals Pty Ltd v FCT* (1967) 117 CLR 631 at 647.

4 *Project Blue Sky Inc v Australian Broadcasting Authority* [1998] HCA 28 at [69].

5 [2016] HCA 45.

6 [2016] HCA 45 at [112].

7 Cl 2(i) of the explanatory memorandum to the Bill that became the *Income Tax Assessment Act 1930* (Cth).

8 [2016] HCA 45 at [84].

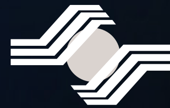
9 *Unit Construction Co Ltd v Bullock* [1960] AC 351.

10 *Esquire Nominees Ltd v FCT* [1973] HCA 67.

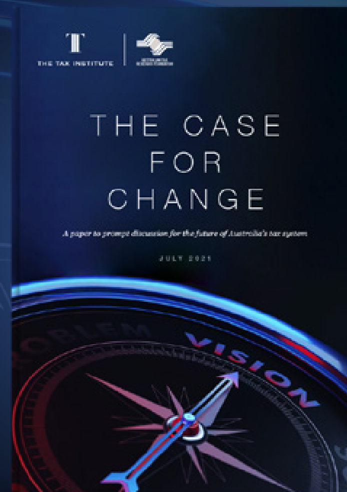
11 [2012] 1 SCR 520.

12 559 US 77 (2010).

13 *Bullock v Unit Construction Co Ltd* [1959] Ch 315.



Thank you for being part of the *Case for Change*



A paper to prompt discussion for the future of Australia's tax system

The completion of the *Case for Change* report is a major milestone in our work towards a fairer, simpler and more efficient tax system. We warmly thank all the contributors, supporters, volunteers and members who leant their time, dedication and expertise to making it possible.

Read the Case for Change

info.taxinstitute.com.au/case-for-change

0124TPA_06/21

A Matter of Trusts

by Lucy Liang, Sladen Legal

CGT liability of foreign beneficiaries

Greensill **confirms foreign beneficiaries of a resident discretionary trust are taxable on gains made on non-taxable Australian property. Was the outcome an unintended consequence of the 2011 changes?**

For many years, the ATO position has been that s 855-10 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) does not disregard a capital gain distributed to a foreign beneficiary of an Australian discretionary trust.[1] More recently, the ATO expressed this position in TD 2019/D6.

In summary, the ATO view is that a foreign beneficiary presently or specifically entitled to a capital gain made by an Australian discretionary trust on an asset that is non-taxable Australian property is assessable on the capital gain even though that would not occur if the foreign person made the gain directly, or through a fixed trust, rather than through a discretionary trust.

The recent Full Federal Court decision in *Peter Greensill Family Co Pty Ltd (trustee) v FCT*[2] (*Greensill*) confirmed the ATO position.

In *Greensill,* Peter Greensill Family Co Pty Ltd, the trustee of the Australian discretionary trust (trust), made capital gains in the income years ended 30 June 2015, 2016 and 2017 on the sale of shares which were not "taxable Australian property". In each income year, the trust distributed capital gains to Mr Greensill, a foreign resident beneficiary of the trust.[3] In each case, the ATO assessed the trustee of the trust under s 98 of the *Income Tax Assessment Act 1936* (Cth) (ITAA36) on the basis that s 855-10 did not apply to disregard the capital gain.

The applicant's position was, in summary, that the capital gains distributed to Mr Greensill were capital gains "from a CGT event" that he could disregard by operation of s 855-10. Section 855-10 provides that a person can disregard a capital gain (or capital loss) from a CGT event if:

- the person is a foreign resident or a foreign trust for CGT purposes just before the CGT event happens; and
- the CGT event happens in relation to an asset that is not taxable Australian property.

At first instance,[4] Thawley J in *Greensill* carefully considered the application of:

- Div 6 ITAA36 which deals with the collection of tax owed by foreign residents from resident trustees;
- Div 6E ITAA36 which removes capital gains from the net income of the trust;
- Subdiv 115-C ITAA97 which deals with capital gains made by trustees; and
- Div 855 ITAA97 which exempts foreign residents from CGT unless the CGT event is happening to taxable Australian property.

His Honour agreed with the Commissioner and ruled that s 855-10 had no application to the present case:[5]

> "… s 855-10(1) indicates that the capital gain to be disregarded is that which is made by an entity immediately as a consequence of the happening of a CGT event; a capital gain which is attributed to a beneficiary, because of a CGT event happening to a CGT asset owned by a trust, was not intended to fall within the phrase 'a capital gain … from a CGT event'. The capital gain deemed to have been made by a beneficiary under s 115-215 of the ITAA 1997 is not a 'capital gain … from a CGT event' within s 855-10(1)."

Section 855-10 would have applied if Mr Greensill, rather than the trust, had owned and disposed of the shares. Similarly, if the trust had been a fixed trust, s 855-40 ITAA97 should have disregarded the capital gain.

The wording of s 855-40 is different to that in s 855-10. A capital gain disregarded under s 855-10 must be "from a CGT event". Section 855-40 applies to a capital gain that "you make in respect of your interest in a fixed trust" where, among other matters, the gain "is attributable to a CGT event happening to a CGT asset of a trust". While the decision of the court in *Greensill* was not about s 855-40, the difference in wording was significant to the outcome.

In *N & M Martin Holdings Pty Ltd v FCT*[6] *(Martin)*, Steward J considered similar factual circumstances to *Greensill*. Steward J followed Thawley J in *Greensill* and, while finding the taxpayer's arguments "rational and thoughtful", found for the Commissioner, saying:[7]

> "*Peter Greensill* is … a very well-reasoned judgment that traverses all of the relevant statutory and extrinsic materials that bear upon the correct construction of s. 855-10. It reaches a logical conclusion after detailed analysis of the language of that provision, statutory context, and legislative history … [I]t is the subject of an appeal to the Full Court … In such circumstances, as a matter of precedent, comity and good sense, in my view I should follow it as a trial judge."

The taxpayers in *Greensill* and *Martin* appealed to the Full Federal Court and that court handed down its unanimous judgment on 10 June 2021 denying the appeals and finding for the ATO.

As at first instance, the key question was whether the capital gain distributed to the foreign beneficiaries was "from a CGT event" for the purposes of s 855-10. The trusts made a capital gain from a CGT event, but was the capital gain distributed to the beneficiaries "from a CGT event" after the application of the rules in Subdiv 115-C to the capital gain?

The Full Federal Court agreed with Thawley and Steward JJ that s 855-10 does not have operation in the context of Subdiv 115-C and held that:[8]

> "… Thawley and Steward JJ were correct to hold that s 855-10(1) has no application to the facts of either case. The provision did not apply to the trustees of the respective trusts because both trusts are resident trusts. Likewise, the provision did not apply to the foreign beneficiaries to disregard any capital gain in the calculation of the amount under s 115-215(3) treated as the beneficiary's capital gain for the purposes of the application of div 102 to the beneficiary, because 'the amount mentioned in s 115-225 in relation to the beneficiary' for the purposes of s 115-215(3) and s 115-220 is not a 'capital gain … from a CGT event' within the meaning of s 855-10. We would therefore dismiss both appeals with costs."

From a policy perspective, some tax commentators say that a foreign resident should not be liable to Australian CGT if the asset is a non-taxable Australian property and s 855-10 does not achieve that intended policy outcome when an Australian discretionary trust is between the foreign resident and asset. But is that the policy?

The 2006 explanatory memorandum[9] that introduced Div 855 states that the purpose of the CGT and foreign residents measure in Div 855 is to further enhance Australia's status as an attractive place for business and investment. The 2006 explanatory memorandum did not discuss foreign residents investing through Australian discretionary trusts.

Is making Australia a better place for foreign residents to invest limited to direct foreign investment, investment through a foreign trust, and investment through an Australian fixed trust? It is unclear whether the government intended to include foreign investment through Australian discretionary trusts.

Thawley J in *Greensill* also questioned the policy objective asserted by the taxpayer:[10]

> "The policy objective asserted by the applicant [that s 855-10 should disregard the gain] is not to be found in the legislative history identified above and nor is it supported by the terms of former s 160L of the ITAA 1936 or the capital gains tax regime when it was introduced."

Further commentary is that s 855-10 not applying in these circumstances is an "unintended consequence" of the changes in 2011 to facilitate the streaming of capital gains following the High Court's decision in *FCT v Bamford*.[11] The second reading speech that accompanied the 2011 changes states that "[t]he government is aware that due to the short timeframe involved in developing these amendments, there may be scope for unintended consequences".[12]

Was the outcome in *Greensill* an unintended consequence of the 2011 changes?

Maybe, or maybe not.

Prior to the 2011 legislative changes, the Commissioner had expressed similar views in ATO ID 2007/60 to those in TD 2019/D6 that s 855-10 does not disregard a capital gain by a foreign beneficiary of an Australian discretionary trust.

In addition, the Full Federal Court decision in *Greensill* confirms that, when interpreting statutes, the words of the legislation text override policy. The Full Federal Court stated that, if courts construe legislation from an assumption about the "desired or desirable reach of the provisions", they risk taking over the policy-making power that belongs to the legislature.[13]

The taxpayer in *Greensill* has applied for special leave to the High Court. Steward J in *Martin* acknowledged that the applicant's submissions have much to commend them and might be favoured by an appellate court. However, the Full Federal Court, as an appellate court, dismissed the taxpayer's appeal. With Steward J now sitting on the High Court, it would be interesting to hear the High Court's views on this matter — either during the special leave application or the substantive hearing if special leave is granted.

In the meantime, while some people may disagree with the ATO interpretation of s 855-10 in TD 2019/D6, that interpretation is now supported by judicial authority. Foreign residents may need to review how they continue to hold Australian assets.

Lucy Liang
Lawyer
Sladen Legal

References

1 See ATO ID 2007/60, and Australian Taxation Office, "Capital gains and non-resident trust beneficiaries", discussion paper, 22 December 2016.

2 [2021] FCAFC 99.

3 In a taxation context, "foreign resident" and "non-resident" are interchangeable.

4 *Peter Greensill Family Co Pty Ltd (trustee) v FCT* [2020] FCA 559.

5 [2020] FCA 559 at [60].

6 [2020] FCA 1186.

7 [2020] FCA 1186 at [79].

8 [2021] FCAFC 99 at [78].

9 Explanatory memorandum to the Tax Laws Amendment (2006 Measures No.4) Bill 2006.

10 *Peter Greensill Family Co Pty Ltd (trustee) v FCT* [2020] FCA 559 at [70].

11 [2010] HCA 10.

12 Explanatory memorandum to the Tax Laws Amendment (2011 Measures No.5) Bill 2011.

13 *Peter Greensill Family Co Pty Ltd (trustee) v FCT* [2021] FCAFC 99 at [70].

Superannuation

by Daniel Butler, CTA, DBA Lawyers

SMSF deeds: how does your supplier rate?

While the provision of documents from non-qualified suppliers may appear to be a simple and low-cost approach, there are numerous risks involved for advisers and end-users.

Introduction

Most SMSF deeds are now probably supplied via non-qualified suppliers, with minimal lawyer input (eg the deed template may have had some input by a lawyer). This is despite the fact that only lawyers are legally qualified and authorised to prepare SMSF deeds.

This article explains the key risks and differences that should be considered by an adviser when obtaining an SMSF deed directly from a law firm compared to a non-qualified supplier.

Non-qualified suppliers

Over the past 10 years, there has been an increasing transition towards documents being prepared via automated technology platforms, largely aimed at minimising cost and human input (especially adviser and lawyer input). Perhaps the biggest change in the supply chain in the past five years has been the ability for advisers, such as accountants and financial planners, to obtain the use of SMSF and related legal documents so that the adviser can prepare documents from the supplier's platform. Typically, the adviser pays a licence fee that permits them to prepare a certain number of documents over a specified period (as compared to, for example, paying a law firm to prepare an SMSF deed for a particular client).

Typically, non-qualified suppliers do not have any significant technical or legal expertise in respect of drafting legal documents such as SMSF deeds and related legal documents. Some of the documents that they supply may have at one stage in the past been reviewed by a lawyer. As superannuation and tax laws are constantly changing, SMSF deeds should be reviewed on at least an annual basis and revised as needed, preferably by lawyers who are SMSF experts.

What does lawyer sign-off involve?

Many non-qualified suppliers claim that their documents are signed-off by a lawyer.

While a reference to "lawyer sign-off" does not have a fixed or "normative" meaning, it conjures up the impression to many that the document has been prepared and reviewed by a lawyer who has approved that document. Thus, care is required when dealing with claims that documents have been signed-off by a lawyer.

The position is likely to be clearer where the SMSF deed is supplied directly from a law firm (and not from an entity that is associated or linked to that law firm). For example, at DBA Lawyers, a lawyer reviews the instructions for each SMSF order and then drafts documents that are appropriate to those instructions (based on an SMSF deed and related legal documents that have been prepared by our lawyers, including the covering letter, completion checklist, trustee resolutions, product disclosure statements, SMSF memos, and related documents).

Unpacking some of the claims on what "lawyer sign-off" covers, you might seek to drill down on:

- whether any of the documents were ever prepared or reviewed by a lawyer and, if so, by whom and when, and whether that person had any relevant SMSF or related expertise; and
- in the event that the original precedents, such as the SMSF deed and related documents, were prepared by a law firm, it would be misleading to claim that completed documents, prepared from those precedents to satisfy specific client orders where the adviser inputs relevant details and chooses the various options for each client, have been signed-off by a lawyer.

Some document supply systems produce documents almost immediately after the data has been entered into the supplier's platform. Naturally, if documents are produced immediately, that is a likely indicator that there is no review taking place.

What happens when something does go wrong?

One simple example of where an SMSF deed may not be valid is where it is not varied in accordance with the variation power in the prior deed. Our experience has shown over many years that many documents from non-qualified suppliers do not stand up to legal scrutiny and may be challenged on various grounds, thus leaving clients "skating on thin ice" when it comes to relying on, for example, a binding death benefit nomination (BDBN) where the SMSF deed has not been varied in accordance with the prior documentation trail. For instance, if each relevant person/entity that must consent to the variation is not made a party to that deed, the deed may be at risk of being challenged. We often find shortcomings in prior variations, missing documents etc.

As discussed below, there is unlikely to be professional indemnity insurance available to an adviser who prepares an invalid deed, as a non-qualified person is not legally authorised to prepare a legal document for a client for a fee.

A client who is supplied a faulty SMSF deed could claim against their adviser. The adviser, in turn, may seek to claim against their supplier. Their supplier may, in turn, seek to claim against the person who prepared the faulty document or system (which may be a law firm that has licensed the document to the supplier). However, where does the negligence or mistake lie, and what are the terms and conditions of the supplier's platform? Most suppliers disclaim liability to the maximum extent possible at law.

Most professional indemnity insurance for advisers (other than lawyers) excludes cover for services that a lawyer must perform. Advisers and end-users should therefore not assume that professional indemnity insurance is available. Further, some non-qualified suppliers may have no insurance cover at all.

Non-qualified suppliers may appear cheaper, but are they?

A recent check on the terms and conditions of use (or disclaimers) issued by a number of non-qualified suppliers revealed that they claim to provide information only and not advice, seek to expressly exclude the fact that they provide legal advice or documents, and recommend that legal sign-off be obtained from a qualified lawyer that the user engages before any document supplied is executed.

These claims are interesting as many non-qualified suppliers provide documents for a fee, disclaim liability and request the user to accept to obtain their own legal advice. Thus, these suppliers are, in essence, merely offering document templates or information but not a legal service and not a document signed off by a lawyer. One wonders whether advisers who use these suppliers are aware of what service they are procuring or have reviewed the detailed terms and conditions, as there appears to be no significant advantage if an adviser then has to seek separate legal advice.

Despite the above issues, many users are typically driven by low costs and not quality or value. Indeed, as the saying goes, "self-interest" generally wins out, especially if an adviser can increase their profit and charge their client a higher price. As noted below, there are significant penalties that can be imposed on non-qualified persons undertaking legal work.

An SMSF deed supplied from a law firm may therefore represent better value, in view of the fact that the deed is drafted and signed-off by a lawyer and is backed by professional indemnity insurance (which is compulsory for lawyers to have). This is one key factor that points towards obtaining legal documents from a law firm.

Broadly, this leads to the analogy that the supply of SMSF deeds is, in certain respects, like comparing someone getting their tooth fixed by a backyard mechanic. While not many people would ever consider getting their teeth worked on by a backyard mechanic, they are likely to be cheaper in extracting a tooth with a pair of plyers than a dentist.

Does updating an SMSF deed constitute legal work?

Most would agree that a BDBN is a simple and straightforward document. However, the *Superannuation Industry (Supervision) Act 1993* (Cth) (SISA93) and the *Superannuation Industry (Supervision) Regulations 1994* (Cth) (SISR94) that introduced express legislative BDBN provisions from 1 July 1999 have now been in practice and tested via numerous court decisions for over 22 years. The recent Supreme Court of Western Australia appeal decision in *Hill v Zuda Pty Ltd*[1] broadly confirmed that the SISA93/SISR94 BDBN provisions do not apply to SMSFs, and therefore a BDBN for a member of an SMSF can be drafted to be non-lapsing and that this is the position in all Australian jurisdictions.

Indeed, we are concerned with the complexity of an increasing number SMSF deeds that offer all sorts of complicated and novel approaches to estate and succession planning, and indeed that they remain largely untested as a matter of case law.

Where an adviser uses a non-qualified supplier, enters client data into the supplier's website, and then produces the necessary documents (deeds, resolutions etc), the adviser generally has to make numerous decisions regarding how to comply with, for example, the variation clause, what parties need to be bound by the deed and, invariably these days, a range of other options that they may be faced with, including:

- Is a BDBN or non-binding nomination required?
- Is an SMSF will, death benefit rule or some other novel document relevant for the client?
- Does the SMSF deed update preserve any reversionary pension directions, BDBNs, SMSF wills, death benefit rules or some other strategy?

In short, an adviser who prepares an SMSF deed update is likely to be undertaking legal work. If the document supplier purports to have any legal sign-off, at best that would typically only relate to the original or master precedent (before any changes by the particular adviser are made); the supplier is not involved in any of the decisions to ensure that the deed update is valid and legally effective. (Note the difference between this example and where an adviser merely *places an order* online with a supplier who then produces the documents using their own staff and resources. This reduces the adviser's risks as the adviser does not directly undertake legal work in respect of the documents supplied. Where an adviser places the instructions with a law firm which produces the document, the adviser's risks are minimised.)

While non-qualified suppliers may initially appear attractive, care must be taken as such services carry a number of significant risks. Advisers who are not legally qualified are therefore taking risks. Such advisers could also be placing their clients at risk and in breach of the law.

What constitutes legal work?

A person can only undertake legal work for reward if they are an Australian legal practitioner. The penalties for breach of this prohibition are substantial. While there are similarities, the legislation regulating legal work differs from one jurisdiction to the next. We examine several provisions from the Victorian legislation which has been adopted in the New South Wales equivalent (uniform) legislation. Extracts from Pt 2.1, Ch 2 of

Sch 1 to the *Legal Profession Uniform Law Application Act 2014* (Vic) follow:

"**9 Objectives**

The objectives of this Part are —

(a) to ensure, in the interests of the administration of justice, that legal work is carried out only by those who are properly qualified to do so; and

(b) to protect clients of law practices by ensuring that persons carrying out legal work are entitled to do so.

10 Prohibition on engaging in legal practice by unqualified entities

(1) An entity must not engage in legal practice in this jurisdiction [Vic], unless it is a qualified entity.

Penalty: 250 penalty units or imprisonment for 2 years, or both.

(2) An entity is not entitled to recover any amount, and must repay any amount received, in respect of anything the entity did in contravention of subsection (1). Any amount so received may be recovered as a debt by the person who paid it …"

The two offences above carry a maximum $45,435 penalty (250 × $181.74), as one penalty unit under the *Monetary Units Act 2004* (Vic) is $181.74 for FY2021-22. Also, a non-qualified entity or person engaging in legal practice could serve up to two years' imprisonment.

Legal work includes the preparation of a document which affects legal rights and that is tailored to the particular needs of another person. The preparation of an SMSF deed update (as outlined above) would satisfy this definition. An SMSF deed update imposes duties on the trustees, and regulates the rights of members and possibly other parties. Furthermore, the deed defines the relationship between the trustees and members, and therefore affects their legal rights. Under many web portals, the entity or person preparing the SMSF documents is the adviser who enters the data and makes the legal decisions as to which parties need to be added etc. The preparation and tailoring of an SMSF deed for a particular SMSF is substantially different to the insertion of the names of the parties in a standard legal form.

The case of *Legal Practice Board v Computer Accounting and Tax Pty Ltd*[2] involved an accountant who inserted the names of the trustees of the fund and some other basic details in the SMSF deed to establish a new fund. It was not a defence that the pro forma deed had itself been drafted by a lawyer, as the adviser's insertion of the parties and other details in broad terms constituted legal work.

Adviser limits under rules of relevant professional bodies

The various professional bodies in Australia have attempted to address the issue of members engaging in legal services, and the associated consequences. Their responses have been as follows:

Accountants who are members of the two major Australian accounting bodies (ie Chartered Accountants Australia and New Zealand, and CPA Australia) are prohibited from preparing legal documents under *CR 3 – Public Practice Regulations*, which states:

"**3.11 Preparation of Legal Documents**

Members must not carry out work which is required by law to be performed by legal practitioners.

Commentary

Legislation in various jurisdictions prohibits unqualified persons from preparing legal documents and Members should ensure that they do not contravene these laws. If in doubt, refer the client to their solicitor or, if appropriate, obtain the client's approval to instruct a solicitor."

The Accounting Professional & Ethical Standards Board APES 110 *Code of Ethics for Professional Accountants (including Independence Standards)* also requires accountants (including chartered accountants and CPA accountants) to act professionally and with integrity.

A member of the Financial Planning Association commits an offence if the member "is found guilty of any breach of the law punishable by imprisonment of more than six months".

From 1 January 2020, compliance with the *Financial Planners and Advisers Code of Ethics 2019* (the Code), currently administered by the Financial Adviser Standards and Ethics Authority, became mandatory for relevant advisers who provide advice to retail clients in relation to relevant financial products. Advisers who are covered by the Code are precluded from the following (among other things):

"**Standard 1:**

You must act in accordance with all applicable laws, including this Code, and not try to avoid or circumvent their intent.

Intent

The intent of Standard 1 is to require advisers to not only comply with the letter of the law in meeting their legal obligations (including the Code of Ethics), but also to comply with the intent of those laws and not seek to avoid or circumvent them. This is a minimum ethical obligation."

Members of other professional bodies should carefully inspect and abide by their rules of conduct. There are sound reasons why these professional bodies seek to limit the services that their members undertake.

Should advisers have the documents they choose to supply checked by a lawyer?

An adviser's choice of document supplier is an implicit recommendation that the document they supply to a client is fit and legally sound for its intended purpose. Thus, advisers who do not obtain their legal documents from a lawyer, and instead choose a non-qualified supplier, are at risk of being sued and of contravening the various rules prohibiting non-qualified persons from undertaking legal work for a fee.

In negligence actions against advisers, the adviser will be measured against the service that a competent and qualified lawyer would provide. It is therefore recommended that an adviser obtain appropriate legal input to the decision of which legal documents they should obtain if they do not deal directly with a law firm. This is also recommended in the disclaimers by numerous non-qualified suppliers.

Conclusion

While the provision of documents from non-qualified suppliers may initially appear to be a simple, low cost and

straightforward approach, there are numerous risks involved. This could expose advisers and end-users to risks that may have long-lasting consequences.

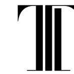
Non-qualified suppliers should be required to disclose these risks to users (typically, advisers and SMSF trustees/directors). This disclosure would assist users in making an informed decision on the advantages and disadvantages of obtaining a document from a lawyer or non-qualified supplier.

Daniel Butler, CTA
Director
DBA Lawyers

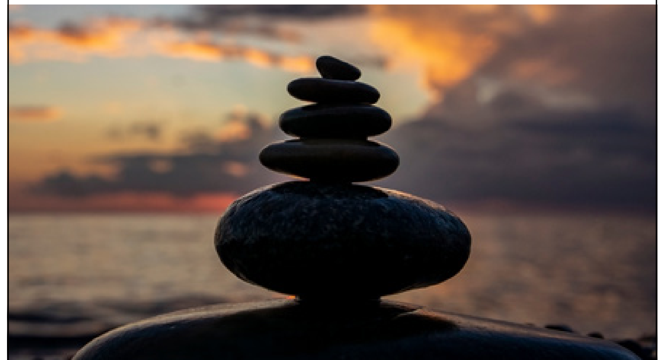
References

1 [2021] WASCA 59.

2 [2007] WASC 184.



THE TAX INSTITUTE



2021 Trust Intensive Series

Program highlights include:

- An outstanding lineup of speakers specialising in trusts
- Topical and pertinent discussion on the effective use of trusts
- Excellent online networking opportunities

Early bird prices close on 13 August

8–15 September 2021
Online
8 CPD hours

Register now
taxinstitute.com.au/trust

0781NAT_07/21

Alternative Assets Insights

by Matthew Sealey, FTI, and
Si Wei Jiang, PwC

NSW property tax reforms update

The NSW Government has announced proposed reforms to allow property buyers to choose between paying stamp duty and land tax or paying an annual property tax.

In brief

As one of the oldest property taxes, stamp duty is ripe for reform. While some of the economic downsides that are associated with stamp duty are shared with other transaction taxes, in the case of stamp duty, these effects are exaggerated because of the rate at which it is applied and the way it is administered.

In late 2020, as part of its 2020-21 Budget, the NSW Government announced proposed reforms to the state's tax system to allow property buyers to choose between paying stamp duty and land tax when purchasing a property or opting to pay an annual property tax instead.

This article provides an update on the current state of the reform process.

Overview

By way of summary, the proposed property tax will have the following features:

- the replacement of stamp duty and land tax with an annual property tax levied on the unimproved land value (ULV) of individual properties, ie vacant land (as opposed to stamp duty which is imposed on the higher measure of improved or unencumbered market value of the land including improvements on the land, eg buildings);
- an opt-in approach whereby a purchaser could elect for the property tax to apply to a property at the time of purchase. However, the election for the property tax to apply to a property is permanent and cannot be reversed by a subsequent purchaser;
- the application of different rates for different types of owners, eg higher rates for commercial land, lower rates for residential investment properties, and even lower rates for owner-occupied residential properties;
- initial price thresholds on opting in to mitigate the fiscal impact but which would still allow over 80% of residential properties to be eligible to opt in from day one once the reforms are implemented;
- protections for tenants against rent increases due to the property tax and a hardship scheme for taxpayers; and
- no effect on properties if they are not bought or sold.

Timeline

The timeline of the development of the reforms to date is as follows:

- 17 November 2020: proposal for root and branch tax reform announced as part of the 2020-21 NSW Budget and the start of the public consultation period;
- 15 March 2021: the public consultation period ended;
- 31 May 2021: the NSW Productivity Commissioner released the *Productivity Commission white paper 2021: Rebooting the economy*, which recommended working closely with the Commonwealth Government to ensure that federal financial arrangements encourage the states and territories to undertake reform (eg by adjusting the carve-up of GST revenue) prior to any roll-out of the reforms;
- 11 June 2021: the government released a progress paper[1] which reiterated that one of the key aims of the reforms is to increase rates of home ownership and provided various updates; and
- 30 July 2021: the deadline to provide comments on the progress paper.

No further official update has been provided on the likely timing of the reforms since the issue of the progress paper.

The progress paper

What follows is a discussion of some of the key aspects of the progress paper, as this is the latest word on the reforms.

Proposed new rates

The progress paper sets out the following rates to be imposed on ULV:[2]

- 0.3% for owner-occupied residential property and farmland;
- 1.1% for investment residential property (up from 1% as initially proposed);
- 2.6% for commercial property; and
- a new 0.3% surcharge on aggregate land holdings with an ULV of over $1.5m (excluding principal place of residence and farmland).

Home ownership and the property tax rate structure

The progress paper reiterates that increasing the rate of home ownership is one of the key aims of the proposed reforms, especially at a time of rapid home price growth, noting that home ownership in NSW has declined from around 70% in the 1990s to around 64% today.[3] Other stated aims of the reforms include increasing the rate of first home ownership, enabling households to become more mobile, and stimulating economic recovery.[4]

The progress paper outlines that the rate structure is intended to reflect the amount of stamp duty and land tax currently being collected on each property class and, following consultation, the above updated rate structure is

now under consideration. It is designed to double down on increasing home ownership by:

- slightly lowering the annual fixed fee for owner-occupied residential property, and slightly raising the ad valorem rate for residential investment properties; and
- introducing a property tax surcharge on large landholdings, which will balance investor tax rates in favour of smaller investors and against larger ones to reflect the greater benefit that the latter receive from opting out of land tax.[5]

It should be noted that an application of differential rates will inevitably give rise to disputes about the classification of property because of the material consequences of that classification. The materiality of the rate differentials can make or break an investment decision and therefore the borderline between the different categories of property is likely to become contested. Accordingly, it will be important that careful consideration is given to the legislative definitions for each of these categories, as well as to what practical guidance is provided to taxpayers to assist them in correctly categorising their properties. Another consideration will be how the new regime should track changes in land use over time, particularly when the usage moves the land from a lower rate category (say, residential) to a higher rate category (say, commercial).

Despite broad community support for policies that increase home ownership, the progress paper notes that there were mixed views regarding how the property tax could actually impact the ongoing affordability of property in NSW.[6] Some respondents to the initial proposal suggested that removing stamp duty would actually cause upward pressure on prices due to an increase in spending power.[7] The government's assertion, to the contrary, is that the increase in transaction volumes and housing supply arising from tax reform will result in long-run downward pressure on prices and rents.[8] In line with this, the government is somewhat boldly projecting a reduction in home prices of between 3% and 4% arising from the reforms,[9] albeit with no time frame specified.

Keeping the property tax affordable over time

Submissions to the government during the consultation period noted that the annual nature of the property tax would create uncertainty over future rate rises or increases in land values which could result in large variations in the tax to be paid each year.[10]

Although the annual tax payments will need to increase over time to allow revenue collections to reflect economic and income growth, the progress paper outlines that the government is considering effective indexation of the tax rates in line with gross state product (GSP).[11] This is really to allay fears of a tax grab by future governments. The system would be similar to the NSW "cap" on council rates by which council rates are adjusted to ensure that total payments do not grow too rapidly. The indexation system would keep the average property tax payment in line with average incomes through the measure of GSP per capita, instead of fluctuating with the more volatile measure of average ULVs, which would hopefully act as an effective "cap" on the growth of property tax rates.

The progress paper also states that legislative protections would be put in place to restrain future governments from changing the rates or the indexation methodology.[12]

Unimproved land value

The property tax will be levied on the ULV of individual properties, ie vacant land (as opposed to stamp duty which is imposed on the higher measure of improved or unencumbered market value of the land including improvements on the land, eg buildings).

The progress paper notes that economists and industry participants in the property market were typically very supportive of the proposal, as ULV is an established concept, for example, in the calculation of land tax and council rates.[13] However, consultation also revealed that others desired greater clarity regarding what ULV is and how it is calculated.[14] Still others expressed a view that the use of ULV could see a shift towards apartment development as apartment owners would be likely to pay less property tax than house owners of equal market value due to the lower amount of land required for each apartment.[15]

Despite such criticism, the government has seemingly doubled down on the use of ULV. A key reason asserted for this is that levying the property on market values would result in a tax on capital improvements, thus providing a disincentive for homeowners to invest in their property.[16]

Choice and the opt-in system

A key aspect of the proposed reforms is the opt-in model. What this means in practice is that, should the proposals be enacted, each purchaser will be able to elect at the time of purchase whether or not they wish to apply the new property tax or remain subject to the existing stamp duty and land tax system. However, the election into the property tax system is permanent for the nominated property and cannot be reversed by a subsequent purchaser. This principle of choice is a novel element of the reforms and, as far as the authors are aware, it is the first time that elective tax reform has been suggested in Australia.

The progress paper states that there was overall support given for providing choice, but the decision of whether to opt in would depend on personal or commercial circumstances, the nature of the property, the availability of exemptions, and the amount of time that an individual expects to hold the property.[17] The feedback was that, in particular, commercial and primary production landowners felt there were circumstances where they would be better off paying stamp duty and land tax under the existing system.[18] This in fact accords with the authors' early discussions with the commercial property sector.

Making a choice is unlikely to be straightforward for many taxpayers as it involves taking into account various uncertainties, such as the potential for ULVs to fluctuate and the impact on future sales of opting in. As such, it is certainly possible that a significant proportion of medium to long-term holders may choose to play it safe and not opt in.

Finally, with the luxury of choice comes the complications of a long transition period. This will be very gradual tax reform indeed, and the progress paper states that it is expected to take about 20 years for the property tax to cover only half of

all residential properties.[19] In practical terms, this means that NSW will be living with a complicated dual track system for property tax for decades to come.

Exemptions

Concerns were raised during the consultation process about how existing stamp duty and land tax exemptions would carry over into the property tax regime. The government has indicated in the progress paper that:

- taxpayers (eg charities) which are currently exempt from stamp duty at the time of purchase and land tax while they are the owner of the land would be exempt from the property tax;
- taxpayers (eg someone who inherits property through a will) who are exempt from stamp duty at the time of purchase but not exempt from land tax while they are the owner of the land would not be exempt from the property tax; and
- taxpayers (eg aged care providers and retirement village operators) who are not exempt from stamp duty at the time of purchase but are exempt from land tax while they are the owner of the land would be entitled to a concessional rate of property tax.[20]

Foreign investors

The progress paper provides no comfort for foreign investors. It states that there will be no change to existing stamp duty and land tax surcharges for foreign purchasers and that they will apply in addition to the property tax.[21] However, while foreign purchasers will not be eligible to opt into the property tax regime on any purchase (to ensure maximum choice for Australian buyers), they will be able to purchase properties which are already in the property tax net.[22]

Build-to-rent

The progress paper states that the treatment of build-to-rent properties will be the same as other types of property, ie developers would be eligible to choose to opt into the property tax regime and, once the development is complete, the fixed charge would be applied to each dwelling.[23]

Developers

According to the progress paper, developers would have the choice of opting into the property tax regime.[24] If they do opt in, the commercial rate of property tax will apply during the development period, and the residential rate will become available when the property is complete and capable of being used as a dwelling.[25] Any subdivision of a development site which is subject to property tax will result in each new property created as a result of the subdivision also being subject to property tax.[26]

Mixed-use properties

Special rules would apply for mixed-use properties whereby the property tax would be apportioned using the apportionment factor recorded by the Valuer-General, eg an apartment above a shop which is on a single title.[27]

Tenant protections

The progress paper asserts that the property tax reforms are not expected to affect rents in the short term but would exert downward pressure on rents by increasing supply.[28] Furthermore, residential landlords will be legally liable for paying the property tax under s 40 of the *Residential Tenancies Act 2010* (NSW).

For commercial tenants, where existing leases permit pass-through of landlords' land tax outgoings, the property tax legislation would allow pass-through of property tax up to the amount of land tax otherwise payable had a new landlord not opted into the property tax regime.[29] However, this will be able to be altered by written agreement.

Hardship

The progress paper states that legislation will provide protection such that no one will be required to sell their home or small business premises due to hardship in meeting their property tax payments.[30] At the Chief Commissioner's discretion, deferral of 100% of property tax payments for natural persons, small businesses and primary producers may be available until a property is sold if they are not able to meet reasonable expenses for food, shelter, clothing, medical treatment, or other essential expenses.[31] Any deferred property tax would accrue a "modest rate of interest" and be payable out of the sale proceeds of the property up to a maximum of 75% of its market value the next time that it is sold.[32]

Fiscal impacts

In terms of fiscal impacts, the progress paper asserts that the reforms, if implemented, would in fact inject $11b into the economy over the first four years.[33]

The progress paper also emphasises that the property tax is not a tax grab as it will cost the government large amounts of revenue for about 20 years before enough properties are subject to the property tax regime and the annual revenue stream from property tax replaces the forgone stamp duty and land tax.[34] The initial price threshold will strike a balance between maximising properties that will be eligible to opt in, while preserving stamp duty on the most valuable properties.[35] However, the authors note that the practical risk associated with the use of price thresholds is that it may exacerbate the potential differential pricing between properties that are subject to the current regime and those that are irrevocably subject to the property tax regime. This could create distortions in the property market in that parties may intentionally transact below a threshold if they wish for the property to be eligible to opt into the property tax regime, thus potentially creating a transaction "void" just over the threshold and excess "bunching" of transactions in the price distribution just below the threshold.

Retrospectivity

The progress paper states that it is intended that people who purchase between the date of the announcement of the property tax reforms proceeding and the commencement of the legislation would be eligible to opt into the property tax regime.[36] Any such announcement would clarify the date of commencement and eligibility criteria.[37] However, purchasers in this category will need to pay the stamp duty up front (ie within the usual three-month lodgment and payment periods) and seek a refund later if they opt in within six months of the commencement of the property tax regime.[38]

Other issues

An unresolved question which has not been addressed by the progress paper is how the acquisition of indirect interests in land (ie under the "landholder duty" rules) will be taxed under the new model. For instance, if a property is subject to the annual property tax, will it be the case that landholder duty will not apply in relation to that property on dealings in the landowner (or deemed landowner) entity? Further, if the one landholder holds a mix of property that has been opted in and property that remains outside the regime, will landholder duty only apply in relation to the property that has not been opted in?

Conclusion

The progress paper fleshes out a number of the points of detail surrounding this significant proposal for fundamental tax reform in NSW. There are many facets to the reforms, and it will be important that the views of stakeholders in the community and in business are properly considered so as to give the reforms the best chance of success if and when they are ultimately enacted.

Matthew Sealey, FTI
Partner
PwC

Si Wei Jiang
Senior Manager
PwC

References

1 NSW Government, *NSW property tax proposal*, progress paper for June 2021. Available at https://www.nsw.gov.au/sites/default/files/2021-06/property-tax-progress-paper-june-2021.pdf.
2 Progress paper, p 25.
3 Progress paper, p 9.
4 Progress paper, pp 9-11.
5 Progress paper, pp 24-25.
6 Progress paper, p 22.
7 Progress paper, p 22.
8 Progress paper, p 25.
9 Progress paper, p 25.
10 Progress paper, pp 26-28.
11 Progress paper, p 29.
12 Progress paper, pp 28-29.
13 Progress paper, p 30.
14 Progress paper, pp 30-32.
15 Progress paper, p 31.
16 Progress paper, p 34.
17 Progress paper, p 35.
18 Progress paper, p 35.
19 Progress paper, p 37.
20 Progress paper, p 38-29.
21 Progress paper, p 41.
22 Progress paper, p 41.
23 Progress paper, p 42.
24 Progress paper, pp 43-44.
25 Progress paper, p 44.
26 Progress paper, p 44.
27 Progress paper, p 45.
28 Progress paper, p 25.
29 Progress paper, p 48.
30 Progress paper, p 49.
31 Progress paper, p 51.
32 Progress paper, p 51.
33 Progress paper, p 11.
34 Progress paper, p 28.
35 Progress paper, p 53.
36 Progress paper, p 55.
37 Progress paper, p 55.
38 Progress paper, p 55.

Video Bundles

300+ videos
12+ bundles
1 CPD hour/video

Find out more
taxinstitute.com.au/COD

0322MEM_07/21

Successful Succession

by Tim Donlan, ATI, Donlan Lawyers,
and Katerina Peiros, ATI, Hartwell Legal

Real and genuine consideration

***Re Owies Family Trust* is new authority on the trustee of a trust exercising real and genuine consideration, and sends loud warnings to trustees and practitioners.**

It will be well understood by many practitioners that the rights of a potential beneficiary of a typical discretionary trust are subject to the terms of the trust deed, are not fixed, and amount only to a right to be considered by the trustee when making distributions of income and capital (*Gartside v Inland Revenue Commissioners*[1]).

In *Gartside*, the court held that beneficiaries of a discretionary trust:

– do not have a proprietary legal or equitable interest in the trust assets and are merely members of a class of potential beneficiaries in relation to the trustee's power of appointment over trust income and capital; and

– do have the right to insist on the proper administration of the trust.

Previous cases relating to the exercise of trustee discretion have confirmed that principle. In the well-known case of *Karger v Paul*,[2] a case involving the exercise of a discretion to appoint income and capital to a potential beneficiary, the Court of Appeal/Supreme Court of Victoria expressed that:

> "It is an established general principle that unless trustees choose to give reasons for the exercise of discretion, their exercise of the discretion cannot be examined or reviewed by a court so long as they act in good faith and without an ulterior purpose …"

and that the trustees "act upon real and genuine consideration".

In *Karger,* the plaintiff, who had a contingent interest in an estate (an estate being a trust), submitted that it was implied that she should have been afforded a fair opportunity of making representations to the trustees "before they exercised their discretion". The court rejected that argument, with McGarvie J stating that:

> "I see no good reason for importing rules of natural justice into the exercise of discretion by the trustees of the will."

In keeping with that principle, and provided a trustee can demonstrate that it has given consideration to a particular beneficiary[3] when exercising discretion as to the making of distributions, its discretion is largely incontestable.

Unless a trustee offers reasons for its decisions to appoint income or capital, leaving itself open to having those decisions challenged, the threshold for a beneficiary to successfully impugn the trustee's discretion is a significant one.

But what is meant by "real and genuine consideration"?

In *Finch v Telstra Super Pty Ltd*,[4] the High Court observed that:

> "There is no doubt that under *Karger v Paul* principles, particularly as they have been applied to superannuation funds, the decision of a trustee may be reviewable for want of 'properly informed consideration' … *If the consideration is not properly informed, it is not genuine.* The duty of trustees properly to inform themselves is more intense in superannuation trusts in the form of the Deed than in trusts of the *Karger v Paul* type … It would be *bizarre if knowingly to exclude relevant information from consideration were not a breach of duty.* And failure to seek relevant information in order to resolve conflicting bodies of material, as here, is also a breach of duty …" (emphasis added)

Then along came further guidance and some hope for disappointed beneficiaries in *Marsella v Wareham*.[5]

In the context of superannuation funds and the conduct of the trustees, the Victorian Supreme Court in *Marsella* considered the exercise of discretion of the trustee of a self-managed superannuation fund regarding payment of a deceased member's death benefits in the context of her estate.

The deceased was the sole member of the fund. She and her daughter were the trustees. The deceased's husband was neither a member nor a trustee of the fund, but he was the sole executor of her estate.

The daughter, as sole surviving trustee, appointed her own husband as a joint trustee of the fund, and together they resolved to distribute all of the death benefits to the daughter. Notably, the deceased's husband had been left without what he considered to be adequate provision in the deceased's will and had commenced a claim for further provision from the estate. The daughter had made her own claim to hold the deceased's home on constructive trust for the deceased's children, including herself. Against the backdrop of such acrimony between the daughter and the deceased's husband (not her own father, this being a second marriage situation), the court ultimately formed the view that the trustees had failed to exercise their discretion with real and genuine consideration of the potential beneficiaries of the deceased's death benefits.

The court commented:[6]

> "The ill-informed arbitrariness with which the first defendant approached her duties also amounts to bad faith. The dismissive tenor of the correspondence from Hill Legal, the willingness to proceed with the appointment and distribution in the context of uncertainties and significant conflict and the lack of specialist advice despite the recommendation of Mr Hayes, all support the conclusions that her conduct was beyond 'mere carelessness' or 'honest blundering'. This conclusion is reached without reference to the lack of evidence deposed by the defendants personally."

Cases addressing whether a trustee had exercised its discretion in good faith and with real and genuine consideration in the context of a discretionary trust had been limited prior to *Re Owies Family Trust*.[7] The Victorian Supreme Court was again required to assess the actions of

the trustee. The case involved a discretionary trust, albeit with more limited potential beneficiaries than a typical family discretionary trust.

The facts broadly were as follows:

Dr John Joachim Owies and Dr Eva Owies were the parents of three children, Paul, Deborah and Michael.

The Owies Family Trust was settled by deed, executed by Eva's sister, Agatha Getzler, as settlor on 30 November 1970.

The trustee of the trust at all times was JJE Nominees Pty Ltd. Paul, Deborah and Michael were the primary beneficiaries of the trust. John and Eva were also general beneficiaries of the trust and at relevant times directors of the company.

The trust held substantial assets comprising real property and listed shares, with an estimated value at trial of around $23m.

Both John and Eva had died before the trial of the proceedings.

There was a level of estrangement between John and Eva with each of Paul and Deborah. There was also an estrangement over many years between Michael with Paul and Deborah. Over the years, the trustee had made no distributions of income to Paul and Deborah, although Deborah did reside in a property owned by the trust, so was not without some form of financial accommodation.

The plaintiffs, Paul and Deborah, brought various claims in the proceedings. The claims included a challenge to the validity of prior deeds of variation to the trust deed which had the effect of changing the identity of the person holding the office of guardian and appointor of the trust. That aspect of the claim is not the focus of this article. The court ultimately found those deeds to invalid.[8]

The plaintiffs also brought claims concerning the distribution of income of the trust between 2010 and 2019.

In those years, substantial distributions were made to John, Eva and Michael, (typically following a standard distribution formula), but no distributions were made to either Paul or Deborah. In the context of the estrangement from Paul and Deborah, that situation is neither unexpected nor uncommon.

Paul and Deborah contended that the trustee had failed to make any resolution distributing the income of the trust for any of the financial years between 2010 and 2017. That aspect of the claim was based on a lack of evidence recording the relevant resolutions, and is a timely reminder for practitioners to carefully attend to the same and ensure that proper resolutions, in accordance with the constitution of a corporate trustee and with the trust deed as amended from time to time, are made and recorded. The plaintiffs argued that, if proper resolutions as to distributions of income had not been made, they would, as primary beneficiaries and takers in default equally with Michael, be entitled to the net income of the trust for each of the relevant years.

Most relevantly for this article, the plaintiffs also argued that any resolutions of the trustee which purported to appoint income for each year between 2010 and 2017 were made in breach of trust as the trustee had failed to give any real and genuine consideration as to whether, in the exercise of its discretion, a distribution should be made to them.

The substance of the arguments advanced by the plaintiffs in that regard were that the trustee had not made any direct inquiries in the relevant years as to their personal and financial circumstances, including their income, health status, financial needs etc. They argued that, had such inquiries been made, it would follow that the trustee acting in good faith would have made distributions in their favour, given their financial positions (particularly when considered in comparison to the other beneficiaries, John, Eva and Michael).

In response, the trustee argued that it had "constructive" knowledge as to each of Paul and Deborah's financial circumstances that was sufficient to sound a real and genuine consideration of them when appointing income in the relevant years.

In the relevant income years the subject of the dispute, both Paul and, to a more substantial extent, Deborah each demonstrated some genuine financial need. Conversely, John, Eva and Michael, to whom income was appointed, did not demonstrate any particular need and each was in strong financial circumstances.

The first principal submission advanced by the trustee in response was that the only examination to be undertaken by the court in relation to the trust is, at most, to consider whether the trustee knew of the identity of the general beneficiaries under the trust.[9] Furthermore, the trustee sought to rely on a provision in the trust deed stating that, subject to any express provision to the contrary, every discretion and power vested in it shall be absolute and uncontrolled.

The court rejected such submission from the trustee.[10]

In its commentary, the court observed that:[11]

> "… because the task of determining whether there was any failure by the trustee to give real and genuine consideration will depend on a consideration of, amongst other things, the information which the trustee had when it resolved to make each of the relevant income distributions, it is necessary to focus on the information which the trustee had at each of these different times."

The other aspect of the challenge brought by Paul and Deborah was whether the trustee should be removed as the trustee of the trust due to its alleged failure to properly execute and administer the trust, and whether Michael should be removed as guardian and appointor of the trust because he was not a fit and proper person to undertake those roles.

The court found that, although knowledge of a particular beneficiary's circumstances can be imputed to a trustee (including a corporate trustee), there was no evidence that the trustee received any information at all about the plaintiffs' circumstances in certain years. That was significant, given that the range of potential beneficiaries of the trust was limited to only five persons.

Moore J said:[12]

> "I … am positively satisfied on all of the evidence that the trustee did not take an informed view of whether or not to exercise its discretion in relation to the making of an income distribution to Deborah or Paul in in 2015 and 2016 (and in 2018 in relation to Deborah)."

However, such finding only applied to certain years, not all of the years claimed by the plaintiffs. As the court had simply found that there was no evidence that the trustee had

received any information about the plaintiffs' circumstances in the 2015 and 2016 financial years (and with respect to the plaintiff Deborah, the 2018 financial year), it was not necessary for the court to then determine whether, as a result of a failure by the trustee to give real and genuine consideration, the result was grotesquely unreasonable.

That then seems to be the threshold test. The court did indicate that, if it were to be called on to determine whether the outcome of the 2018 determinations as to appointment of income were grotesquely unreasonable with respect to Deborah, it would have found that, in the circumstances, it was not, given that she had the use of a property owned by the trust.

The remedy sought by the plaintiffs was the removal of the trustee pursuant to s 41 of the *Trustee Act 1958* (Vic).[13]

The court's discretion to remove a trustee can be exercised where the proper administration of the trust requires it and "a chief consideration is the welfare of the beneficiaries".[14] The discretion to remove a trustee can involve consideration of various factors, including any past breach of trust, the unfitness of the trustee to act in that office, and a failure to act impartially between the beneficiaries.

Ultimately in *Re Owies Family Trust*, the court declined to make any order as to the removal of the trustee. While it did express concerns about the ability of the trustee to act impartially (in view of its findings of a failure to give real and genuine consideration to the distributing income to the plaintiffs in prior years), it noted that, in the subsequent years and at the time of trial, distributions of income and corpus had been made to Deborah. It was also significant that the previous directors of the trustee had both died and that the trustee, under the control of a new directorship, assured the court that it would act impartially in the future.

Conclusion

Although the plaintiffs in *Re Owies Family Trust* succeeded in some of their claims, the remedy sought by them did not follow. The utility of the action may lie in an outcome that ensures that the trustee exercises greater diligence when resolving to make future distributions and when keeping records of its determinations. Perhaps the trustee may look on the plaintiffs more favourably in the future. That is by no means guaranteed.

When performing their duties and exercising discretion, trustees must give real consideration which requires having more than mere knowledge of the identity of potential beneficiaries. When giving real and genuine consideration to the exercise of its discretion, and when acting in good faith in accordance with the purpose for which the discretions were conferred, the trustee must turn its mind to the actual circumstances of potential beneficiaries and compare their needs to other beneficiaries.

Significant consideration was given by the court as to whether the trustee had strictly complied with the requirements of the trust. The court was required to assess whether:

- variations to the trust deed were valid where the variations were not made in strict accordance with the terms of the trust deed;
- a successor appointor and a successor guardian can be appointed by a variation to the schedule to the trust deed;
- the guardian had validly consented to the variations;
- income distribution resolutions had been made in circumstances where older resolutions could not be located;
- a director of the trustee had acted properly and within their delegations when the role of the solicitor became blurred once he became a co-director of the trustee and personal adviser or confidante; and
- decisions of the trustee were properly documented and what evidence was required to show whether real and genuine consideration had been given by the trustee.

It is likely that such disputes could have been avoided with a greater level of trustee diligence.

Perception is important. Trustees who demonstrate a level of hostility to a potential beneficiary will leave themselves more vulnerable to criticism than those who remain impartial and diligent in all respects.

The cases reviewed in this article involve smaller groups of potential beneficiaries. The threshold for a disappointed beneficiary from a wider pool of potential beneficiaries (particularly "general" as opposed to "specified or primary" beneficiaries) would seem higher again.

Tim Donlan, ATI
Principal
Donlan Lawyers

Katerina Peiros, ATI
Incapacity, Wills and Estates Lawyer
Accredited Specialist – Wills & Estates (Vic)
Hartwell Legal

References

1 [1968] AC 553.

2 [1984] VR 161.

3 Whether the consideration needs to be directed to a particular beneficiary or need only extend to a particular class of beneficiaries is an issue that remains to be further clarified.

4 [2010] HCA 36 at [66].

5 *Marsella v Wareham (No. 2)* [2019] VSC 65; and on appeal *Wareham v Marsella* [2020] VSCA 92.

6 *Marsella v Wareham (No. 2)* [2019] VSC 65 at [57] per McMillan J.

7 [2020] VSC 716.

8 Not overly surprising given the nature of the variations sought and the findings of the Western Australian Supreme Court in *Mercanti v Mercanti* [2016] WASCA 206.

9 *Re Owies Family Trust* [2020] VSC 716 at [280].

10 *Re Owies Family Trust* [2020] VSC 716 at [283].

11 *Re Owies Family Trust* [2020] VSC 716 at [313].

12 *Re Owies Family Trust* [2020] VSC 716 at [341].

13 Legislation in all jurisdictions in Australia provides for the removal of a trustee: s 36 of the *Trustee Act 1936* (SA); s 70 of the *Trustee Act 1925* (NSW); s 80 of the *Trusts Act 1973* (Qld); s 32 of the *Trustee Act 1898* (Tas); s 77 of the *Trustees Act 1962* (WA); s 48 of the *Trustee Act 1958* (Vic); s 27 of the *Trustee Act 1893* (NT); s 70 of the *Trustee Act 1925* (ACT).

14 *Re Owies Family Trust* [2020] VSC 716 at [353], citing *Wareham v Marsella* [2020] VSCA 92 at [103] (quoting *Miller v Cameron* (1936) 54 CLR 572 at 580-581).

Events Calendar

August 2021

STATE/EVENT	DATE	CPD
Online		
Tax Depreciation Incentives Webinar	12/8/21	1.5
2021 R&D Masterclass	18/8/21	4
2021 Death … & Taxes Conference	19/8/21	12
Queensland		
2021 Death … & Taxes Conference – face-to-face	19/8/21	12
South Australia		
2021 Local Tax Club – Adelaide – Part 7: R&D and Government Incentives	31/8/21	1.5
Victoria		
2021 R&D Masterclass	18/8/21	4
2021 Local Tax Club – Melbourne – Part 7: NALI and NALE = NASTY	19/8/21	1.5

For more information on upcoming events, visit **taxinstitute.com.au/professional-development**.

Cumulative Index

The following cumulative index is for volume 56, issues (1) to (2). Listed below are the pages for each issue:

Vol 56(1): pages 1 to 84 **Vol 56(2): pages 85 to 142**

A

Absolute entitlement
trust vesting 38, 39
Accommodation expenses 92
Accountants
SMSF deeds 125, 127
Administrative penalties
default assessments 94
Advisers
SMSF deeds, non-qualified suppliers 125–128
Affordable housing (NSW)
build-to-rent developments 79
property tax rate 129, 130
Aggregated turnover
calculation 92
company tax rates 15–17
Allowances
travel and overtime meal allowances....92
Assessable income
land, sale and subdivision 9
Assets
use of, safe harbour method....32
Australia
corporate income tax rates....15
royalty defined....99
tax structure compared with OECD 105
Australian Capital Territory
tax reform....89
Australian economy
recovery 104
Australian financial services licence....74
Australian resident trusts
foreign resident beneficiaries, capital gains....11–14, 35–37, 123, 124
Australian tax system
efficiency....106, 108
equity 106, 108
reform....104–109
simplicity 107, 108
Australian Taxation Office
administrative and interpretative guidance....2
client identity verification....5
National Tax Liaison Group meeting....2
Australian Treasury
Div 7A consultation paper....27–33

B

Base rate entities
company tax rates 15–17
Base rate entity passive income 16, 17
Benchmark interest rate
Div 7A....91
Binding death benefit nomination.... 125, 126
Biotechnology and medical patents.... 17, 91
Board of Taxation
granny flat arrangements....95
R&D tax incentive.... 113
Boilerplate clauses
share sale agreements....68
Build-to-rent developments
NSW....79, 131
Burial rights
GST supply 7
Business continuity test
same business test....49–51
similar business test 50–53

C

Canada
corporate income tax rates....15
Capital account or revenue account
prepaid rent....8, 9
Capital gains tax
Australian trusts, foreign beneficiaries....11–14, 35–37, 123, 124
event A1 47
event E1 39
event E5 38
event E7 39
event I2....37
foreign-source income....36, 37
granny flat arrangements....6, 95–97
trust vesting 37–39
Car parking benefits
FBT....92, 93
Cars — see **Motor vehicles**
Carve-outs
tax indemnity 65
Cemeteries
GST, supply of burial rights....7
CGT exemptions
granny flat arrangements....6, 95
Childcare....107
Circular trust resolutions 43, 44
Clearance certificates
share sale agreements....68
Client identity verification....5
Commercial parking stations....93
Commissioner of Taxation
discretion to disregard Div 7A....22
Company tax rates
base rate entities.... 15–17
franking distributions 17
Compliance
client identity verification....5
Concessional tracing rules 47
Consideration
real and genuine 134–136
share sale agreements....67, 68
Consolidated groups
determining losses transferred....54–56
interaction of loss rules....57–59
recouping losses transferred....54
transferring losses to 53
Continuity of ownership test
concessional tracing rules....47
concessions....62
losses....45–49
notional shareholders 47–49
saving provision 46
substantial continuity of ownership....47
Contribution reserving....73, 74
Corporate tax rate
base rate entities.... 15–17
enterprise tax plan 15
Corporate tax residency
rules 119–121
Covenant to pay
mergers and acquisitions 64–68
COVID-19 measures
Div 7A loan repayment extension....91, 92
loss recoupment 45, 52, 59, 61, 62
permanent establishments created by 7
recovery from impact....104
TTI support 87
TTI volunteers 86
Cross-border transactions
software, royalty withholding tax....99–102

D

Debt forgiveness
Div 7A....25, 32
Declarations
share sale agreements....68
Deductions for expenditure
prepaid rent....8, 9
R&D....113–117
Deemed dividends
Div 7A....25–33
Default assessments
onus of proof....93, 94
Depreciation
cars, business use....7
Developers
property tax reforms (NSW)....131
Disability 96
Disabled persons
granny flat interest eligibility....96
Discretionary trusts
beneficiaries
– foreign residents, capital gains....11–14, 35–37, 123, 124
– identifying....71
circular trust resolutions 43, 44
foreign persons....42, 43
land tax surcharges 42, 43, 71
real and genuine consideration.... 134–136
trust splitting 39–42
Distributable surplus
Div 7A loans 28, 29
Distribution rights
software, royalty withholding tax....99–102
Dividends
Div 7A
– deemed 25–33
– distributable surplus....28, 29
– later set-off....26, 27
Division 7A
14-year amendment periods....28
assets, safe harbour method....32
benchmark interest rate....91
breaches, self-correction....31
Commissioner's discretion to disregard 22
deemed dividends 25–33
FBT anti-overlap provisions 33
interposed entity rules 24, 25
later dividends....26, 27
loans
– 10-year loans....29, 30
– 14-year amendment periods 28
– debt forgiveness....25, 32
– distributable surplus....28, 29
– ordinary course of business 32
– pre-4 December 1997....26, 30
– proposed rules....29
– repayment 22–24, 91, 92
– transitional rules....30, 31
minimum yearly repayments and COVID-19....91, 92
non-resident private companies....31, 32
proposed reforms 22–33
Treasury consultation paper 27–33
UPEs 27, 30, 31
Documentation
SMSF deeds, non-qualified suppliers.... 125–128
Due diligence
share sale agreements....67
Dwelling
granny flat interest in....96

E

Education
retraining and reskilling benefits, FBT....6
Elder abuse
granny flat arrangements....95
Electric vehicles....89, 90
Enterprise tax plan
corporate tax rate 15
Equity
Australian tax system....106, 108
Estate planning — see **Succession and estate planning**
Expenditure
deductibility — see **Deductions for expenditure**

F

Fairness
tax system....106, 107
Family trusts
trust splitting 39–42
Federal Budget 2021-22
corporate tax residence....119
loss carry back measures....59, 61
tax cuts 17
Financial planners
SMSF deeds 125, 127
Fixed trusts
identifying beneficiaries 72
Foreign beneficiaries
Australian trusts, CGT....11–14, 35–37, 123, 124
Foreign companies
permanent establishments created by COVID-19....7
private companies, Div 7A 31, 32
Foreign duty surcharges
discretionary trusts 71
Foreign investors
property tax (NSW)....131
Foreign persons
land tax surcharges 42, 43
Foreign residents
discretionary trust beneficiaries, capital gains....11–14, 35–37, 123, 124
Div 7A, private companies 31, 32
share sale agreements....68
Foreign-source income
CGT....36, 37
Forgiveness of debts
Div 7A....25
France
corporate income tax rates....15
Franking distributions
company tax rates 17
Fringe benefits tax
car parking benefits....7, 8, 92, 93
Div 7A, anti-overlap provisions 33
skills training exemption....6

G

Gender equity....107
Germany
corporate income tax rates....15
Global tax environment — see **International tax**
Goods and services tax
Australia compared with OECD countries....105
cars 7
low-value imported goods 91

reform.......105
supply of burial rights.......7
Granny flat arrangements
CGT.......6, 95–97

H
Hardship
property tax (NSW).......131
Henry review.......105, 108
Housing affordability (NSW)
build-to-rent developments.......79
property tax rate.......129, 130

I
Identity verification.......6
Income
foreign-source, CGT.......36, 37
Income tax
Australia's reliance on.......105
individual residents.......17
Industry Innovation and Science Australia.......111, 117
Insolvency
retention obligations.......6
Integrity measures
loss carry back rules.......60
R&D.......11
Interest income
not base rate entity passive income.......16, 17
International tax
corporate tax residency.......119–121
Interposed entity rules
Div 7A.......24, 25
Italy
corporate income tax rates.......15

J
Japan
corporate income tax rates.......15

K
Know-how
software.......100, 101

L
Land
sale and subdivision.......9
Land tax (NSW)
build-to-rent developments.......79
reform.......89, 129–132
Land tax (SA)
reform.......89
Land tax (Vic)
reform.......90
Land tax surcharges
discretionary trusts.......71
foreign persons.......42, 43
Landholder duty rules
property tax (NSW).......132
Leases
prepaid rent, allowable deductions.......8, 9
Licensing
software, royalty withholding tax.......99–102
Liquidation
retention obligations.......6
Loan agreements
COVID-19 measures.......91, 92
Loans
Div 7A
– 10-year loans.......29, 30
– 14-year amendment periods.......28
– debt forgiveness.......25, 32
– distributable surplus.......28, 29
– ordinary course of business.......32
– pre-4 December 1997.......26, 30
– proposed rules.......29
– repayment.......22–24, 91, 92
– transitional rules.......30, 31
Loss carry back rules
claiming offset.......60
integrity rules.......60
temporary measures.......59–61
Losses
business continuity test.......49–53
consolidated groups and MEC groups.......57, 58
continuity of ownership test.......45–49
loss carry back measures.......59–61
strategies to utilise.......61, 62
tax consolidation rules.......53–59
Low and middle income tax offset.......6
Low-value imported goods
GST.......91
Luxury car tax.......7

M
Medical and biotechnology patents.......17, 91
Mental health and wellbeing surcharge (Vic).......90
Mergers and acquisitions
share sale agreements.......64–68
tax indemnity.......64–68
Minimum yearly repayments
Div 7A complying loan agreements and COVID-19.......91, 92
Motor vehicles
car limit.......7
car parking benefits, FBT.......7, 8, 92, 93
car threshold amount.......7
luxury car tax.......7
stamp duty.......89
Multinational corporations
software, royalty withholding tax.......99–102
Multiple entry consolidated groups
loss rule modifications.......57, 58

N
National Tax Liaison Group meetings.......2
New South Wales
build-to-rent developments.......79
tax reform.......89, 90, 129–132
wind farms, fixtures and valuation.......76–79
New Zealand
corporate income tax rates.......15
Non-resident private companies
Div 7A.......31, 32
Notional shareholders
continuity of ownership test.......47–49

O
OECD
global company tax rates.......15
Model tax convention on income and on capital.......101
Pillar One and Two reforms.......2
tax structure compared with Australia.......105
Onus of proof
default assessments.......93, 94
Ordinary course of business
Div 7A loans.......32
Overtime meal allowances.......92

P
Patent box
medical and biotechnology innovations.......17, 91
Payroll tax
state Budgets.......89, 90
Penalties
legal practice, unqualified entities.......127
SMSF deeds, non-qualified suppliers.......126
Permanent
term not in definition of "commercial parking station".......93
Permanent establishments
created by COVID-19 impacts.......7
Prepayment of rent
allowable deductions.......8, 9
Primary place of employment
aircraft crew car parking benefits, FBT.......7, 8
Private companies
non-resident, Div 7A.......31, 32
Professional indemnity insurance.......126
Property tax (NSW)
reform.......89, 129–132
Public cemeteries
GST, supply of burial rights.......7

Q
Queensland
tax reform.......89, 90

R
R&D
offset rates.......114, 115
tax incentives.......111–118
Real and genuine consideration.......134–136
Receivers
retention obligations.......6
Reforms
Div 7A.......22–33
Relationship breakdown
elder abuse.......95
Rent
build-to-rent developments (NSW).......79, 131
prepaid, allowable deductions.......8, 9
Reporting obligations
sharing economy.......91
Research and development tax incentive.......91, 111–118
Resident of Australia.......119
Resident trust for CGT purposes.......37
Residential property
foreign duty surcharges.......71
Retraining
FBT exemption.......6
Ride sourcing
reporting obligations.......91
Royalty withholding tax
licensing and distribution of software.......99–102

S
Same business test.......49–51
Same share, same interest rule.......46
Saving provision
continuity of ownership test.......46
Self-managed superannuation funds
deeds, non-qualified suppliers.......125–128
real and genuine consideration.......134
Share sale agreements
mergers and acquisitions.......64–68
Sharing economy
reporting obligations.......91
Similar business test.......50–53
Skills training
FBT exemption.......6
Small business entities
base rate entities.......16, 17
Social security
granny flat arrangements.......95, 96
Software
royalty withholding tax.......99–102
South Australia
tax reform.......89, 90
Stamp duty
build-to-rent developments (NSW).......79
property tax (NSW).......129–132
state Budgets.......89, 90
State Budgets
tax reform.......89, 90
Statutory construction
tax legislation.......13, 14
Statutory interpretation
corporate tax residence.......120
Succession and estate planning
fixed trusts.......72
real and genuine consideration.......134–136
trust splitting.......39–42
Superannuation
contribution reserving.......73, 74
SMSF deeds, non-qualified suppliers.......125–128

T
Tasmania
tax reform.......89
Tax consolidation rules
interaction with loss recoupment.......53–59
Tax disputes
share sale agreements.......67
Tax education
Advanced Superannuation Dux Award, study period 2, 2020
– Helen Cameron.......103
CommLaw1 Dux Award, study period 3, 2020
– Deanne Whelan.......19
CommLaw2 Dux Award, study period 3, 2020
– Deanne Whelan.......19
Graduate Diploma of Applied Tax Law, 2020 graduates.......20
Tax Adviser of the Year Awards
– nominations.......3
Tax incentives
patent box.......91
R&D.......111–118
Tax indemnity
carve-outs.......65
mergers and acquisitions.......64–68
tax warranties.......66
Tax offset
loss carry back.......59–62
low and middle income.......6
R&D.......111–117
R&D rates.......114, 115
Tax Practitioners Board
client identity verification.......5
Tax professionals
client identity verification.......5
Tax reforms
Australian tax system.......104–109
build-to-rent land tax/stamp duty.......79
property tax (NSW).......129–132
state Budgets.......89
Tax Institute submissions on.......2
Tax returns
share sale agreements.......67
Tax warranties
tax indemnity.......66
Tenant protections
property tax reforms (NSW).......131
The Tax Institute
National Tax Liaison Group meeting.......2
submission to ATO, client identity verification.......5
Tax Adviser of the Year Awards.......3
Tax Policy and Advocacy team.......3, 89
The Case for Change.......2, 3, 86, 109
volunteers.......2, 86
Thodey review.......105, 106, 108
Total superannuation balance
contribution reserving.......74
Training
retraining and reskilling benefits, FBT.......6
Transfer pricing rules
Div 7A loans.......28
Transparency
Australian tax system.......108
Travel allowances.......92

Trust
Australian tax system 108
Trust splitting
succession and estate planning 39–42
Trust vesting
capital gains and losses 37–39
Trustees
Australian discretionary trusts, foreign capital gains 11–14, 35–37, 123, 124
real and genuine consideration 134–136
Trusts
establishment 70–72

U
Unimproved land value (NSW)
property tax 130
United Kingdom
corporate income tax rates 15
United States
corporate income tax rates 15
Unpaid present entitlements
Div 7A loans 30, 31
pre-16 December 2009 as debts 27

V
Valuation
wind farms (NSW) 76–79
Vesting — see **Trust vesting**
Victoria
mental health and wellbeing surcharge 90
tax reform 89, 90

W
Wills
fixed trusts 72
Wind farms
fixtures and valuation (NSW) 76–79
Withholding tax
royalties, software charges 99–102

Legislation

A New Tax System (Goods and Services Tax) Act 1999
Div 81 7
Budget Savings (Omnibus) Act 2016 118
Corporations Act 2001 74
s 254T 28
Duties Act 1997 (NSW) 42
s 54(3) 39
s 104JA 42
Financial Planners and Advisers Code of Ethics 2019 127
Financial Sector (Collection of Data) Act 2001
s 5(3) 17
Foreign Acquisitions and Takeovers Act 1975 42
Fringe Benefits Tax Assessment Act 1986 6
Div 10A 8
s 20 8
s 39A 8
s 39A(1) 92
s 136(1) 33, 93
Income Tax Assessment Act 1922-1930 119
s 2(i) 119
Income Tax Assessment Act 1930 119, 121
Income Tax (Dividends, Interest and Royalties Withholding Tax) Act 1974
s 7 99
Income Tax Rates Act 1986
s 23(2) 15
s 23AA 16
s 23AB(1) 16
s 23AB(2) 15–17
s 23AB(2)(ii) 17
Income Tax (Transitional Provisions) Act 1997
Subdiv 40-BB 117
s 137-10 98
ITAA36 120
Pt III
– Div 6 12, 123
– Div 6D 35, 43
– Div 6E 12, 36, 123
– Div 7A 22–33
– Subdiv EA 25
Pt IVA 17, 24, 60, 61, 117
s 6(1) 100, 119, 120
s 44 32
s 47A 32
s 82KZMD 8
s 95 11
s 95(2) 37
s 97 36
s 98 11, 12, 36, 123
s 98(2A) 36
s 98(3) 36
s 98(4) 43
s 98A(2) 35
s 99 37
s 100A 33, 35
s 102UK(1)(ca) 43
s 102UK(2) 44
s 102UK(3) 44
s 102UM 43
s 108 31, 32
s 109BC 31, 32
s 109C 24
s 109C(3) 25
s 109CA 32
s 109D 23, 27, 32
s 109D(1) 91
s 109D(5) 26
s 109E 22, 23
s 109E(3) 23
s 109E(5) 91
s 109F 25
s 109F(3) 26
s 109G(3) 25–27, 32
s 109G(3A) 27
s 109K 24
s 109L 24, 25
s 109M 32
s 109N(1)(b) 91
s 109Q 30
s 109R 22–24
s 109R(2) 23, 24
s 109RB 22, 31
s 109RB(3) 22
s 109T 24, 25, 33
s 109V 24, 25, 33
s 109W 24, 25, 33
s 109X 24, 25
s 109XA 27
s 109XB 27, 91
s 109Y(2) 28
s 109ZB 33
s 109ZC 26, 27, 33
s 109ZC(2) 27
s 109ZC(3) 27
s 128B(2B) 99
s 128D 99
s 167 93, 94
s 170(1) 68
s 170(10AA) 28
s 202A 16
s 254 6
s 254(1)(a) 6, 7
s 254(1)(d) 6
Sch 2F 43
ITAA97 6, 120
Div 40 62
Div 102 13
Div 128 37
Div 137 95
Div 160 59
Div 165 49
Div 166 47, 49, 62
Div 175 51
Div 290 73
Div 293 73
Div 707 53
Div 855 11, 12, 14, 35, 36, 39, 76, 77, 123
Subdiv 115-A 36
Subdiv 115-C 12, 13, 36, 123, 124
Subdiv 124-M 68
Subdiv 137-A 95
Subdiv 166-E 48
Subdiv 328-C 60
Subdiv 355-G 116
Subdiv 355-H 116
Subdiv 707-A 53, 55, 56
Subdiv 707-C 55, 62
Subdiv 719-F 53
Subdiv 768-H 36
Subdiv 900-B 92
s 6-5 9
s 8-1 8
s 10-25 68
s 26-25 99
s 26-55 61, 74
s 104-35 98
s 104-75 38
s 104-75(5) 39
s 104-75(6)(a) 39
s 104-170 37
s 106-50 39
s 110-45(3) 68
s 115-110 36
s 115-200 to 115-230 12
s 115-210(1) 12
s 115-215(3) 11, 13, 36, 39
s 115-220 11, 13, 35
s 115-225 13
s 115-228 43
s 116-20 68
s 116-50 68
s 118-115 96
s 118-120 96
s 124-780 69
s 124-780(2)(a) 69
s 124-780(3)(c) 69
s 137-10 95
s 137-10(1) 96, 98
s 137-10(2) 96
s 137-10(2)(a) 95
s 137-10(3) 96
s 137-15 95–97
s 137-20 95, 97
s 137-25 95
s 160-10 59
s 160-35 63
s 160-35(1)(e) 63
s 165-10 45
s 165-12 45
s 165-12(7) 46
s 165-13 50
s 165-13(2) 49
s 165-165 46
s 165-210 49, 50
s 165-211 50
s 166-5 49
s 166-5(3) 47
s 166-175 62
s 202-45 26
s 307-205 74
s 328-110 16
s 328-115 16, 92
s 328-115(1) 16
s 328-180 117
s 355-100 116
s 355-115 115
s 355-115(3) 115
s 355-225(1)(b) 117
s 355-305 116
s 355-310 117
s 355-315(2) 116
s 355-315(3) 116
s 355-440 116
s 355-440(2) 116
s 355-445 116
s 355-445(2) 116
s 355-446 116
s 355-447 116
s 355-448 116
s 355-449 116
s 355-450(1) 116
s 355-465 117
s 355-466 117
s 355-467 117
s 355-468 117
s 355-475(1) 117
s 701-1 68
s 707-120(1) 62
s 707-140 62
s 707-145 56
s 707-210(4)(c) 62
s 707-305(2) 63
s 707-305(3) 62
s 707-315 63
s 707-320 55, 63
s 707-320(1) 63
s 707-320(2) 63
s 707-320(3) 63
s 707-325(2) to (5) 63
s 721-15(1) 68
s 721-15(3) 68
s 815-150 28, 68
s 855-5 14
s 855-10 12, 14, 39, 123, 124
s 855-10(1) 11, 13, 35, 36
s 855-40 14, 123
s 855-40(1) 12, 14
s 855-40(2) 36
s 976-1 27
s 995-1 37
s 995-1(1) 95, 98
Land Tax Management Act 1956 (NSW)
s 3A 43
s 9E(2)(c) 79
Legal Profession Uniform Law Application Act 2014 (Vic)
Sch 1
– Pt 2.1, Ch 2 127
Limitation Act 1969 (NSW)
s 54 26
s 63 26
Monetary Units Act 2004 (Vic) 127
New Business Tax System (Consolidation) Act (No. 1) 2002 63
Property Law Act 1958 (Vic)
s 154A 77
Residential Tenancies Act 2010 (NSW)
s 40 131
Social Security Act 1991 96
s 23(1) 95
s 23(5A) 96
s 23(5B) 96
s 23(5C) 96
s 23(5D) 96
Succession Act 2006 (NSW)
Ch 3 39
Superannuation Industry (Supervision) Act 1993 126
Superannuation Industry (Supervision) Regulations 1994 126
reg 7.08 73, 74
Tax Agent Services Act 2009 5
Tax Laws Amendment (2006 Measures No. 4) Bill 2006 124
Tax Laws Amendment (2011 Measures No. 5) Act 2011 36
Tax Laws Amendment (2011 Measures No. 5) Bill 2011 124
Tax Laws Amendment (Research and Development) Act 2015 111, 115
Tax Laws Amendment (Research and Development) Bill 2013 111
Taxation Administration Act 1953
s 14ZZK(b) 94
Sch 1
– Subdiv 12-H 43
– s 12-280 99
– s 14-201(1)(e) 68
– s 14-210(2) 68
– s 14-225 68
– s 14-225(2) 69

– s 14-225(3) ...69
– s 388-60 ...69
– s 388-75 ...69
Taxation Laws Amendment Bill (No. 4) 2003 ...26
Treasury Laws Amendment (2017 Enterprise Incentives No. 1) Act 2019 ...51, 52
Treasury Laws Amendment (2021 Measures No. 4) Act 2021 ...95
s 2 ...98
Treasury Laws Amendment (2021 Measures No. 4) Bill 2021 ...6, 98
Treasury Laws Amendment (A Tax Plan for the COVID-19 Economic Recovery) Act 2020 ...6, 118
Treasury Laws Amendment (A Tax Plan for the COVID-19 Economic Recovery) Bill 2020 ...111, 113, 115, 116, 120
Treasury Laws Amendment (Enterprise Tax Plan Base Rate Entities) Act 2018 ...15
Treasury Laws Amendment (Enterprise Tax Plan Base Rate Entities) Bill 2017 ...18
Treasury Laws Amendment (Enterprise Tax Plan No. 2) Bill 2017 ...17
Treasury Laws Amendment (Making Sure Multinationals Pay Their Fair Share of Tax in Australia and Other Measures) Bill 2018 ...120
Treasury Laws Amendment (Research and Development Incentive) Bill 2018 ...111, 112, 114, 115
Treasury Laws Amendment (Research and Development Tax Incentive) Bill 2019 ...111–115, 120
Treasury Laws Amendment (Tax Relief So Working Australians Keep More Of Their Money) Bill 2019 ...18
Trustee Act 1893 (NT)
s 27 ...136
Trustee Act 1898 (Tas)
s 32 ...136
Trustee Act 1925 (ACT)
s 70 ...136
Trustee Act 1925 (NSW) ...71
s 70 ...136
Trustee Act 1936 (SA)
s 36 ...136
Trustee Act 1958 (Vic)
s 41 ...136
s 48 ...136
Trustees Act 1962 (WA)
s 77 ...136
Trusts Act 1973 (Qld)
s 80 ...136

Rulings and other materials

Accounting Professional & Ethical Standards Board
APES 110 Code of Ethics for Professional Accountants ...127
Australian Taxation Office
GSTD 2021/D2 ...7
ID 2007/60 ...14, 124
ID 2010/82 ...29
ID 2011/104 ...25
IT 2660 ...101, 102
LCR 2019/1 ...52
LCR 2019/3 ...52
LCR 2019/5 ...16, 17
PBR 1051421869428 ...41
PBR 1051574799355 ...52
PBR 1051795970990 ...52
PCG 2018/9 ...44
PS LA 2006/2 (GA) ...26
PS LA 2010/4 ...31
PS LA 2011/29 ...22
TA 2018/2 ...101
TD 2011/16 ...25
TD 2013/22 ...73
TD 2018/13 ...25
TD 2018/15 ...98
TD 2019/14 ...39–42
TD 2019/14EC ...41
TD 2019/D6 ...14, 36, 123, 124
TD 2019/D7 ...36, 37
TD 2021/5 ...6, 7
TD 2021/6 ...92
TD 2021/D1 ...16, 92
TR 93/12 ...99–101
TR 96/26 ...93
TR 1999/9 ...50, 51, 62
TR 2004/9 ...55
TR 2004/D25 ...38
TR 2005/12 ...30
TR 2007/2 ...59
TR 2010/3 ...27
TR 2010/8 ...22
TR 2018/5 ...44
TR 2018/6 ...37–39
TR 2019/1 ...16, 32
TR 2021/2 ...92, 93
TR 2021/D4 ...99–102
Chartered Accountants Australia and New Zealand
CR 3 – Public Practice Regulations ...127
OECD
Model tax convention on income and on capital
– art 7 ...101
– art 12 ...101
– art 12(2) ...101
– art 13 ...101
Revenue NSW
Revenue Ruling G 014 ...79

Cases

A
Alcan (NT) Alumina Pty Ltd v Commr of Territory Revenue [2009] HCA 41 ...121
Amerind, Re; Carter Holt Harvey Woodproducts Australia Pty Ltd v The Commonwealth [2019] HCA 20 ...38
Aston (Aust) Properties Pty Ltd v Commr of State Revenue (Taxation) [2012] VCAT 48 ...71
Aussiegolfa Pty Ltd (Trustee) v FCT [2018] FCAFC 122 ...40
Australian Competition and Consumer Commission v ACN 099 814 749 Pty Ltd [2016] FCA 403 ...121
AWF Prop Co 2 Pty Ltd v Ararat Rural City Council [2020] VSC 853 ...77
B
Balcaskie Investments Pty Ltd v Chief Commr of State Revenue [2017] NSWCATAD 21 ...39
Behrndt and FCT [2021] AATA 1769 ...93
Boensch v Pascoe [2019] HCA 49 ...44
Bullock v Unit Construction Co Ltd [1959] Ch 315 ...121
Bywater Investments Ltd v FCT [2016] HCA 45 ...36, 120
C
Carter Holt Harvey Woodproducts Australia Pty Ltd v The Commonwealth [2019] HCA 20 ...38
Certain Lloyd's Underwriters Subscribing to Contract No. IH00AAQS v Cross [2012] HCA 56 ...14
Commissioner of Inland Revenue v Ward 69 ATC 6050 ...33
D
Dion Investments Pty Ltd, Re [2020] NSWSC 1661 ...71
Dyda Pty Ltd v Commr of State Taxation (SA) [2018] SASC 156 ...40
E
Esquire Nominees Ltd v FCT [1973] HCA 67 ...121
Esso Australia Resources Ltd v FCT [1998] FCA 1655 ...14
F
Finch v Telstra Super Pty Ltd [2010] HCA 36 ...134
Fischer v Nemeske Pty Ltd [2015] NSWCA 6 ...33
Fundy Settlement v Canada [2012] 1 SCR 520 ...120
G
Ganter v Whalland [2001] NSWSC 1101 ...14
Gartside v IR Commrs [1968] AC 553 ...134
H
Hertz Corp v Friend 559 US 77 (2010) ...120
Hill v Zuda Pty Ltd [2021] WASCA 59 ...126
I
In the Will of Docker (1976) 12 ALR 521 ...44
K
Kafataris v DCT [2008] FCA 1454 ...38
Karger v Paul [1984] VR 161 ...134
Kinsela v Caldwell [1975] HCA 10 ...71
Knight v Knight [1840] EngR 862 ...70
L
Lane; FCT v [2020] FCAFC 184 ...44
Legal Practice Board v Computer Accounting and Tax Pty Ltd [2007] WASC 184 ...127
Lonsdale Sand & Metal Pty Ltd v FCT [1998] FCA 155 ...26
M
Marsella v Wareham (No. 2) [2019] VSC 65 ...134
McCarthy and FCT [2021] AATA 1511 ...9
McCurry v FCT [1998] FCA 512 ...9
McGowan & Valentini Trusts, Re [2021] VSC 154 ...70
Mercanti v Mercanti [2016] WASCA 206 ...136
Meyerstein, Re [2009] VSC 564 ...71
Miller v Cameron (1936) 54 CLR 572 ...136
MP Metals Pty Ltd v FCT (1967) 117 CLR 631 ...121
Mussalli v FCT [2021] FCAFC 71 ...8
N
N & M Martin Holdings Pty Ltd v FCT [2020] FCA 1186 ...11, 12, 35–37, 123
O
Ogilvie v Adams [1981] VicRp 92 ...26
Oswal; FCT v [2012] FCA 1507 ...44
Owies Family Trust, Re [2020] VSC 716 ...134–136
P
Peter Greensill Family Co Pty Ltd (trustee) v FCT [2020] FCA 559 ...11, 12, 35–38, 124
Peter Greensill Family Co Pty Ltd (trustee) v FCT [2021] FCAFC 99 ...11, 44, 123, 124
Project Blue Sky Inc v Australian Broadcasting Authority [1998] HCA 28 ...121
Q
Quikfund (Australia) Pty Ltd v Airmark Consolidators Pty Ltd [2014] FCAFC 70 ...121
S
SPIC Pacific Hydro Pty Ltd v Chief Commr of State Revenue [2021] NSWSC 395 ...76–79
SPIC Pacific Hydro Pty Ltd v Chief Commr of State Revenue (No. 2) [2021] NSWSC 486 ...76–79
U
Unit Construction Co Ltd v Bullock [1960] AC 351 ...120, 121
V
Virgin Australia Airlines Pty Ltd v FCT [2021] FCA 523 ...7
VL Finance Pty Ltd v Legudi [2003] VSC 57 ...26
W
Wareham v Marsella [2020] VSCA 92 ...134, 136
West v Weston Matter No. 4365/96 [1998] NSWSC 419 ...71

Authors

A
Ananda, A
Tax Counsel's Report
– ATO client verification requirements ...5
B
Butler, D
Superannuation
– Contribution reserving: hurdles and risks ...73
– SMSF deeds: how does your supplier rate? ...125
C
Cullen, R
Alternative Assets Insights
– NSW wind farm: fixtures and valuation issues ...76
D
Donlan, T
Successful Succession
– Real and genuine consideration ...134
F
Fettes, W
Superannuation
– Contribution reserving: hurdles and risks ...73
G
Godber, P
President's Report
– Recognising our tremendous volunteer efforts ...86
– Things to fix in the tax system ...2
H
Huang, R
Alternative Assets Insights
– NSW wind farm: fixtures and valuation issues ...76
Hurst, G
CEO's Report
– Growing together through change ...3
– Ongoing challenges for our community ...87
J
Jeremiah, R
A Matter of Trusts
– Certainty and establishing a trust ...70
Jiang, SW
Alternative Assets Insights
– NSW property tax reforms update ...129
Jones, D
Mid Market Focus
– Company tax rates and base rate entities ...15
L
Lanyon, V
Share sale and purchase agreements ...64

Liang, L
A Matter of Trusts
– CGT liability of foreign beneficiaries ... 123

M

Ma, M
Associate Tax Counsel's Report
– State Budgets: a mixed approach to tax reform ... 89

Mavropoulos, B
Corporate tax residence: a hidden risk ... 119

N

Nguyen, A
R&D tax incentive amendments ... 111

Noolan, A
The dark corners of Div 7A ... 22

P

Peiros, K
Successful Succession
– Real and genuine consideration ... 134

S

Sangha, R
Don't lose your losses ... 45

Saville, S
Don't lose your losses ... 45

Schurgott, K
Trust hot topics ... 35

Sealey, M
Alternative Assets Insights
– NSW property tax reforms update ... 129

Smyth, D
R&D tax incentive amendments ... 111

Spencer, L
A Matter of Trusts
– Certainty and establishing a trust ... 70

T

TaxCounsel Pty Ltd
Tax News – what happened in tax?
– June 2021 ... 6
– July 2021 ... 91
Tax Tips
– Discretionary trusts: CGT and non-resident beneficiaries ... 11
– Granny flats and CGT ... 95

The Tax Institute
The case for reform ... 104

W

Whelan, L
Mid Market Focus
– Are software charges subject to royalty withholding tax? ... 99

TAXATION *in Australia*®
ISSN 0494-8343

Publishing House
The Tax Institute
ABN 45 008 392 372

Level 37, 100 Miller Street
North Sydney, NSW 2060

General Manager – Commercial Transformation & Special Projects
James Paterson

Content Delivery Manager, Knowledge & Learning
Carla Reddy

Managing Editor
Deborah Powell

Content Consultant
Andrew Mills

Graphic Designers
Mei Lam
Claus Huttenrauch

Typesetter
Midland Typesetters, Australia

Advertising
Business Relationship Manager
Brian Martin 08 6165 6600

© 2021 The Tax Institute
This journal is copyright. Apart from any fair dealing for the purpose of private study, research, criticism or review, as permitted under the Copyright Act, no part may be reproduced by any process without written permission.

Disclaimer
Unless otherwise stated, the opinions published in this journal do not express the official opinion of The Tax Institute. The Tax Institute accepts no responsibility for accuracy of information contained herein. Readers should rely on their own inquiries before making decisions that touch on their own interests.

Giving back to the profession

The Tax Institute would like to thank the following presenters from our July 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.

Roy Abbas, CTA

Scott Andersen

Daniel Angelovich

Arthur Athanasiou, CTA (Life)

Philip Bisset, CTA

Neil Brydges, CTA

Suzanne Bushell

Glendon Coote, FTI

Liam Cox

Adam Dimac

Amanda Donald, FTI

Luke Furness

Mark Gioskos, FTI

Frank Hinoporos, CTA

Paul Hockridge, CTA

Robyn Jacobson, CTA

Julianne Jaques, QC, CTA

Lee Jurga

Tim Kelleher, CTA

James Leslie-Watt

Mark Macrae, CTA

Rose McEvoy

Mark Morris, FTI

Andrew O'Bryan, CTA

Rachel O'Donnell, CTA

George Psarrakos, CTA

Ashley Shield

Ilonka Spaeth, CTA

Rajan Verma, FTI

Petr Vrsecky

Mark Wilkinson, CTA

Chris Wookey, CTA

Andrew Wright

Adrian Zuccarini, FTI

Contacts

National Council

President
Peter Godber, CTA

Vice President
Jerome Tse, CTA

Treasurer
Marg Marshall, CTA

National Councillors
Paul Banister, CTA
Leanne Connor, CTA
David Earl, FTI
Len Hertzman, CTA
Marg Marshall, CTA
Eddy Moussa, CTA
Tim Sandow, CTA
Todd Want, CTA

National Office

CEO: Giles Hurst

Level 37, 100 Miller Street
North Sydney, NSW 2060

Tel: 02 8223 0000
Email: ceo@taxinstitute.com.au

State Offices

New South Wales and ACT

Chair: Glen Hutchings, FTI

Level 37, 100 Miller Street
North Sydney, NSW 2060

Tel: 02 8223 0031
Email: nsw@taxinstitute.com.au

Victoria

Chair: Fiona Knight, CTA

Level 3, 530 Collins Street
Melbourne, VIC 3000

Tel: 03 9603 2000
Email: vic@taxinstitute.com.au

Queensland

Chair: John Ioannou, CTA

Level 11, Emirates Building
167 Eagle Street
Brisbane, QLD 4000

Tel: 07 3225 5200
Email: qld@taxinstitute.com.au

Western Australia

Chair: Bill Keays, CTA

Level 32, Central Park
152 St Georges Terrace
Perth, WA 6000

Tel: 08 6165 6600
Email: wa@taxinstitute.com.au

South Australia and Northern Territory

Chair: Nick Wilkins, CTA

The Tax Institute, WOTSO Adelaide
217/219 Flinders Street
Adelaide, SA 5000

Tel: 08 8463 9444
Email: sa@taxinstitute.com.au

Tasmania

Chair: Ian Heywood, CTA

The Tax Institute, WOTSO Adelaide
217/219 Flinders Street
Adelaide, SA 5000

Tel: 1800 620 222
Email: tas@taxinstitute.com.au

THE TAX INSTITUTE

0049KNOW_08/21

taxinstitute.com.au