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The Tax Institute

Taxation in Australia

Reshaping the GST for the future
The Tax Institute

Superannuation death benefits: nomination options
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We welcome original contributions that are of interest to tax professionals, lawyers, academics and students.

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Insights from the Institute

Regular columns

Tax News – at a glance

by TaxCounsel Pty Ltd

August – what happened in tax?

The following points highlight important federal tax developments that occurred during August 2022. A selection of the developments is considered in more detail in the “Tax News – the details” column on page 131 (at the item number indicated).

Electric cars: FBT incentive

An amending Bill (the Treasury Laws Amendment (Electric Car Discount) Bill 2022), which was introduced into parliament on 27 July 2022, contains amendments that, when enacted, will give effect to the government’s proposal to remove fringe benefits tax on eligible electric cars. **See item 1.**

Other amendments

The Treasury Laws Amendment (2022 Measures No. 2) Bill 2022, which was introduced into parliament on 3 August 2022, contains amendments that, when enacted, will give effect to a number of previously announced measures. **See item 2.**

Multinational tax: integrity and transparency

A consultation paper released by the Treasury on 5 August 2022 seeks submissions in relation to the government’s election commitment to introduce a multinational tax integrity package to address the tax avoidance practices of multinational enterprises (MNEs) and to improve transparency through better public reporting of MNEs’ tax information. **See item 3.**

Military superannuation benefits

Exposure draft legislation and explanatory material have been released by the government that, when enacted, will ensure that the decision of the Full Federal Court in *FCT v Douglas* ([2020] FCAFC 220) only affects the schemes and benefits specifically outlined in the decision and that no veteran faces worse income tax outcomes because of the decision. **See item 4.**

Payments to certain Indian firms

Exposure draft legislation and explanatory material have been released in relation to a change that is to be made in relation to the taxation by Australia of certain payments made to non-resident Indian firms providing technical services remotely to Australian customers. **See item 5.**

Division 7A: final determination

The Commissioner has released a final determination which sets out the way that he now considers Div 7A of the *Income Tax Assessment Act 1936* (Cth) applies where a private company becomes presently entitled to income of a discretionary trust (TD 2022/11). **See item 6.**

Treaty shopping: withholding rates

The Commissioner has released a taxpayer alert in relation to treaty shopping arrangements designed to obtain the benefit of a reduced withholding tax rate under a double tax agreement in relation to royalty or dividend payments from Australia (TA 2022/2). **See item 7.**

Self-education expenses

The AAT has rejected a claim made by an Army officer for deductions for self-education expenses incurred in the 2018 and 2019 income years in relation to the obtaining of a Juris Doctor degree which is a post-graduate law degree undertaken at a master degree level (*YDXM and FCT* [2022] AATA 2382). **See item 8.**

Bank account deposits: onus of proof

In two recent related decisions, the AAT has rejected appeals by an individual and a company against assessments that were made by the Commissioner by reference to unexplained bank deposits (*Goldsworthy and FCT* [2022] AATA 2472; *TOC Processing Pty Ltd and FCT* [2022] AATA 2479). **See item 9.**

Shorter period of review exclusions

Exposure draft regulations have been released which will exclude certain medium business entities from accessing a shorter two-year period of review for income tax assessments.

Amendments made in 2020 increased access to several small business entity tax concessions by expanding eligibility to include medium business entities (entities with an aggregated turnover of $10m or more and less than $50m). This enabled medium business entities to access some concessions that were previously only available to small business entities, including a shortened period of review of two years instead of four years.

It was, however, announced that the shortened period of review would not apply for entities with complex affairs or significant international tax dealings, and therefore these entities would continue to have a four-year amendment period.

President's Report

by Jerome Tse, CTA

The importance of a professional network

President Jerome Tse reflects on the value of networking and connection in building a meaningful career.

How The Tax Institute has helped me

A well-worn piece of professional advice we've all heard is that it's not what you know, it's who you know. For tax professionals, that wisdom rings partly true. We all know that when dealing with tax, what you know certainly does matter. But sometimes who you know matters just as much.

When I reflect on the early years of my career, one of the things I am grateful to have accomplished early on is building a strong network of similarly minded leaders, peers and friends in the tax space.

I started my Tax Institute journey while working at PricewaterhouseCoopers. I recall organising my first CPD event on tax losses, ringing to speak with senior ATO officers and other tax practitioners to get them involved. At the same time, I was expanding my network of peers and mentors, all as a mere first or second year tax professional. A few years later and with the support of my then employer, Hall & Wilcox, I began presenting at Breakfast Clubs, and graduated to presenting papers with senior practitioners at the Victorian State Convention in Lorne.

Involving myself in the tax community as a member of The Tax Institute has opened doors for me in a multitude of ways throughout my career. My network of senior tax professionals and peers, including past Presidents and Deputy Commissioners, supported me as I charted a career path through various roles, introduced me to new areas of interest, and kept me current on issues in the world of tax. It still does to this day.

Being connected to a professional community has also been a benefit during major life changes. I moved to Sydney in 2013 and, on moving, the late Gordon Cooper AM, a past President, invited me to lunch with some senior Sydney tax professionals. That included then KPMG Partner and now Second Commissioner, Jeremy Hirschhorn.

Through The Tax Institute, I wasn't starting from scratch – I was starting from a position of having the support and opportunities I needed to make local connections and solidify my standing in the local tax community.

Networking done right takes effort, a genuine interest in others, and a considerable time commitment. Being part of The Tax Institute isn't an alternative to the work of creating a valuable professional network; you're still required to put in the time, effort and interest. But it is a leg up, starting you off on the right foot, with the right people. And as I now near the role of "Past President", I am determined to afford young tax professionals the same, if not more, opportunities.

Opening the door for you to connect

Attending conferences and events is about updating what you know and connecting with who you know. It's often one of the best ways to engage with, and expand, your network, particularly when you have the opportunity to attend in-person.

The Institute holds hundreds of CPD events at which you can connect with other members and peers from the wider tax community. Our biggest event of 2022, The Tax Summit, is fast-approaching. It is perhaps, the best opportunity for face-to-face networking that many of us have had in the last two and a half years.

In particular, I am very much looking forward to meeting members on Sydney's newest superyacht, *The Jackson*, and attending the gala dinner and Tax Adviser of the Year Awards ceremony, where our community will recognise our brightest stars and to reconnect after a long time apart. We'll be recognising peers from across our member network who do exceptional work in their area of expertise.

Applications for the awards are now closed. Thank you to everyone who entered or encouraged others in their network to enter. We have received many worthy entries from practitioners who have gone above and beyond the call of duty. Our judges will have their work cut out in assessing the winners.

At the last in-person Tax Summit in 2020, the gala dinner was an incredible night of celebration. It's shaping up to be an even bigger experience this year. So, if you'll be joining us for the event, I encourage you to make time in your itinerary for the gala dinner and the other networking opportunities across the three-day program.

I'm looking forward to seeing you there. And if you are one of our younger members or are otherwise new to the profession, like those before me, I would be very pleased to meet you and chat about where you and The Tax Institute might take your career.

CEO's Report

by Giles Hurst

Recognition for work well done

CEO Giles Hurst reflects on the value of recognising our peers and ourselves for successes big and small.

The professional landscape is a busy environment and has been that way for many years. For tax professionals, shifting economic priorities and policies in the wake of COVID-19 and changing work practices in an increasingly digital world have made this especially true.

It's important to take time amid the rush of day-to-day work, strategy, planning and growing in your career to recognise the work already done. With so much to do, it can be tempting to rush from project to project, client to client, without time for reflection. But recognising our own achievements and those of our peers and friends makes us better as tax professionals and as people.

In 2021, a study of workplace motivations from O.C. Tanner showed that 37% of people were best motivated to do great work when they were recognised for it. It's a better motivator than promotions, training or salary increases. As a leader, I'm perpetually conscious of the power of recognition and thanks. From a small scale to a grand one, taking a moment to acknowledge the work of those around us is key to building good relationships, productive organisations and a strong profession. We all like to be told when we're doing a good job.

When we're doing an *amazing* job, it sometimes calls for a black tie awards ceremony and the recognition of leaders and peers from across the profession.

As Jerome mentioned in his President's Report to you this month, applications for the Tax Adviser of the Year Awards are now closed. Thank you for the time and effort you put into sharing your stories of success with us.

We have called for applications in five categories this year, including the return of Chartered Tax Adviser and Emerging Tax Star, and the introduction of three new categories that recognise the contribution of individuals from different areas of our membership: Tax Adviser – Accountant, Tax Adviser – Lawyer, and Inhouse Tax Adviser. Each of these specialties comes with its own challenges and successes.

I'm excited that we will have the opportunity to hear the stories and celebrate the way our members contribute to the profession in different ways.

At the beginning of October, we will be announcing finalists in each of the categories and then, at the end of the month, I hope we will see you all at The Tax Summit for the gala dinner, where we will announce the winners. Attendance is included in your event ticket.

The gala dinner and awards ceremony are an important part of The Tax Summit experience. As Jerome has said, it's an opportunity to create and strengthen connections with other tax professionals. It's also a much-needed opportunity to recognise and celebrate those among us who are doing exceptional work and leading our profession forward.

There has been no shortage of inspiring stories rising from the tax profession over the last few years, and I look forward to bringing these into the spotlight when we all gather at the ICC for what I feel confident will be the tax profession's brightest celebration of the year.

Associate's Report

by Abhishek Shekhawat, ATI

Australia's approach to work-related expenses

With tax time for the 2022–23 income year underway, this month's column discusses the existing difficulties with, and alternatives to, Australia's approach to work-related expenses.

Tax time for the 2022–23 financial year is progressing and taxpayers need to undertake the long and arduous process of calculating the correct deductions for their work-related expenses (WREs). Unfortunately, and despite their best efforts, many taxpayers are likely to get their WREs wrong due to the difficulties with Australia's current approach. This continues to raise the question of whether Australia should adopt an alternative to the current approach.

Difficulties with WREs

According to the ATO's Taxation Statistics 2019–20, approximately 14.96 million individuals lodged an income tax return, with almost 9.5 million individuals claiming a combined total of around $21.64b in deductions for WREs. The average and median claims for WRE deductions were $2,303 and $1,092, respectively. However, a significant number of taxpayers are likely getting their WRE deductions wrong. The ATO's tax gap findings estimate a net tax gap of 5.6%, or $8.43b, for individuals who are not in business, with incorrect claims for WRE deductions likely to occur even if the taxpayer seeks the assistance of a tax professional.

Despite the plethora of guidance on WREs provided by the ATO, the inherent complexity and extensive record-keeping requirements are the key drivers for the tax gap. The ATO estimates that incorrect WRE deductions account for 44% of the tax gap for individuals, with nexus and/or substantiation being the reason for around two-thirds of all adjustments and incorrect returns.

With the ongoing level of complexity, cost and compliance burdens, it's no wonder that taxpayers get it wrong, even if they are trying to do the right thing. For example, it is practically difficult for taxpayers to correctly apportion work-related internet or electricity expenses, especially when there are multiple users with varying use cases in a single household. This is further complicated by stringent substantiation requirements that vary depending on the calculation method taxpayers want to use to calculate their home office deductions. Since a decision doesn't need to be made until the end of the financial year, this effectively requires taxpayers to keep records for all calculation methods for the whole year. This complexity is only for one aspect of one category of WREs.

What are the alternatives?

Even if the amount of the incorrect deduction is small, it poses a significant revenue risk across the large individual taxpayer population base. With our current system's reliance on personal income tax receipts, we need to make sure that our system for WRE deductions is simple, efficient and easy to substantiate. Below, some alternatives and adjustments to Australia's current approach to WREs are briefly discussed.

Standard deduction

As noted in The Tax Institute's *Case for Change* paper, a standard deduction, with an option for taxpayers who have higher expenses to claim actual expenses with full substantiation, is a preferred alternative to the current approach. Being noticeably simpler to apply, a standard deduction could, depending on the amount set, be an attractive option for many taxpayers. Taxpayers who elect to use a standard deduction would have no record-keeping requirements. This would address the two biggest factors of nexus and substantiation as identified in the ATO's tax gap findings. A standard deduction could also be factored into the existing pay as you go withholding system. When combined with income prefill, this could allow taxpayers with simple affairs to have an effective one-step tax return experience.

Limiting or removing WREs

As an alternative, Australia could limit deductions for WREs to certain types of expenses or could remove them altogether. This approach would likely need to be paired with an adjustment to the personal income tax rates or the tax-free threshold to ensure that individuals do not bear an unfair tax burden compared to other taxpayers.

Streamlining and modernising substantiation

Changes to the underlying rules for WRE deductions should also be accompanied with streamlined substantiation requirements, reducing errors and better assisting taxpayers to claim the correct amount. For example, a single set of record-keeping rules across all calculation methods for home office expenses would allow taxpayers to readily understand their obligations and choose the best option for their circumstances at the end of the year. There may also be opportunities to work with digital service providers to identify avenues to automate record-keeping requirements, such as digital logbooks or work from home diaries.

Let us know in The Tax Institute's Community what you think the ideal reform options are for WRE deductions.

Tax News – the details

by TaxCounsel Pty Ltd

August – what happened in tax?

The following points highlight important federal tax developments that occurred during August 2022.

Government initiatives

1. Electric cars: FBT incentive

An amending Bill (the Treasury Laws Amendment (Electric Car Discount) Bill 2022), which was introduced into parliament on 27 July 2022, contains amendments that, when enacted, will give effect to the government's proposal to remove fringe benefits tax (FBT) on eligible electric cars.

More particularly, the amendments are introducing an electric car discount in the form of an FBT exemption. This will allow for car fringe benefits comprising the use, or availability for use, of an eligible car that is a zero or low-emissions vehicle to be exempt from FBT. A car benefit will be an exempt benefit for a year of tax if:

- the car is a zero or low-emissions vehicle (as defined);
- the value of the car at the first retail sale was below the luxury car tax threshold for fuel-efficient vehicles ($84,916 for 2022–23); and
- the car is first held and used on or after 1 July 2022.

The FBT exemption will apply to battery electric cars, hydrogen fuel cell electric cars, and plug-in hybrid electric cars.

Provided the conditions of the exemption are met, an electric car that was ordered prior to 1 July 2022 but was not delivered until after 30 June 2022 would be eligible for the exemption (even if an employer acquired legal title to the car before 1 July 2022). This is because the car would not be both held and used until after 30 June 2022. A second-hand electric car may qualify for the exemption, provided the car was first purchased new on or after 1 July 2022.

The FBT exemption is to be reviewed after three years in the light of electric car take-up to ensure that it remains effective.

2. Other amendments

The Treasury Laws Amendment (2022 Measures No. 2) Bill 2022, which was introduced into parliament on 3 August 2022, contains amendments that, when enacted, will give effect to a number of previously announced measures.

Record-keeping course

Proposed amendments to the *Taxation Administration Act 1953* (Cth) (TAA53) will empower the Commissioner to direct an entity to complete an approved record-keeping course as an alternative to existing financial penalties where he reasonably believes that the entity has failed to comply with its tax-related record-keeping obligations.

The Commissioner will be able to issue a tax records education direction to an entity three months after the day the Bill receives royal assent.

Electronic platform operators

Under other proposed amendments to the TAA53, electronic platform operators will be required to provide information on transactions made through the platform to the ATO.

These amendments are to apply from 1 July 2023 for transactions in relation to the supply of taxi travel and short-term accommodation, and from 1 July 2024 for all other transactions.

Self-education expenses

There are also amendments that will remove the $250 non-deductible threshold for work-related self-education expenses by repealing s 82A of the *Income Tax Assessment Act 1936* (Cth) (ITAA36), with effect from the 2022–23 income year.

Removing the $250 non-deductible threshold will reduce compliance costs for individuals claiming self-education expense deductions and simplify the tax return process.

AAT stay order

Amendments to the TAA53 will enable small business entities to apply to the Small Business Taxation Division of the AAT for an order staying, or otherwise affecting, the operation or implementation of decisions of the Commissioner that are being reviewed by the AAT.

These amendments are to apply in respect of applications for review made on or after the day after royal assent.

Downsizer contributions

Amendments to the *Income Tax Assessment Act 1997* (Cth) (ITAA97) will allow individuals aged 55 and over to make downsizer contributions to their superannuation plan from the proceeds of selling their main residence.

The amendments are to apply to downsizer contributions made on or after the first 1 January, 1 April, 1 July or 1 October that occurs after the day the amendments become law.

3. Multinational tax: integrity and transparency

A consultation paper released by the Treasury on 5 August 2022 seeks submissions in relation to the government's election commitment to introduce a multinational tax integrity package to address the tax avoidance practices of multinational enterprises (MNEs) and to improve transparency through better public reporting of MNEs' tax information.

Tax integrity issues arise due to MNEs adopting increasingly sophisticated tax planning practices. MNEs can take advantage of the differences between jurisdictions' tax systems to minimise their tax paid, typically by moving the incidence of taxation from a high taxation jurisdiction to a low taxation jurisdiction, or by avoiding a taxable presence in high taxation jurisdictions altogether.

Transparency is a key factor underpinning the integrity of the tax system. It can help to deter MNEs from entering into arrangements to minimise their tax paid, and helps to build community confidence that MNEs are paying their fair share of tax in Australia.

The consultation paper seeks to consult on the implementation of proposals to:

- amend Australia's existing thin capitalisation rules to limit interest deductions for MNEs in line with the Organisation for Economic Cooperation and Development's (OECD's) recommended approach under action 4 of the base erosion and profit shifting program;
- introduce a new rule limiting the ability of MNEs to claim tax deductions for payments relating to intangibles and royalties that lead to insufficient tax paid; and
- ensure enhanced tax transparency by MNEs through measures such as: public reporting of certain tax information on a country-by-country basis; mandatory reporting of material tax risks to shareholders; and requiring tenderers for Australian Government contracts to disclose their country of tax domicile.

The changes contemplated in the consultation paper seek to target activities deliberately designed to minimise tax, while also considering the need to attract and retain foreign capital and investment in Australia, limit potential additional compliance cost considerations for business, and continue to support genuine commercial activity.

The consultation paper complements the government's other MNE tax initiatives, including Australia's ongoing participation in negotiations on the OECD "two-pillar" solution to address the tax challenges of the digitalisation of the economy, which includes a 15% global minimum effective tax rate on the profits of large MNEs.

4. Military superannuation benefits

Exposure draft legislation and explanatory material have been released by the government that, when enacted, will ensure that the decision of the Full Federal Court in *FCT v Douglas*[1] only affects the schemes and benefits specifically outlined in the decision and that no veteran faces worse income tax outcomes because of the decision.

It was held by the Full Federal Court in that case that certain veterans' invalidity pension payments under the Defence Force Retirement and Death Benefits (DFRDB) and Military Superannuation Benefits (MSB) schemes were superannuation lump sums for income tax purposes rather than superannuation income stream benefits.

The amendments proposed in the exposure draft Bill will retrospectively and prospectively reverse the impact of the *Douglas* decision in relation to all schemes, other than invalidity benefits and death benefits for beneficiaries of invalidity pensioners paid from the DFRDB and MSB schemes that commence on or after 20 September 2007.

In addition, the draft Bill contains amendments to introduce a non-refundable tax offset to prevent adverse income tax outcomes being experienced by veterans in the DFRDB and MSB schemes affected by the *Douglas* decision.

The draft Bill also extends these changes to spouse's and children's pensions paid to a spouse or child following the death of a member of a DFRDB or an MSB scheme affected by the *Douglas* decision.

5. Payments to certain Indian firms

Exposure draft legislation and explanatory material have been released in relation to a change that is to be made in relation to the taxation by Australia of certain payments made to non-resident Indian firms providing technical services remotely to Australian customers.

More particularly, the proposed amendments (which are to be made to the *International Tax Agreements Act 1953* (Cth)) will stop Australian taxation on income of non-resident Indian firms providing technical services remotely (not through a permanent establishment) to Australian customers that are covered by art 12(3)(g) of the Australia–India tax agreement,[2] that is a not a royalty within the meaning of the ITAA36, and that is only taxable in Australia because of the operation of art 12(3)(g) and art 23 of the Australia–India tax agreement.

The draft legislation proposes that the amendments will commence on the later of the day of royal assent and the day the Australia–India Economic Cooperation and Trade Agreement (AI-ECTA) enters into force for Australia. However, the amendments will not commence at all if the AI-ECTA does not enter into force.

The Commissioner's perspective

6. Division 7A: final determination

The Commissioner has released a final determination which sets out the way that he now considers Div 7A ITAA36 applies where a private company becomes presently entitled to income of a discretionary trust (TD 2022/11).

TD 2022/11 describes when a private company provides financial accommodation (and thus a loan) where it is made presently entitled to income of a trust and either:

- that entitlement remains unpaid (an unpaid present entitlement); or
- the trustee satisfies the present entitlement by setting aside an amount from the main trust fund (main trust) and holding it on a new separate trust (sub-trust) for the exclusive benefit of the private company beneficiary.

In both situations, the relevant time will be after the end of the income year in which the present entitlement arises.

TD 2022/11 applies to trust entitlements that arise on or after 1 July 2022 and replaces TR 2010/3 and

PS LA 2010/4 which have been withdrawn with effect from 1 July 2022 for trust entitlements arising on or after that time. Taxpayers can continue to rely on both TR 2010/3 and PS LA 2010/4 in relation to trust entitlements that arose on or before 30 June 2022.

TD 2022/11 states that, for the avoidance of doubt:

- the Commissioner will take a compliance approach of not devoting compliance resources to sub-trust arrangements conducted in accordance with PS LA 2010/4 in respect of trust entitlements arising before 1 July 2022, even though those sub-trust arrangements may commence after 30 June 2022; and
- the determination does not apply to unpaid present entitlements that arose before 16 December 2009.

7. Treaty shopping: withholding rates

The Commissioner has released a taxpayer alert in relation to treaty shopping arrangements designed to obtain the benefit of a reduced withholding tax (WHT) rate under a double tax agreement (DTA) in relation to royalty or dividend payments from Australia (TA 2022/2).

Typically, this benefit is sought via the interposition of one or more related entities between an Australian resident and the ultimate recipient of the royalty or dividend, where the interposed entity is a resident of a treaty partner jurisdiction. The ultimate recipient is generally located in a jurisdiction that either does not have a DTA with Australia or, where it is a treaty partner of Australia, the DTA provides a less favourable treaty benefit.

Arrangements that pose a potential risk of treaty shopping may display some of the following features and the ATO is likely to make further enquiries where such factors exist:

- structures and restructures involving the interposition of an existing or newly incorporated entity between Australia and the ultimate recipient of royalties or unfranked dividends;
- the interposed entity may have significant existing operations and employees and the taxpayer may contend that commercial benefits and/or synergies flow to the Australian operations or the interposed entity; and/or
- royalty or unfranked dividend payments (or potential future royalty or unfranked dividend payments) to the interposed entity are (or would be) subject to WHT at reduced rates under the relevant DTA compared with Australian domestic law or the applicable WHT rate under the DTA between Australia and the country of residence of the ultimate recipient.

The ATO is concerned that arrangements of the kind described in TA 2022/2 may be entered into or carried out by taxpayers for a principal or main purpose of obtaining a treaty benefit to which they would not otherwise be entitled. These arrangements may attract the operation of the anti-avoidance rules provided under Australia's DTAs (for example, the main purposes test contained in the applicable royalty and dividend articles in a number of Australia's DTAs).

Arrangements covered by TA 2022/2 also include those which may attract the operation of the general anti-avoidance rules and/or diverted profits tax in Pt IVA ITAA36 and other provisions under Australian domestic law.

TA 2022/2 is not directed at arrangements which facilitate bona fide investment into Australia that obtain treaty benefits in a manner consistent with the object and purpose for which the benefit is intended to be conferred.

Recent case decisions

8. Self-education expenses

The AAT has rejected a claim made by an Army officer for deductions for self-education expenses incurred in the 2018 and 2019 income years in relation to the obtaining of a Juris Doctor degree which is a post-graduate law degree undertaken at a masters degree level (*YDXM and FCT*[3]).

The taxpayer joined the Australian Army in 2008 and was employed as a general services officer (GSO) from 2012. He was not a legal officer in the Army and had no intention of becoming one. He was promoted from the rank of captain to major with effect from January 2022.

The taxpayer conceded that there was no requirement for him to have a Juris Doctor degree to be promoted, that to his knowledge the other persons promoted did not have Juris Doctor degrees, and that the absence of such a degree would not prevent him from being promoted in the future, including to the most senior ranks of the Army.

The AAT held that, while the taxpayer's tertiary studies were viewed favourably, they were not required as part of his promotion application and were one of many factors considered by the Army's Promotions Advisory Committee. The taxpayer's Juris Doctor studies could not be regarded as having led to the increase in his income. It could not be said that the taxpayer "spent money to earn more". There was no "real connection" between the Juris Doctor units, and ultimately the degree itself, to the taxpayer's increased income via his promotion.

9. Bank account deposits: onus of proof

In two recent related decisions, the AAT has rejected appeals by an individual and a company against assessments that were made by the Commissioner by reference to unexplained bank deposits (*Goldsworthy and FCT*[4]; *TOC Processing Pty Ltd and FCT*[5]).

The individual

In the case of the individual, the taxpayer lodged an income tax return for the 2012 income year in June 2013 reporting a taxable income of nil. Subsequently, he lodged an amended return reporting a taxable income of $7,371.

The Commissioner conducted a preliminary review of the taxpayer's return as a result of which an amended assessment was issued in March 2015. In that assessment, the Commissioner assessed the taxpayer's taxable income at $703,758. A comprehensive audit followed in which the Commissioner identified what he considered to be various "unexplained deposits" to the taxpayer's bank accounts.

A further amended assessment was issued on 3 May 2017. Additionally, the Commissioner assessed an administrative penalty at the rate of 75% of the alleged shortfall (on the footing that the taxpayer's conduct amounted to intentional disregard of the law) and a shortfall interest charge (SIC).

The taxpayer objected to the assessments. The Commissioner's objection decision partly allowed the objection by omitting part of the deposits from one source from the calculation of the taxpayer's taxable income. The penalty and SIC assessments were reduced proportionately, but not otherwise. The remaining amounts in dispute were primary tax of $2,377,470, an administrative penalty of $1,552,789 and an SIC of $590,230.

It was the taxpayer's submission that the amounts the Commissioner treated as income were, in fact, amounts loaned to him by a third party located outside Australia and by his parents, and therefore were not income.

The AAT held that, if it was the case that the Commissioner had not confined the issues in dispute, the taxpayer could not succeed by merely proving that the "unexplained deposits" were amounts loaned to him. Rather, the taxpayer would need to prove what amount should have been assessed as his taxable income; that is to say, the taxpayer would have to prove the actual amount of his taxable income for the income year.

In light of certain extracts from the Commissioner's statement of issues, facts and contentions and his submissions, the AAT said that it was clear that the Commissioner had not confined the issues in dispute. It was also clear that the taxpayer was on notice of this. The AAT was also satisfied that the taxpayer had been afforded an opportunity that was reasonable in the circumstances to put his case forward.

Accordingly, the taxpayer had not discharged the burden of proving the amount of his taxable income and the taxpayer's appeal in relation to the assessed income tax, penalty and SIC was dismissed.

The company

In the case of the taxpayer company, of which the individual taxpayer was the director, the taxpayer company lodged an income tax return for the 2012 income year on 26 June 2013 reporting nil taxable income but did not lodge a return for 2013 when it was due. Following an audit, the Commissioner identified credit card deposits to the taxpayer company's merchant facility account with Bendigo Bank in the following aggregate amounts (called merchant credits): for the 2012 income year $43,227, and for the 2013 income year $4,357,664.

Corresponding amounts were transferred from the taxpayer company's account to an account of another company (Scanalert International Pty Ltd (Scanalert)) that was controlled by the director, which in turn transferred funds totalling $3,869,406 to three companies incorporated in the British Virgin Islands.

The Commissioner considered the amounts deposited to the taxpayer company's account to be unexplained deposits and issued an amended assessment to the taxpayer company for the 2012 income year and a default assessment for 2013 income year, treating the deposited amounts as assessable income of the taxpayer company. Associated assessments of administrative penalties and SIC were also issued. The Commissioner disallowed the taxpayer company's objections against the assessments.

The taxpayer company contended that the amounts credited to its merchant facility account at Bendigo Bank represented payments received from an unrelated company, South East Horizon Info-Tech (SEHI-T), for which it was undertaking "batch processing" of payments from "member sales transactions" for a fee of "5%–7%". The taxpayer company contended that the transfers to Scanalert were made to facilitate the international transfers to the three companies or other recipients as directed by a representative of SEHI-T because international payments could not be made from the Bendigo Bank facility.

Alternatively, the taxpayer company submitted that the amounts received in the merchant facility account were held on behalf of SEHI-T and on that basis were never assessable income of the taxpayer company.

The Commissioner contended that the taxpayer company had not discharged the burden of proving that the assessments were excessive. In particular, that there was little evidence beyond the necessarily self-serving statements of the director to support the taxpayer company's claims, and the relationship between the taxpayer company and the other parties had not been adequately explained.

The AAT said that what was provided by the taxpayer company in the way of contemporaneously created records or documentation to corroborate the director's evidence was "so surprisingly sparse". There were no financial statements, no minutes of meetings of the taxpayer company or Scanalert, and no contractual document evidencing the terms on which the taxpayer company was said to have received over $4m into its account and paid out a similar amount to Scanalert as part of the provision of batch processing services to SEHT-I.

The absence of appropriate records was largely unexplained. Further, it arose in the context of amounts in excess of $4m passing through the taxpayer company's account over a period of a mere five months. Self-evidently, these were not insignificant amounts. It was to be expected that an entity handling such sums of money would maintain records explaining the receipts and payments. That was so even if, as the applicant maintained, the payments were processed on behalf of SEHI-T.

The AAT said that it may be the case that the taxpayer company operated as the director set out in his witness statements. However, the AAT was duty bound to affirm the objection decision unless it was satisfied on the evidence that the assessments were excessive and that the taxpayer company's taxable income was as the taxpayer company asserted. The AAT said that it was unable to be so satisfied.

As the taxpayer company had not challenged the penalty or SIC assessments on any other basis, the AAT affirmed the Commissioner's objection decisions.

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References

1 [2020] FCAFC 220.

2 *Agreement between the Government of Australia and the Government of the Republic of India for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income.*

3 [2022] AATA 2382.

4 [2022] AATA 2472.

5 [2022] AATA 2479.

Tax Tips

by TaxCounsel Pty Ltd

CGT main residence: knockdown rebuild

Not infrequently, a taxpayer who either owns or acquires a dwelling will knock it down and build another. This can give rise to CGT issues.

Background

Where land with a dwelling on it is acquired, the dwelling is demolished and a new dwelling is constructed on the land, a number of CGT issues can arise not only under what may be called the general CGT provisions, but also under the CGT main residence exemption (or concession) provisions.

This article particularly considers the issues in the context of the following two basic scenarios:

1. where the acquisition of the land and dwelling occurred pre-CGT and the demolition of the existing dwelling and the construction of the new dwelling occurred post-CGT; and
2. where the acquisition of the land and dwelling occurred post-CGT.

Some issues that may arise if land on which a dwelling is situated is subdivided are also noted.

The general position is that, if a taxpayer builds a dwelling on land they already own, the land does not qualify for the CGT main residence exemption until the dwelling becomes their main residence. However, a taxpayer can choose to treat land as their main residence for up to four years (or a longer time if allowed by the Commissioner) before the dwelling becomes their main residence in certain circumstances. This concession can apply where a dwelling is built, repaired, renovated or finished.[1]

References in this article to pre-CGT are references to before 20 September 1995, and references to post-CGT are references to after 19 September 1995.

Some CGT basics

The CGT asset concept

The expression "CGT asset" is defined in s 108-5 ITAA97 in broad terms. Note 1 to the section gives a number of statutory examples, including "land and buildings".

It is also provided, "to avoid doubt", that part of an asset is itself a CGT asset (s 108-5(2)(a) ITAA97).

The usual position is that, in accordance with property law principles, land and any structures on it would constitute a single CGT asset. The usual position is, however, eroded in important respects, particularly by the provisions of Subdiv 108-D ITAA97 (Separate CGT assets). Of most present relevance is s 108-55(2) ITAA97. Under that provision, a building or structure that is constructed on land that the taxpayer acquired pre-CGT is taken to be a separate CGT asset from the land if the construction contract was entered into post-CGT or, if there were no construction contract, the construction started post-CGT.[2]

Putting to one side the situation just mentioned where a post-CGT dwelling would be treated as a CGT asset that is separate from the land on which it is situated, the demolition of a dwelling situated on land would constitute the demolition of part of a CGT asset (as the dwelling would be part of a CGT asset (the land)).

It should be noted that, depending on the context, a reference in the CGT provisions of the ITAA97 to a CGT asset may be to the actual asset (for example, land, a car) or to a legal or equitable interest in an asset. Thus, in the context of the CGT main residence exemption provisions, the concept of a "dwelling" is defined in s 118-115 ITAA97 by reference to the actual building ("(a) a unit of accommodation that: (i) is a building or is contained in a building …"). But there are also references to the legal or equitable interest in the land. Indeed, the concept of an "ownership interest" in land or a dwelling turns on the taxpayer having a legal and equitable interest in the land (s 118-130 ITAA97).

CGT event issues

Where a dwelling is demolished, CGT event C1 (loss or destruction of a CGT asset) would happen (s 104-20 ITAA97). That CGT event happens "if a CGT asset you own is lost or destroyed".

The Commissioner's view, expressed in TD 1999/79, is that the word "destroyed" in the context of CGT event C1 contemplates both voluntary and involuntary actions. The determination states:

> "The *Macquarie Dictionary*, 3rd ed, defines the word 'destroy' as '1. to reduce to pieces or to a useless form; ruin; spoil; demolish. 2. to put an end to; extinguish'. The word in its context in CGT event C1 applies if a CGT asset is destroyed in an involuntary occurrence, such as a natural disaster, or if it happens by the actions of others over which the taxpayer has no control. It also applies if a CGT asset is destroyed in a voluntary occurrence – if, for example, it happens due to a deliberate act of the taxpayer (e.g., a taxpayer might demolish a building in the course of redeveloping a property)."

Where CGT event C1 happens, a capital gain or capital loss that would otherwise be made is disregarded if the CGT asset (in the present context, the land and the dwelling) was acquired pre-CGT (s 104-20(4) ITAA97).

It would seem that, quite apart from the CGT main residence exemption, no capital gain or capital loss would be made from the happening of CGT event C1 where a dwelling on land acquired post-CGT is demolished to enable a new dwelling to be constructed. This is because the CGT cost base and reduced cost base apportionment rules in s 112-30 ITAA97 would not operate to attribute any part of the cost base or reduced cost base of the land and dwelling to the dwelling.

More particularly, although s 112-30(2) ITAA97 provides for the cost base and reduced cost base of a CGT asset to be apportioned if a CGT event happens to some part of the asset (but not to the remainder of it), the apportionment formula in s 112-30(3) would not result in any apportionment of the cost base or reduced cost base if there were no actual capital proceeds from the happening of CGT event C1. The effect of s 112-30(4) in such a situation is that the whole of the cost base and reduced cost base would be attributed to the land.

This is subject to the qualification that a capital loss may arise if the demolished dwelling was deemed to be a separate CGT asset. This would be so, for instance, where a dwelling that is demolished was constructed post-CGT on pre-CGT land.

Sale of land after demolition

If, after a dwelling acquired post-CGT is demolished, the taxpayer were to sell the vacant land, the CGT main residence exemption would not apply and there would potentially be a capital gain or capital loss.[3] If, instead of disposing of the vacant land, the taxpayer constructs another dwelling which becomes their main residence, a number of CGT main residence exemption issues will arise.

Special CGT main residence rule: building a dwelling

In the context of this article, s 118-150 ITAA97 provides an important CGT main residence concession which can apply where a dwelling is built, repaired, renovated or finished. What is of present relevance is where a dwelling is built and the concession is referred to as the main residence building concession. The operation of the concession where a dwelling is repaired, renovated or finished is not considered.

More particularly, if a dwelling is built by a taxpayer on land in which the taxpayer has an "ownership interest" (other than a life interest), s 118-150 ITAA97 provides the taxpayer with a choice to treat the dwelling as having been their main residence for a period of up to four years. No other dwelling can be treated as the taxpayer's main residence during this period, except during a changeover period permitted by s 118-140 ITAA97 where another dwelling is acquired.

For the main residence building concession to be available, the dwelling that is finished must:

- become the taxpayer's main residence "as soon as practicable"[4] after the dwelling is built; and
- continue to be the taxpayer's main residence for at least three months (s 118-150(3) ITAA97).[5]

The Commissioner has expressed his views (with examples) on how the first bullet point above operates in TD 92/147, including the factors that may be relevant for the purpose of determining when a dwelling will be finished. TD 92/147 also states that whether a dwelling becomes the taxpayer's main residence as soon as practicable after the construction of the dwelling is finished depends on the facts of each case. The personal circumstances of the taxpayer may be relevant in limited cases only.

The maximum period that a dwelling that is built may be treated as a taxpayer's main residence as a result of a choice being made under the main residence building concession is the shorter of:

- four years (or a longer period allowed by the Commissioner) before the dwelling becomes the taxpayer's main residence; or
- the period starting when the taxpayer acquired their ownership interest in the land and ending when the dwelling becomes the taxpayer's main residence (s 118-150(4) ITAA97).

The Commissioner's view is that a taxpayer cannot choose to have a shorter period of exemption for a new dwelling in order to exempt the old home for part of the construction period.[6] This suggests that the Commissioner considers that a choice provided for by the main residence building concession must be for the period that the concession can, in the particular circumstances, operate for.

If there was a dwelling on the land at the time when the taxpayer acquired their ownership interest in the land, and the dwelling was occupied by the taxpayer or anyone after that time, the period that can be relevant for the purposes of a choice under s 118-150 ITAA97 runs from the time when the dwelling ceased to be occupied by any person (s 118-150(5) ITAA97). For an illustration of how this provision applies, see ATO ID 2003/810 which has been withdrawn on the basis that it is a simple restatement of the law.

Example (adapted from an example in the ATO *Guide to capital gains tax 2022*)

Grant bought vacant land on which he intended to build a new home under a contract that was settled on 3 September 2007. He bought his previous home under a contract that was settled on 3 November 1994.

Grant finished building his new home on 3 September 2021. He moved into it on 7 October 2021, which was as soon as practicable after completion. He sold his previous home under a contract that was settled on 1 October 2021.

Grant can treat the new home as his main residence from 7 October 2017. In these circumstances, the main residence exemption applies for the period of four years immediately before the date the new home actually becomes his main residence. He can also claim the exemption for his previous home from 3 November 1994 to 6 October 2017.

Both homes are also exempt from 1 April 2021 to 1 October 2021, the date Grant disposed of the old home. This is because the maximum six-month exemption also applies.

The Commissioner will consider extending the maximum four-year period if the delay in building or renovating the dwelling was:

- beyond the taxpayer's control, for example, the builder becomes bankrupt and is unable to complete the building or renovation; or
- caused by unforeseen circumstances such as illness or injury to the taxpayer or a family member that caused the work to be stopped.[7]

Building a dwelling: pre-CGT land

If post-CGT a taxpayer builds a dwelling on land which they acquired pre-CGT, the dwelling will be treated as being a separate CGT asset (see above). Accordingly, the CGT main residence exemption potentially applies to this deemed separate asset.

An important point is that, for the CGT main residence exemption to apply to a period before the dwelling became the taxpayer's main residence (in practical terms, the period during which the dwelling was being built), the circumstances that permit a choice being made under the main residence building concession would need to be satisfied and the choice made (TD 2017/13).

Example (adapted from TD 2017/13)

Erica owns pre-CGT land on which she started to build a dwelling on 1 January 2016. The dwelling was completed on 1 January 2021 and Erica moves in immediately. She lives in the dwelling until the settlement of the sale of the property on 1 April 2021.

As the dwelling was Erica's main residence from 1 January 2021 to 1 April 2021, she will qualify for the main residence exemption for that period. She can also choose under s 118-150(2) ITAA97 to extend the main residence exemption for the four-year period prior to 1 January 2021 as she has met the conditions: the dwelling became her main residence on completion and she resided in it for at least three months.

As the property was Erica's main residence for this three-month period, and she makes a choice to apply s 118-150 ITAA97, she will qualify for the main residence exemption for the period from 1 January 2017 to 1 April 2021 (four years and three months). If the choice is made, no other dwelling can be treated as Erica's main residence during this period.

Building a dwelling: post-CGT land

If a new dwelling is constructed post-CGT to replace a previous dwelling that was demolished, the taxpayer can get a full CGT main residence exemption when they dispose of the property if:

- the original dwelling was their main residence for the full period they owned it, the dwelling was not used to produce assessable income, and it was on land covering an area of two hectares or less;
- the new dwelling becomes the taxpayer's main residence as soon as practicable after it is completed, it continues to be their main residence until they dispose of it, and that period is at least three months;
- the taxpayer makes a choice to treat the vacant land and new dwelling as their main residence in the period starting when they stopped occupying the previous dwelling and ending when the new dwelling becomes their main residence, and this period is four years, or a longer period if allowed by the Commissioner, or less; and
- the taxpayer disposes of the land and new dwelling together.

Accordingly, if the taxpayer has a dwelling that they acquired post-CGT and they live in it while they built their new home, they must decide whether to:

- maintain the exemption for their old home; or
- have the exemption applied to the land (including the dwelling that is being built on it) for the shorter of:
  - the time from when they acquired the land until the new home becomes their main residence; or
  - the four-year (or longer if allowed by the Commissioner) period immediately before the date on which the new home becomes their main residence.

Adjacent land issues

The CGT main residence exemption can extend (subject to an area limitation) to land that is adjacent to a dwelling. This is provided for by s 118-120(1) and (2) ITAA97:

> "(1) This Subdivision applies to a dwelling's adjacent land (if the same CGT event happens to that land or your ownership interest in it) as if it were a dwelling.
>
> (2) Land adjacent to a dwelling is its ***adjacent land*** to the extent that the land was used primarily for private or domestic purposes in association with the dwelling."

Where the main residence building concession is potentially available and is chosen, the CGT main residence exemption applies as if the dwelling was the taxpayer's main residence before it was in fact the taxpayer's main residence. However, where the land is a post-CGT asset, it is not clear how land that is adjacent to the dwelling may qualify for the CGT main residence exemption during a period when the dwelling was in fact not the taxpayer's main residence.

In this regard, the determination of whether land qualifies as adjacent land turns on whether the use of the land is primarily for private or domestic purposes in association with the dwelling. It is not clear how this use requirement could be met before there was a dwelling on the land.[8]

Changing main residence concession

The CGT main residence exemption provisions contain a changing main residence concession which, if its terms are met and the taxpayer chooses it to apply, allows the taxpayer to treat two dwellings as their main residence for a period of up to six months (s 118-140 ITAA97).

The Commissioner accepts that the changing main residence concession can apply in conjunction with the main residence building concession (TD 1999/43).

Example (adapted from TD 1999/43)

David acquired his first dwelling on 1 July 2009. Before he disposed of it on 1 December 2020, he acquired a vacant block of land on 1 March 2016 on which he erected a new dwelling. The dwelling was completed on 31 October 2020. He moved in on 1 December 2020 (which was as soon as was practicable to do so) and continues to live there.

In accordance with the main residence building concession, David chose to treat the new dwelling as his main residence for the period 1 December 2016 to 30 November 2020. As a result, David can treat his first dwelling as his main residence from 1 July 2009 to 30 November 2016 only. Additionally, as David owned two dwellings at the same time, he can apply both s 118-150 and s 118-140 ITAA97 to treat both dwellings as his main residence for the six-month period from 2 June 2020 to 1 December 2020. This means that David cannot treat his first dwelling as his main residence for the period 1 December 2016 to 1 June 2020.

Subdivision of land and construction of another dwelling

A factual situation that sometimes arises is where a taxpayer subdivides land on which their main residence is situated into two blocks and builds a new dwelling on the vacant block which becomes their main residence.

The application of the CGT main residence exemption in relation to the two dwellings in such a situation is considered in TD 2000/13 and TD 2000/14. The same factual situation is considered in each determination but TD 2000/14 considers what implications there are if the taxpayer makes a choice for the main residence building concession to apply in respect of the new dwelling.

TD 2000/13 and TD 2000/14 state that the full main residence exemption is not available in respect of either of the dwellings and that this will be so whether the dwellings are sold under a single contract of sale or under separate contracts of sale. As far as adjacent land is concerned, in both situations, two dwellings are sold and the adjacent land cannot be used, in terms of the main residence exemption, in association with both dwellings throughout their ownership periods.

An example in TD 2000/14 assumes that the original dwelling is sold and that the taxpayer will then decide whether to make a choice for the main residence building concession to apply in relation to the new dwelling. A choice for this concession to apply in relation to a dwelling would only need to be made by the time of lodgment of the return of income for the income year in which the CGT event in relation to the particular dwelling happened.

However, it is also provided that the way a taxpayer prepares their income tax returns is sufficient evidence of the making of a choice (s 103-25 ITAA97). This may mean that, if the income tax return of the taxpayer for the income year in which the original dwelling is disposed of is prepared on the basis that a choice is made under the building, repairing and renovating concession, this will be sufficient to lock the taxpayer into a choice as to the operation of the main residence exemption in relation to the new dwelling.

Disposal of vacant land

If a taxpayer subdivides the land on which their main residence is situated and sells off a vacant block, the CGT main residence exemption will not apply to any capital gain or capital loss that arises on the sale. In some circumstances, there may be a question of whether the subdivision and sale may give rise to the derivation of ordinary income.

Observations

It will be appreciated that the CGT main residence exemption can give rise to substantial difficulties and care needs to be taken when considering the application of the exemption. This is unfortunate because it potentially affects a large number of taxpayers.

The issue discussed in relation to the operation of the adjacent land provisions potentially affects each CGT main residence provision that has the effect of deeming a dwelling to be a taxpayer's residence during a period when it was in fact not the taxpayer's main residence. It is submitted that this should be the subject of legislative amendment.

TaxCounsel Pty Ltd

References

1 S 118-150 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97). This concession is referred to in this article as the "main residence building concession".

2 In some circumstances, a capital improvement made post-CGT to a pre-CGT asset may be taken to be a separate CGT asset (s 108-70 ITAA97).

3 See ATO, *Guide to capital gains tax 2022*, at "Destruction of dwelling and sale of land". Available at www.ato.gov.au/Individuals/Tax-return/2022/In-detail/Publications/Guide-to-capital-gains-tax-2022/?page=71.

4 For a decision in which the expression "as soon as practicable" was considered, see *The State of Western Australia v Rothmans of Pall Mall (Australia) Ltd* [2001] WASCA 25.

5 Provision is made for the case where the taxpayer dies during the construction period or before the expiration of the three-month period (s 118-155 ITAA97).

6 See ATO, *Guide to capital gains tax 2022*, at "Destruction of dwelling and sale of land". Available at www.ato.gov.au/Individuals/Tax-return/2022/In-detail/Publications/Guide-to-capital-gains-tax-2022/?page=70.

7 See ATO, *Guide to capital gains tax 2022*, at "Destruction of dwelling and sale of land". Available at www.ato.gov.au/Individuals/Tax-return/2022/In-detail/Publications/Guide-to-capital-gains-tax-2022/?page=70.

8 There are special rules that may apply where there is a compulsory acquisition of adjacent land (ss 118-240 to 118-255 ITAA97).

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Runxiang Wang
Senior Accountant, Centre of Wealth Accounting Services, Victoria

Please provide a brief background of your career in tax.

I have five years' professional experience working in public practice. I am a CPA and work as a senior accountant, specialising in the corporate tax and SMSF area.

I started out as a graduate accountant in an international trading company. After one year, I found that I was interested in a career in public practice, so I started my first professional job as a graduate accountant in a public accounting firm. Now, I am studying to achieve the internationally recognised CTA designation.

Why did you choose to study the Chartered Tax Adviser Program?

The main reason I chose the Chartered Tax Adviser Program is that it teaches me exactly where I can find specific legislation regarding tax issues. I really enjoy the feeling of being able to cite the legislation while providing tailored and detailed tax advice. The program has given me enormous confidence while speaking with clients.

What have you learned from CTA2B Advanced, and have you applied this to your role?

One of the main skills I have acquired is the ability to analyse legislation when I encounter any technical questions in practice. I have also gained extensive knowledge in corporate tax, GST and FBT, which are all areas that I come across in my day-to-day practice.

Some of my corporate clients have Div 7A issues, while others have a range of FBT issues. With my newly acquired knowledge, I can quickly locate the potential issue, help mitigate the risk, and offer solutions. One example is arranging a complying loan between the corporate entity and the directors to avoid Div 7A tax implications. The subjects have also helped me to understand the impact of any change of legislation on my clients, such as the recent draft s 100A regarding Div 7A.

How did you juggle study, work and other commitments?

At the beginning of each semester, I make a detailed study plan. I always leave one week empty so that I can decide to spend that extra time on work or family closer to the time.

I always make sure that I read the study material thoroughly before attending the live seminar, and this helps me to gain a better understanding of the key study points. After the seminar, I always write down a summary of the key points in my own words, so that it deepens my memory.

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

My goal is to complete the Chartered Tax Adviser Program and achieve my CTA designation by the end of the year. I would then like to spend more time on corporate law.

What advice do you have for other tax professionals considering the Chartered Tax Adviser Program?

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Reshaping the GST for the future

by The Tax Institute

This chapter of the *Case for Change* considers Australia's goods and services tax (GST). The GST is imposed at a rate of 10% of the final price of goods and services, subject to a broad range of exemptions and exclusions that effectively exclude around 50% of consumer spending from its scope. In the 20 years since its introduction, there has been a myriad of amendments to the GST law, but no substantive changes. Rebalancing the tax mix, including reviewing the GST base and/or rate of GST and addressing the potential inequities arising from doing so, is crucial to improving the resilience of our tax system. Holistic tax reform must include a comprehensive review of the GST regime. Note: The data contained within this chapter has not been updated since original publication of the *Case for Change*.

Understanding the GST

The GST is a broad-based tax levied on the sale of goods and the provision of services. It is a form of value-added tax (VAT), whereby the 'value added' is broadly the difference between the sale price of a good or service and the cost of the inputs used to create that good or service. In most instances, the final consumer bears the full burden of the GST. In Australia, GST is imposed at a rate of 10% of the final price of goods and services, subject to a broad range of exemptions and exclusions relating to, among other things, food, health, education, rent, childcare and financial services.

Background to the introduction of the GST in Australia

The GST was introduced by the Howard Government through the enactment of the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (GST Act) and took effect from 1 July 2000.

The GST replaced the federal wholesale sales tax (WST) and various state[1] taxes in an attempt to address a number of issues under the WST regime including, among other things, the WST's relatively small and shrinking revenue base, the inequitable incidence of the WST, and certain constitutional and political problems with regard to state taxation and fiscal relations between the Commonwealth and the states.

However, the main reason for the introduction of the GST was to improve how the state governments funded public services and public infrastructure.[2] More specifically, the GST was introduced to establish a stable, predictable revenue source for the states, which would grow with the size of Australia's economy. Unfortunately, in the two decades since its introduction, the GST has far from achieved this.

While in the 20 years since its introduction, there has been a myriad of amendments to the GST law, there have been no substantive changes to the GST in that time. Overtly omitted from the Henry review[3] in 2009, a comprehensive review of the GST regime and meaningful changes are well overdue, and must be considered as part of a serious tax reform agenda.

Issues

Recovering from significant events

Holistic tax reform which supports Australia's economic recovery in the wake of the COVID-19 pandemic and the bushfires and floods, which have had a resounding impact throughout the country, must include a comprehensive review of the GST regime.

Consumption tax revenues are affected by macroeconomic and policy changes, including changes in the level and composition of expenditure and the rate and base. During times of economic downturn, these variables impact consumption tax revenues. The OECD has undertaken studies analysing the drivers of change in consumption tax revenues during periods of economic downturn.[4] The GFC was used as a case study to provide learnings as to how the COVID-19 pandemic may affect tax revenues. The study noted that, during the GFC, tax revenues in OECD countries fell considerably, with most countries experiencing the lowest point in their tax revenues as a share of GDP for several decades.

However, revenues from consumption taxes were typically less affected and have been viewed as more stable over time than revenues from other bases such as corporate income.[5] As noted in the *Case for Change* paper, with Australia being one of the exceptions, most OECD countries place considerable reliance on consumption taxes as a main source of revenue. It has therefore been considered important, by the OECD, to identify drivers of change in consumption and consumption tax revenue. The importance is heightened in the context of the various COVID-19-related relief packages provided around the world.

Consumption tax regimes like the GST are vulnerable to economic downturns, particularly when the downturn directly affects private consumption. While consumption levels during the GFC remained reasonably stable, consumption tax revenues declined considerably at the time due to increases in government and public service consumption and a shift in the kind of consumer spending being undertaken towards exempt or concessionally taxed goods and services.[6] In many ways, consumption patterns have not reverted to pre-GFC levels and this has left consumption tax systems around the world more susceptible to economic downturn.[7]

While the extent of the impact of the (as yet ongoing) COVID-19 pandemic on GST revenue is not yet known, what is clear is that it has caused significant uncertainty about the future, including trends in consumption. While it is acknowledged that the present environment has not had a negative impact for all sectors, undoubtedly, GST revenue overall will be affected in the short term by changes to the level and composition of household spending, as well as by the impact of the pandemic on the relative prices of products, including through the exchange rate.[8] While a short-term impact may be accepted, the greater concern is that changes in consumption patterns will have an impact into the medium and longer term, paving the way for an untenable future.[9]

Also, when assessing the long-term impacts of the pandemic, an important variable is the impact of halted migration (and tourism), although this is expected to be somewhat mitigated by 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 assumptions. This is expected to cause a flow-on decline in household consumption and therefore GST revenue over the longer term.[10]

The GST has an important role to play to facilitate Australia's fiscal recovery in the wake of the COVID-19 pandemic. The government must give due consideration to the impact of the GST regime on the resilience of the broader tax system and its ability to generate revenue in the future, particularly in periods of economic downturn which may or may not be predicted. This involves a review of GST policy specifically, in addition to broader policy considerations.

Rebalancing the tax mix and addressing the potential inequity of GST reform

A necessary part of the broader consideration of rebalancing the tax mix is the impact on particular sectors of such a shift. Low-income households spend a higher proportion of their income on consumption than high-income households. While higher-income earners spend more on goods and services that attract GST in absolute terms, as a proportion of total income, the spend, and therefore the impact of any reform, is greater for lower-income earners. This is exacerbated by the current concessions and reliefs in respect of GST being poorly targeted and not providing genuine relief to those who are in most need.

Reforms broadening the GST base or increasing the GST rate may therefore result in the GST having a greater impact on the income of individuals, particularly for low- to middle-income earners. The solution to this is not inaction, but rather better engagement with the transfer system. The transfer system should be used to deliver transfer benefits to those who experience hardship as a result of the operation or reform of the GST regime. This should be the case as in any other cause of hardship, concessions and relief from which are generally delivered through the transfer system.

It is also important to note that, while too often the GST debate is solely focused on the domestic impact, there is an important international aspect. While some exports result in no GST being collected, tourism is one of the more obvious examples where GST is collected from non-residents, subject to very limited exemptions. That is, given tourism is one of Australia's largest industries, GST broadens the population (base) from which tax can be collected. For example, Queensland alone is three times the size of France, yet we have an Australia-wide population that is one-third of that of France. Despite the relatively smaller population, we still require infrastructure across that expanse of land. That infrastructure is largely funded by government revenue generated by taxes, including the GST.

"The transfer system should be used to deliver transfer benefits to those who experience hardship ..."

Taxing private consumption while tourists are visiting Australia makes sense, given that they use and enjoy the goods and services while they are here. By increasing the GST rate and/or broadening the base, additional revenue can be generated from tourist consumption in Australia, not only from consumption by Australians. This supports a genuine rebalancing of the tax mix. The potential reforms in this regard that are suggested below do not exceed OECD averages and are in no way so extreme that they could be expected to deter tourism. It is also noted that such consumers would not benefit from the transfer system, ensuring that any additional revenue generated from this sector can be redistributed as required.

To view an expansion of the GST, whether in terms of the base or rate, or a combination of both, as undesirable or a negative step is both short-sighted and misdirected. An increase in any aspect of a tax is often met with apprehension and objection. Often, this is because it is considered in isolation, and marketed solely as a further burden on taxpayers without consideration of the underlying need for the revenue sought to be collected. Indeed, the GST, in particular, has long been considered political 'kryptonite', for which there has not been the political will to address its shortcomings. However, failure to listen to expert advice and courageously act on it not only undermines the will of the Australian people, but also undermines their future.

For this reason, potential options for reform must not be considered or implemented in isolation. Rather, they must be considered as part of a holistic package of measures, in conjunction with other mechanisms that will address such undesirable outcomes, some of which are considered below.

Broad exemptions from GST

There is a long list of items that are in some way exempt from GST. Originally, such exemptions were introduced for reasons including equity (that is, the disinclination to tax goods that comprise a significant proportion of consumption by low-income households) and administrative ease (that is, excluding items that are administratively complex in order to reduce the compliance burden both for taxpayers and the ATO alike). Fresh food is an example of the former, and financial services fall into the latter category. External factors were also relevant in some cases, particularly in relation to education, childcare services and healthcare services, where consumption in those areas has the effect of encouraging economic growth and increasing productivity. However, the rationales for the existing exemptions have not always proven true, nor are they the only way to achieve their underlying objectives.

An item may be exempted from attracting the full rate of GST in one of two ways. A GST-free item does not attract any GST on the final supply of the good or service, and any GST paid on inputs in relation to that item may be claimed back as a tax credit. Distinct from GST-free items are input taxed items. Like GST-free goods and services, input taxed items have no GST imposed on the final supply of the relevant good or service, but producers are unable to claim refunds for any GST that is paid on inputs. This means that there is some GST levied on the item through the production and distribution chain. Input taxed items include residential rent and financial services, as well as products from businesses with a turnover of less than $75,000 or not-for-profit organisations with a turnover of less than $150,000.

In the *Tax benchmarks and variations statement*, Treasury identified the following categories as the main areas giving rise to forgone revenue:

- fresh food;
- education;
- health (including drugs and medicinal preparations, medical aids and appliances, medical and health services, residential care, community care and other care services, and private health insurance);
- childcare services, water, sewerage and drainage services; and
- financial supplies (including the financial acquisitions threshold (input tax credits), input taxed treatment, and reduced input tax credits).[11]

Other exemptions and reliefs apply to, among other things: diplomats, diplomatic missions and approved international organisations; boats for export; tourism (including global roaming by visitors to Australia, the tourist refund scheme for goods taken out of Australia, domestic travel as part of an international arrangement, and travel agents arranging overseas travel); religious services; supplies of farmland; general registration thresholds; simplified accounting methods; precious metals; and cross-border transport supplies.

Disproportionate compliance burden

One of the fundamental problems with the current GST regime is the associated disproportionately high compliance burden. Like any consumption tax, the GST has the potential to be straightforward and extremely efficient. However, the broad exemptions noted above are a key example of where the existing regime has gone too far down the path of equity at the expense of simplicity. The decisions to treat particular goods and services as taxable or exempt have not been founded in sound tax policy, but rather have been determined for political reasons. This approach dates back to the formative period prior to the enactment of the GST.

Sweeping exemptions are problematic in their own right, but exemptions from certain taxable goods and services, such as in the case of food, not to mention carve-outs from exemptions, only add to the confusion for taxpayers and cloud the system. In another example, financial services is prima facie input taxed. However, many entities have GST-free international transactions, added to which there are the peculiarities associated with reduced input tax credits which, together, creates additional complexity. These complexities increase the cost of understanding and complying with the GST. It also makes it more difficult to administer the GST, with ambiguity being a cause for disputes. These costs are borne by individuals, small to medium-sized enterprises and large businesses alike.

It is time to depoliticise the debate. The GST compliance burden must be reviewed and alleviated. This must be done in consideration of the entire GST regime, including its many exemptions, and, indeed, in the context of broader, holistic tax reform.

Declining GST-to-GDP ratio

As noted above, the GST was intended to be a growth tax. However, empirical data proves that the GST has not kept up with the growth of the economy over the past 20 years.[12] In fact, there has been a decline in GST revenue relative to the size of the economy.

GST revenue increased from $28.5b in 2000–01 to $64.6b in 2018–19, being a 130% increase. In that same time period, the size of the economy, as measured by GDP, increased by 180%. This shows that the GST-to-GDP ratio has declined from its peak at 4% in 2003–04 to 3.3% in 2018–19.[13]

Factors which have contributed to this decline include unequal price growth in items subject to GST compared to GST-free items, a decline in household spending, increases in spending on GST-free items such as health services and education, and the significant impact of the exchange rates. If these trends continue, the Parliamentary Budget Office (PBO) has estimated that the GST-to-GDP ratio will likely decline further to 3.2% in 2030–31. This is equivalent to a shortfall of up to $24b compared to the early 2000s.[14]

Decline in household spending on GST-applicable items. Household spending is the single largest component of the economy. However, in recent decades, household consumption has contributed far less to economic activity. This is largely attributable to an increase in the share of mining exports and an increase in income savings behaviour.[15] As can be seen from Figure 1, over the past 20 years, notwithstanding the sharp increases in 2008–09 and between 2010–11 and 2014–15, the rate of decline of household expenditure has been fairly steady.

In terms of expenditure, household spending comprises both GST-applicable and GST-free items, the latter category most notably including fresh food, health, education and rent. Data suggests that there has been a downward trend in the share of household spending which attracts GST.[16]

According to the ABS, household expenditure subject to GST declined by 6% from its peak at 65% in 2003–04 to 59% in 2018–19. This decline is largely due to changes in the composition of household consumption. In particular, younger generations are allocating an increasing proportion of their income to rent and education, while households aged 65 and over are spending an increasing amount on medical goods and health services. Further, data shows that, while Australians are still buying more goods and services that attract GST than those that do not, spending on GST-free goods and services has increased due to considerably faster price growth in those categories (discussed below).[17]

Uneven price growth in items subject to GST compared to GST-free items.[18] Since the introduction of GST, the value of household spending on GST-free items has doubled, while items subject to GST have increased by only one-and-a-half times.[19] The divergence is even greater considering that the price of GST-free goods and services, such as rent, health and education, has increased considerably faster than the price of items subject to GST. In fact, various goods and services subject to GST, including, among other things, retail (such as apparel) and vehicles, have experienced little, or even negative, price growth since the early 2000s. This is the case despite the Australian dollar having appreciated over time. The exception to this are utilities and tobacco, which have both experienced rapid price growth at rates faster than GST-free items.[20] In the case of tobacco, price increases have largely been driven by staged increases in tobacco excise rates.[21] In part, this price growth has offset the weak price growth of other items subject to GST. Whether the absence of GST on some goods and services encourages consumption of those goods and services (and that increase in demand causes price increases) or not is questionable. Nonetheless, fewer exemptions can provide greater transparency of price changes.

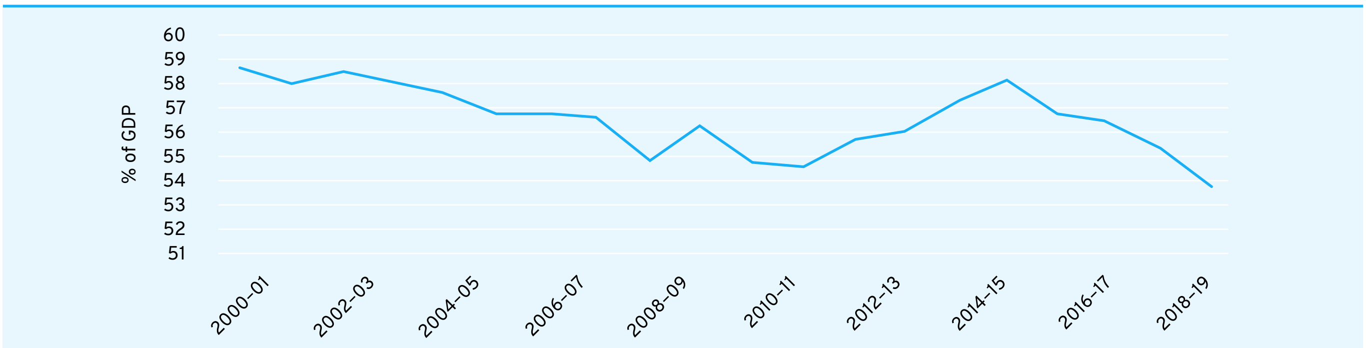
Over-reliance on GST revenue by state governments

The GST is levied by the Commonwealth and the revenue is then paid to the states under s 96 of the Commonwealth Constitution as a general revenue grant. This arrangement is given effect by the *Intergovernmental Agreement on Federal Financial Relations*, an intergovernmental agreement which was signed by the Commonwealth and all state governments in 1999. A copy of the agreement is set out in Sch 2 to the *A New Tax System (Commonwealth-State Financial Arrangements) Act 1999* (Cth). Importantly, s 11(1) of that Act provides that the GST rate and base are not to be changed without the unanimous agreement of all states, and requires that any such changes should be consistent with the following principles: (a) maintaining the integrity of the GST base; (b) administrative simplicity; and (c) minimising compliance costs for taxpayers.

The GST comprises the states' largest source of revenue. In 2018–19, the GST accounted for 22% of NSW's revenue expenditure, while for other states, it provided between 10 and 45% of revenue expenditure.[22] The significance of GST revenue is compounded by the fact that the states have limited capacity to raise revenue through other taxes and duties. In addition to the GST, the balance of revenue derived by the states (aside from revenue generated from their own state taxes) takes the form of various Commonwealth Government grants.

The distribution of GST to the states is based on the principle of horizontal fiscal equalisation, with the intention that each state has the same fiscal capacity to provide public infrastructure and services. Operation of the GST was intended to resolve, to some degree, the vertical fiscal imbalance (VFI) between the Commonwealth and the states. VFI manifests in this context where the states are committed to greater expenditure than they can manage through revenue that they raise independently (for example, through state taxes, duties and other levies). As outlined above, given that there is less household spending on GST-applicable goods and services, the Commonwealth is

Figure 1. Household final consumption expenditure as a share of GDP



Source: ABS, *Australian system of national accounts*, 2019–20 financial year.

collecting less GST now, and consequently distributing less GST revenue to the states.

Continued erosion of the GST revenue base will amplify, rather than rectify, VFI. Erosion of GST revenue has adverse implications for state budgets, limiting their ability to deliver frontline services and fund infrastructure that will produce long-term benefits for Australians, or that are necessary to assist in the recovery of the economy from the impact of the COVID-19 pandemic.

States may request that the Commonwealth provide greater transfer or grant funding, both generally and for specific purposes, to make up for the shortfall in GST revenue. However, this is neither a simple nor a sustainable solution, and in any case, relies on the Commonwealth having alternative resources to provide the support requested. If the GST is not reformed effectively to increase the overall revenue it generates, the Commonwealth will need to consider alternative means to support the states. Insufficient GST revenue means that the states may also need to resort to increasing debt or raising other taxes. This perpetuates existing issues in the state tax landscape and is not a long-term solution at the state or federal level.

Options

Potential strategies for GST reform

Any consideration of reform of GST must be tempered with the experience of most other countries that reform of the base, in particular, has been rare. Add to that the peculiar arrangement in Australia that the inter-governmental agreement creates an environment such that any change to GST is next to impossible (see below). While these considerations are important, it would be contrary to the intent of both the *Case for Change* paper and the profession to simply resign oneself to the current flawed system.

GST reform must be part of a broader, holistic package of reforms involving changes to income and corporate taxes, and the transfer system. As indicated throughout the *Case for Change* paper, reform will be most effective where it is delivered as a package of measures for the overall benefit of all Australians. It must be acknowledged that certain aspects of any such package may advantage certain sectors of society, while other aspects may disadvantage those same groups in comparison to the status quo. However, the overriding objective must be a system that is an overall improvement on our current framework, and one which can see us through for years to come.

Revisiting the framework for cooperation and consultation between the states and the Commonwealth

The *Intergovernmental Agreement on Federal Financial Relations* prescribes that any change to the GST framework, and specifically to its rate or base, requires the unanimous support of the Commonwealth, states and territories. The agreement was originally intended as an instrument of political expediency which would support a fair outcome for all of the states. However, in the present reality, it has served as a hurdle to genuine reform despite changes in the economy and shifts in consumption patterns. The Tax Institute considers that, particularly in relation to the restrictions on amendments to the tax base and rate, the agreement has become outdated and out of step with our economic reality. Its purpose and continued operation should be reconsidered. This will only be overcome by bona fide cooperation between the federal and state governments.

It is therefore critical that the states and Commonwealth work together to reach a mutually beneficial agreement on the way forward. This should take into account not only reforms required now, but also the scope to improve flexibility in the future. Political tensions between certain states, and between the states and the Commonwealth, for various reasons may be acknowledged but cannot justify inaction. GST reform is in the best interests of the government at all levels, and the Australian people. Strong political will is critical and leaders must demonstrate that they have, at the forefront of their decision-making, the best interests of the Australian people.

Failing state and federal governments being capable of agreement, it is possible for the Commonwealth to consider GST-like taxes that could do the work that the collective governments may be reluctant to do. For example, a Commonwealth only GST/VAT could be imposed alongside the existing system. Alternatively, a cash-flow tax could be imposed that would operate like a GST. It may be sufficient for the Commonwealth to threaten such an approach to get the states to the table.

Addressing inequity and countering the regressive effect of consumption tax

It is critical to address inequities arising from potential reforms by instilling community confidence in mechanisms of redress. In this aspect of reforms, it would be ideal for low- and middle-income earners to be better off on a net basis, though an overall neutral outcome for this sector of society should be a minimum standard. Practically, it is envisaged that, in respect of GST reform, at least the bottom two (if not, three) quintiles of households should be fully compensated for their increased GST payments.

One method of redress would be increasing income support payments for lower- to middle-income earners. This may be achieved by providing direct annual transfer support payments to households with lower income tax earnings, rather than higher-income households which benefit from income tax reductions. For the most part, transfer payments, such as the family tax benefits, NewStart and the age pension, are already means tested. While transfer payments are indexed and capture increased costs of goods and services, depending on the scale of reform considered, additional compensation is likely to be necessary to ensure low-income households are not worse off than under the current system. Where compensation is delivered through the transfer system, it will be necessary for there to be agreement for this outcome between the state and federal governments, given that GST revenue (and any increases thereto), while collected by the Commonwealth, accrues and is paid to the states, whereas transfer payments remain within the remit and budget of the federal government. That is, not all of an increase in GST can simply go to the states; it will be necessary for compensation and related tax relief to be taken into account first.

Importantly, unlike existing concessions, compensatory mechanisms should be appropriately targeted. Where the GST base is broadened to encompass goods and services currently outside the scope of the GST, this requires consideration of the sectors most adversely affected by such changes. For example, if health-related goods and services are brought within the ambit of the GST, consideration should be given to providing relief to the elderly, being the group which spends the most on such items. Likewise, where childcare is brought within scope, families should be provided with some support. Families and young adults, in particular, should similarly be provided with additional support in the case that education becomes subject to GST, given that they comprise the sector of society that would be most affected by such a change.

While shifting reliance from income taxes to consumption tax has an array of benefits as highlighted above and considered throughout the *Case for Change* paper, for the purposes of compensating low- to middle-income households, cuts to personal income tax rates are unlikely to have a material impact. This is because, under the existing personal income tax regime, the tax-free threshold and range of tax offsets and concessions available to low- and middle-income earners mean that the majority of households comprising the two lowest income quintiles are likely to already pay very little personal income tax, if any. This is further support for providing compensation through the transfer system rather than the personal income tax regime.

Alternatively, different tax rates may be applied to different classes of goods and services (discussed further below).

Regardless of the option chosen to overcome potential inequity arising from GST reform, it will be critical to educate the community on the changes and true impact thereof, as well as the methods of compensation available to those to whom it is applicable. It will be equally important to implement safeguards to ensure that any such compensatory mechanisms are not eroded over time. Further, transitional arrangements and one-off adjustments may be useful to allow individuals and businesses adequate time to adjust to the changes.

Options for reform – broadening the GST base and increasing the GST rate

Over the last decade, there have been numerous calls to expand the GST rate or base.[23] Broadening the GST base and/or increasing the rate may raise the amount of GST revenue collected, leading to GST becoming a greater part of the tax mix.

While a single rate is simpler to administer, most countries employing a consumption tax model operate tiered rates. Australia falls within this majority (given that a reduced rate of zero for some goods and services is taken to be a separate tier). In fact, in 2018, only two OECD countries did not have at least one reduced rate (including a reduced rate of zero).[24] The European Union sets a minimum standard rate of 15% and permits two reduced rates of not less than 5% for a limited list of goods and services.[25]

Modelling has demonstrated the revenue outcomes for several variations of base and rate increases. Without increasing the GST rate from 10%, broadening the base to include some of the main items currently exempt from GST could increase revenue by $21b. Alternatively, an increase of only 2.5% (equalling a GST rate of 12.5%) applied to the existing base would increase revenue by $14b. If the base is broadened to include some of the main items currently exempt from GST and those items are taxed at a lower rate of 5%, with the existing base being taxed at 12.5%, the revenue potential is $25b. Where all items attracting GST, including those currently exempt items, are taxed at 12.5%, the revenue increase is $40b.[26] In any case, the modelling demonstrates that even a slight change can have a significant impact on the revenue generated.

Option 1: Broadening the GST base – 10% GST imposed on a broader base (including fresh food, health and education)

The six most significant classes of GST-free or exempt items are fresh food, health, education, rent, childcare and financial services. Broadening the GST base to include some, if not all, of these categories may be an effective means to counteract declining GST revenue.

Importantly, while some behavioural change may be expected to follow an increase to the GST rate, studies have shown that spending on GST-exempt goods and services (particularly fresh food, health and education) is not materially affected by their price relative to other goods and services.[27]

Further, broadening the GST base would result in a GST framework which is simpler and more efficient. Studies undertaken by The Grattan Institute have demonstrated that:[28]

> "A broader based tax may have lower administrative costs as businesses which deal in both exempt and non-exempt goods simplify their accounting. Having fewer 'grey lines' between exempt and non-exempt categories reduces opportunities for tax avoidance and lobbying by rent-seekers for exclusion of particular goods."

Fewer exemptions result in a system that is cheaper to administer in the long run. This is true of the New Zealand GST system which has almost no exemptions.[29] Compliance becomes easier as taxpayers can understand the scope of the provisions without requiring higher levels of professional tax advice to determine whether particular consumption is within or outside of the scope of the GST. Ultimately, having fewer exemptions would also reduce the distortions and complexities that arise from applying the existing GST framework. It would helpfully eliminate the need to determine, for example, "whether Italian mini ciabatta is a 'cracker' (and therefore subject to GST) or 'bread' (and therefore exempt from it)".[30]

While fewer exemptions may have a greater impact on certain sectors of society, such as low- to middle-income earners, we consider that the most appropriate way to address any perceived inequity in the application of the GST regime is through the transfer system. By doing so, the problem of poorly targeted concessions is reduced, if not eliminated, and those households that are adversely affected are more directly compensated.

Option 2: Increasing the GST rate – a 12.5% to 15% rate of GST imposed on the existing base (without broadening the base)

The percentages suggested below are examples only. Further consultation and comprehensive modelling should be undertaken before a rate is determined, regardless of the option to be pursued.

Where a tiered rate system is applied to the current base, there should not be a substantial increase in administrative complexity as there will be no additional work required to determine whether an item is within scope but, rather, merely another calculation based on a different rate.

In 2020, standard VAT/GST rates across OECD countries stabilised at the record level of 19.3% (see Figure 2). As illustrated in Figure 3, compared to other OECD countries, Australia continues to have one of the lowest rates of VAT/GST. Worse still, since the introduction of the GST in 2000, there has not been a single change in the rate, whereas at least 23 OECD countries have increased their VAT rate, on average by 2.4%. Most countries have done so in response to economic pressures caused by financial crises.

Increasing Australia's GST rate may be an effective means to counteract declining GST revenue. As outlined above, a general increase to Australia's GST rate across all goods and services currently subject to GST should not be materially more or less efficient or costly to administer if it is to apply to the existing base.

Option 3: Broadening the GST base and increasing the GST rate (see below variations)

Other potential options for reform comprise a combination of both broadening the GST base and increasing the GST rate. Some examples are proposed below. Again, the percentages suggested below are examples only. Further consultation and comprehensive modelling should be undertaken before a rate is determined, regardless of the option to be pursued.

Option 3(a). A 12.5% to 15% rate of GST is imposed on the existing base and also equally on health and education.

Option 3(b). A 12.5% to 15% rate of GST is imposed on an even broader base (including fresh food, health and education) in addition to the existing base.

Option 3(c). A tiered system imposing GST at 5% for currently exempt goods and services and increasing the rate on currently non-exempt goods and services to 12.5% to 15%.

Whichever of these options is pursued, as noted previously, there will need to be appropriate compensation through the transfer system and a reduction in income tax rates to compensate low- and middle-income earners.

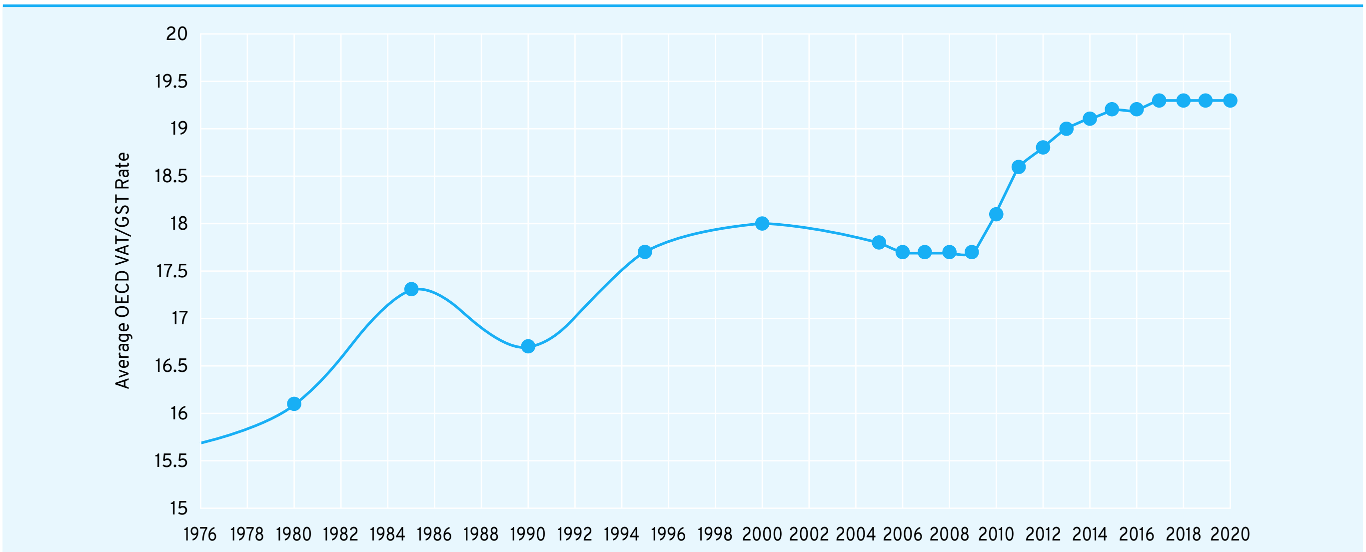
Specific areas for reform

There are certain aspects of the GST regime which contain unique issues and which we consider merit specific attention. These issues are not intended to be an exhaustive list of shortcomings within the current GST regime, but rather examples of certain areas where particular issues manifest and bespoke solutions may be required.

Financial services – issues and options for reform

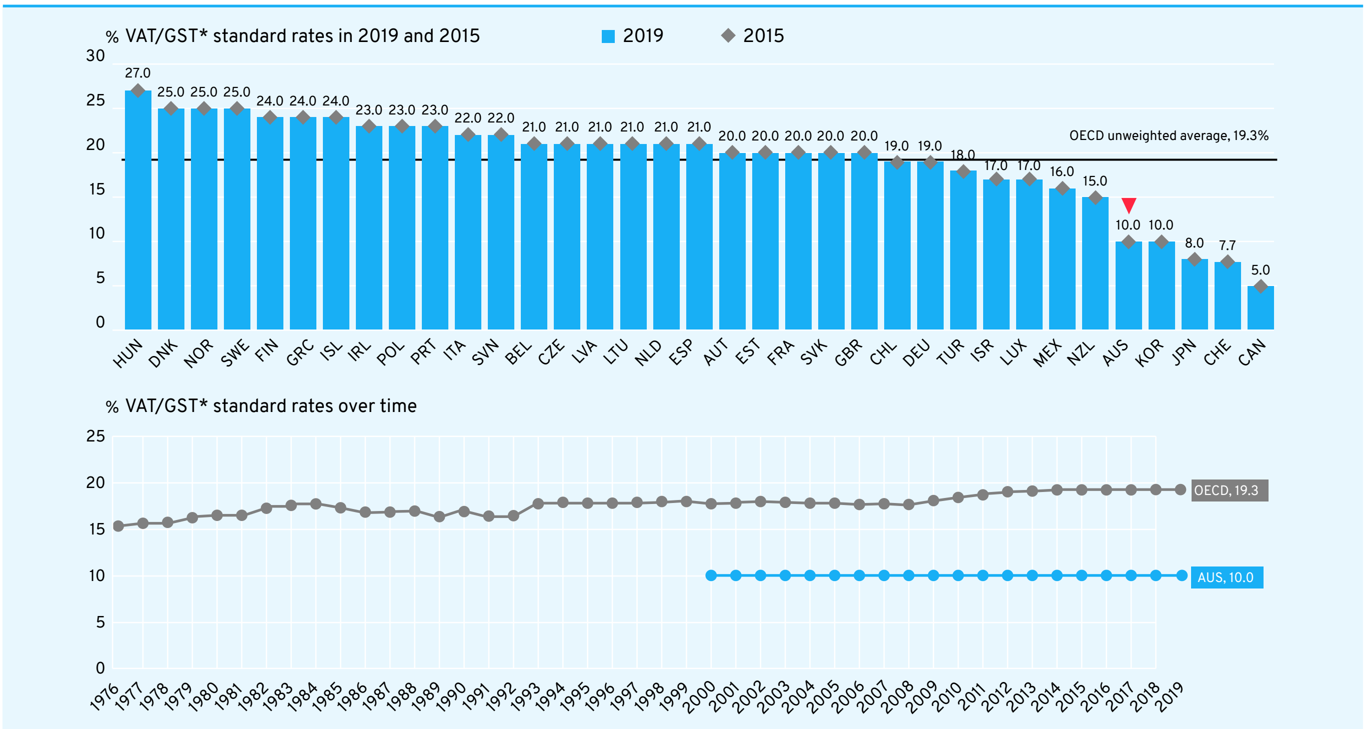
Full taxation of financial services under the GST Act. In recent years, the big four Australian banks have obtained an average return on equity of 15%.[31] This is significantly higher than average returns achieved by the major banks in most advanced economies.

Figure 2. Evolution of standard VAT/GST rates – OECD average 1976–2020



Source: OECD, *Consumption tax trends 2020: VAT/GST and excise rates, trends and policy issues.*

Figure 3. Standard VAT/GST rates across OECD countries and over time



* VAT/GST refers to value-added tax/goods and services tax.

Source: OECD, *Tax database*, 1 January 2019.

In Australia, as is generally common international practice in respect of other GST/VAT regimes, the financial services sector receives concessional input taxed treatment under the GST. The Treasury had estimated that the financial services sector would receive net tax concessions of approximately $12.4b from 2019 to 2022. This, of course, extends beyond the big four banks, though they are the major players in the industry. The major bank levy only partly offsets the cost of these GST concessions. While financial services are input taxed largely for the purposes of administrative ease, this is a significant lacuna in potential GST revenue and redress must be considered. There are several potential options for reform in this area.

Removal of concessional GST treatment for financial services. The lending and deposit-taking activities of the banking sector give rise to unique challenges in bringing financial services within the scope of the GST. While GST can be readily applied to bank fees, banks earn a large proportion of their income from the margin between their lending and deposit rates. It is not feasible to allocate such revenue to individual transactions so as to be able to apply GST in the usual way.

For this, essentially administrative, reason, most financial services are input taxed. This means that GST is not applied to the revenue generated from interest margins and input tax credits are denied for the GST attached to the inputs used in generating that revenue.[32] The result is a significant anomaly compared to other sectors of the economy.

Over the years, there have been numerous proposals to remove this tax concession by applying GST to financial services in a different manner. One such way is a supplementary financial tax (SFT).[33] An SFT does not require an allocation of GST to revenue attributable to individual transactions. Rather, it involves taxation of revenue from the interest margin income of banks, broadly on a bank-by-bank basis. It is noted that a similar approach applies to the collection of GST from gambling, whereby GST is allocated to the difference between money received and money paid out on an enterprise-by-enterprise basis.[34] An SFT ensures that, while interest margins are fully taxable, banks would receive full input tax credits, like other providers of fully taxable goods and services.

One shortcoming of the SFT, as originally proposed, is that it applies with respect to both household and business uses of financial services. This is contrary to the general approach under the GST regime, whereby registered business customers are able to claim GST input tax credits which effectively reduce their GST burden. The model of businesses claiming input tax credits is not feasible under the SFT because it is not allocated to individual customers.

However, if the SFT were to be charged to each financial institution at a discounted rate to proportionately reflect tax collected in relation to household (and not business) use, the SFT could operate as a purely consumption-based tax. For example, if 40% of the margin-based income of a financial service provider were attributed to business customers, the SFT rate would be discounted from 10% to 6% (assuming the current GST rate of 10% were to remain in place).[35]

This proposal can be compared to the New Zealand GST regime, which features such discounted rates. In this context, in New Zealand, GST input tax is applied, but discounted to reflect the business customer share of services. New Zealand grants input tax relief determined by reference to business-to-business financial supplies. It has adopted a broad definition of financial services, akin to the EU model. The GST treatment of financial services between GST-registered entities changed in 2005 from input taxation, whereby no GST was applied and no input tax credits were claimed, to GST-free treatment, whereby no GST applies and input tax credits may be claimed. The impetus for the reform was the flow-on effect arising from embedded GST in business-to business transactions.[36] The rules allow an additional input tax deduction for financial service providers by reference to the taxable status of the recipient of the relevant financial supply. While the approach does not impact the amount of output tax paid, by treating financial supplies as GST-free and not input taxed, financial service providers qualify for higher input tax relief.

The approach adopted in New Zealand reduces the GST cost to financial institutions to the extent that their customer base includes other GST-registered businesses. By reducing GST costs at the intermediate level of production, it improves efficiencies but does have the effect of reducing revenues.[37] To the extent that full relief is available because the financial institution is GST-free, the bias in favour of self-supply is eliminated and efficiency is increased.[38] However, the relief from the cost of GST on inputs for financial institutions does not necessarily flow through to the recipients of the relevant supply in the form of a reduced price.[39]

Financial institutions that operate at the household level incur a higher cost structure compared to those at the wholesale level. As a result, there would generally be distortions that occur due to lower rates of return, assuming that the input tax costs cannot be passed on to those households.[40] Further, the New Zealand system imposes GST costs on outsourcing (whether domestically or offshore) to the extent that the financial institution cannot access business-to-business relief. This means that, for financial service supplies to households, self-supply and offshore competition distortions remain.

In terms of administrative feasibility, in principle, this kind of apportionment should be no more complex than other kinds of apportionment. This is not to say that existing methods of apportionment have been easy to come by, let alone to achieve consensus. However, there is a breadth of ATO guidance in this area from which learnings may be drawn.[41] And, indeed, given that many New Zealand institutions are subsidiaries of Australian financial service providers, it is expected that there would be learnings and experience that could be carried across.[42]

Implementation of an SFT requires a clearly defined tax base, being the interest margin income of banks. Given that the GST is a cash flow-based tax, one option for defining the tax base is a cash flow measure of income from financial intermediation.[43] In these circumstances, the cash flow is equal to the inflows from new deposits and interest received on loans, net of the outflows from new loans and interest paid on deposits.[44]

Alternatively, an accrual measure of income from financial intermediation could be implemented. The premise of this method is that financial service providers generate income by charging more than a reference rate for loans, while paying less than the relevant reference rate for deposits.[45]

To reduce complexity, the tax base could be limited to only interest income from loans net of interest payments on deposits. However, this ignores the cost of funding any gap in the difference between the value of loans and the value of deposits, whether through debt and/or equity, which is taken into account under the first two approaches.[46]

Successful implementation of an SFT would therefore require inclusion of discount rates to reflect the business customer share of services, effectively accommodating for the input tax credit. It would also require a clear definition of the tax base, that is, the interest margin income of banks.

In addition to introducing substantial operational and compliance obligations for financial institutions, an overarching concern relates to the passing on of costs. While the economic impact of taxing the consumption of financial services is uncertain as it is largely untested, it is likely that customers of financial service providers will bear the ultimate cost, rather than the financial institutions themselves. This is because costs including the additional GST revenue, and potentially related expenditure such as in relation to compliance costs, are likely to be passed on to customers. This may also have a broader impact on the availability of credit. The relative incidence of such a change should be carefully considered and comprehensively modelled.

Luxury items – issues and options for reform

Imposing a higher GST rate for luxury items (compared to basic items) could raise additional GST revenue without exacerbating the impact of a rate increase on low- to middle-income earners, as discussed above. On the contrary, depending on how a tiered rate system is structured for basic versus luxury items, a tiered system has the potential to lessen any regressive effect of the GST. Nonetheless, it must be acknowledged that differentiated rates, generally, fly in the face of simplification of the tax system more broadly.

Luxury items may be considered, broadly, as those items that are non-essential. However, without adequate consideration, introducing a tiered system of this kind could introduce a higher degree of complexity into the tax system. As a starting point, this is envisaged to encompass luxury cars and other vehicles (not necessarily the same as for FBT purposes), high-end electronics, and alcohol and tobacco, rather than the kinds of products stocked in supermarkets or similar venues. In the case of luxury cars, it should be noted that the existing rules in this area are implicitly archaic in that they become particularly problematic in the context of electric vehicles, which were not contemplated at the time such provisions were introduced. Since electric vehicles are generally more expensive than the equivalent fuel-powered cars, they are more likely to attract luxury car tax, in addition to standard upfront costs like GST and duty.

This makes the upfront cost of an electric vehicle potentially far more than a fuel-powered car, despite the electric car not necessarily having any 'luxury' characteristics.

In the context of food, it is acknowledged that there may be some types of food found in supermarkets or their equivalents which are relatively expensive and could potentially fall into the 'luxury' category. However, we are of the view that simplicity should prevail over any risk of leakage in this regard. This is particularly important in the context of food, given the high level of complexity and associated compliance burden surrounding the categorisation of food.

It is noted though that, given that this level of differentiation for the purposes of a tiered rate system is not currently a feature of the GST regime, there is currently insufficient reliable data on consumption patterns in respect of particular items which would fall at various points on the spectrum from basic to luxury. Further comprehensive research is required to appropriately categorise items and to inform a suitable rate structure.

Options for reform

- Establish a non-partisan, independent tax policy and reform commission to undertake a comprehensive review of the Australian tax system at the state and federal levels and to manage a process of tax reform, including the development of underlying tax policy.
- As part of a holistic package of reform which shifts reliance away from personal and corporate income taxes:
  - increase the GST rate by at least 2.5% from 10% to 12.5%, with a view to future incremental increases to align more closely with the OECD average; and
  - broaden the GST base to include goods and services currently exempt or otherwise GST-free, at a minimum at a lower rate, otherwise at a single rate as suggested above.

Conclusion

The debate surrounding GST must be depoliticised. If we are serious about tax reform and ensuring our tax system is more resilient, there needs to be an informed debate around the tax mix and the merits of reforming both the base and rate of GST. The scaremongering needs to be parked and full consideration given to how potential inequities arising from GST reform can be more appropriately addressed through the other elements of the tax and transfer system.

The Tax Institute

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Superannuation death benefits: nomination options

by Kym Bailey, CTA, Technical Services Manager, JBWere

Self-managed superannuation funds are a flexible investment structure for housing superannuation savings. However, care is required to ensure that the opportunities are able to be successfully navigated. While unplanned tax is often the main consequence of inappropriate superannuation structuring, when it comes to death benefits, there can be wider implications, including the usurp of the member's legacy objectives. A common misconception is that a person's will is sufficient to ensure that their superannuation lands where they expect it to. Other misconceptions include a broader range of potential beneficiaries than the law permits and, for SMSFs, to whom, and how, death benefits can be paid. Recent case law has provided further guidance on the correct interpretation of SMSF death benefit processes and helps to provide some clarity around the common misconceptions. This article provides a guide to considerations for appropriate superannuation succession planning by straddling the various laws and judicial interpretations.

Introduction

The lifespan of superannuation can be described as comprising three broad phases: the build, the spend and the ultimate disposal.

More formerly, the build phase is the accumulation phase where a member builds their balance prior to retirement. Following retirement, the de-accumulation (spend) phase is where the member draws their superannuation to support lifestyle. The third phase of the superannuation lifespan is succession following the member's death.

While the first and the middle phases are reasonably well understood, superannuation succession is complex, with many considerations in play including the potential for tax to apply to the death benefit. This alone is possibly the most underestimated component of superannuation, along with misconceptions around how superannuation capital interacts within the broader estate of the deceased.

There are strict rules around all aspects of superannuation, including providing the general framework for the payment of death benefits. In the first instance, it is the trustee who decides how and to whom the death benefit will be paid. Provided the decision is made in accordance with the terms of the fund's trust deed and the legislative requirements, it will stand.

Remembering that superannuation funds are a form of a trust, it is important to consider trust and case law on top of the specific superannuation and tax law that applies.

The High Court provided three factors required for the effective exercise of trustee discretion in *Finch*:[1] to act in good faith; to give real and genuine consideration to the exercise of the discretion; and to ensure that the reasons for the decision are sound.

As the membership is also the trustee for an SMSF, superannuation succession is at its most flexible. However, this can also present the biggest risks to the successful disposition of a deceased's member's balance. De-risking death benefit decision-making made via trustee discretion involves the use of "nominations".

This article delves into the issue of nominations and how, when and why they may be used to craft a better succession outcome for a particular member.

Rule 1: Superannuation is not an estate asset

On the death of a member of a superannuation fund, the trustee of the fund is required to attend to the payment of the deceased's superannuation benefits, not the person's executor.

Rule 2: Tax must be understood

In order to understand where tax applies to a superannuation death benefit, it is necessary to understand the categories of superannuation dependants.

Table 1 sets out allowable superannuation beneficiaries and categorises them as either a "tax or non-tax dependent". The "dependant category" varies between superannuation law and tax law which influences the form of the payment, and the tax treatment. Adult children and former spouses are two of the key differences.

The taxing of superannuation death benefits is briefly discussed.

The member's LPR is one of a limited range of beneficiaries potentially eligible to receive a superannuation death benefit and, as such, care is required when developing an estate plan to consider the nuances associated with superannuation benefits.

Table 1. Allowable superannuation beneficiaries

Dependant[2] category	Tax dependant (tax-free)	Non-tax dependant (tax at 15% on taxed component)*	Allowable form of death benefit payment	Note
Spouse	Yes	na	Lump sum, pension (including reversionary pension).	Includes de facto and same sex spouse.
Former spouse	Yes	na	Lump sum to LPR.	Tax-free, but must be paid via the estate.
Child	Children aged under 18 years or disabled child of any age.	Children aged over 18 years.	Children aged 18–25 years can be paid pension, including a reversionary pension. No pension if not dependant after 18 years of age. Exception for a disabled adult child.	Includes birth, adopted, step-child, child of a spouse (as defined in s 4 of the *Family Law Act 1975* (Cth)).
Financial dependant	Yes	na	Lump sum, pension (including reversionary pension).	Can include child aged 18–25 years if studying or otherwise dependent.
Member of an "interdependency relationship"	Yes	na	Lump sum, pension (including reversionary pension).	Two persons (whether or not related by family) have a close personal relationship, live together and one or each of them provides the other with financial and domestic support and personal care.
LPR	If paid to spouse, minor child or other dependant.	If capital paid to adult children or other beneficiaries of the will, no requirement to be superannuation beneficiaries (eg former spouse).	The LPR deals with the superannuation in accordance with the testator's instructions. Superannuation pensions not available but testamentary trusts can be used for superannuation proceeds.	The person's will determines the destination of the superannuation proceeds and thereby the tax implications.

* Superannuation components that have had taxed applied, eg superannuation guarantee charge, salary sacrifice, earnings on invested capital.

Making the death benefit decision

The trustee of a superannuation fund is required to "cash" a deceased member's benefits "as soon as practicable".[3]

When making the death benefit decision, the fund trustee must consider the following:

- member nominations;
- the fund's trust deed; and
- superannuation law.

Where there is no member nomination in place, the trustee must pay the death benefit in accordance with the fund's trust deed and the superannuation law.

The existence of a valid member nomination may streamline the death benefit payment process by removing some, or all, of the trustee decision-making.

The discussion below focuses on the member nomination category as this is where a person can actively consider the best structuring option for their superannuation estate planning.

Death benefit nominations

Nominations can take the form of:

- a non-binding death benefit nomination;
- a binding death benefit nomination (BDBN) – this can be non-lapsing or time-restricted, if the deed permits; or
- a reversionary pension.

Death benefit nominations can be made in favour of all beneficiary categories. However, reversionary pension nominations are restricted to a subset in the category of dependants.

The LPR is *not eligible* to be a reversionary pension beneficiary, which means that the option of a death benefit pension is not available. The trustee must pay the death benefit out of the superannuation fund to be dealt with as an estate asset.

Death benefit nominations can be made in favour of more than one beneficiary. However, the allocation to all members must not exceed 100% of the deceased's superannuation member balance in the fund.

A reversionary pension can only have one beneficiary nomination.

Table 2 sets out some of the considerations for each type of nomination that is potentially available to members.

Nominating the LPR

Included in the short list of eligible beneficiaries of a superannuation death benefit is the LPR,[4] which includes the executor of the deceased's will or the "administrator" under a grant of administration (intestate estates).

The LPR, however, does not look to the terms of the deceased's will, or the grant of administration, when acting for the deceased superannuation member. It is only where the superannuation is cashed in favour of the LPR that the terms of the will decide the destination for the capital.

Once a superannuation fund trustee pays the death benefit to the LPR, the executor must determine whether the distribution of the superannuation capital is taxable. Proceeds paid to a tax dependant are tax-free, including where the capital is distributed to a testamentary trust where the sole capital beneficiary is a tax dependant.

Table 2. Pros and cons of alternatives for death benefit instructions/actions

	Pros	Cons
Reversionary pension	Pension continues on the death of the original pension holder. No administrative duties for the grieving widow/er. The reversionary beneficiary can continue to receive their own pension for a 12-month period after death without needing to adjust their transfer balance cap (TBC).	Timing risks include: • uncertainty regarding the optimal time to commute the survivor's pension to maximise their TBC; and • SMSF trade-off decisions are required regarding: • pension drawings from two pensions versus a reduced exempt current pension income (ECPI) percentage if the survivor commutes earlier than the 12-months after death; and • commuting at the date of death versus anticipating favourable market movement in the following 12 months.
Death benefit pension	Trustee discretion as to the timing of the commencement of the pension (within limits of a "reasonable period"). Can marry up the timing of the dependant's pension commutation. No requirement for a minimum pension to be paid from the death benefit pension in the year of death. ECPI percentage is not impacted.	The survivor, as a trustee, must actively deal with the death benefit. There is no 12-month grace period.
Non-binding or no nomination	Trustee discretion to determine the form and beneficiary of the death benefit. Ensures flexibility is available if legislative changes provide favourable options.	Trustee discretion to determine the form and beneficiary of the death benefit. May be impacted by unfavourable legislative changes. SMSFs require consideration of trustee succession to ensure the success of the implementation of the deceased's wishes.
Binding nomination	Certainty as to the beneficiary of the death benefits. Can also be used to provide certainty as to the form of the death benefit. Useful if mental capacity is lost. Preferred for the last of a couple as the LPR will step in to make the death benefit decisions and payment.	Inflexibility. If non-lapsing, it is important to review regularly for currency to ensure that the settings remain appropriate. Loss of mental capacity can limit alteration opportunities. An SMSF trust deed is the primary authority for a BDBN so nomination can be invalidated if it is not in accordance with the deed.[5]
Direct payment to beneficiary	Superannuation is able to be paid promptly to the beneficiary(s) which is useful from a cashflow/liquidity perspective.	Capital has no asset protection. Asset protection needs to be considered for direct superannuation distribution strategies. Non-tax dependants are impacted by tax on the tax component including the Medicare levy.
Payment to the estate	Testamentary environment provides a larger range of potential beneficiaries as well as potential asset protection features, and can provide tax management opportunities. No Medicare levy is paid on the taxed component of the death benefit if the ultimate beneficiary is a non-tax dependant.	Structuring of the will is required to manage the potential for tax to be paid on the death benefit. Testamentary trust and superannuation proceeds trusts should be considered. Delays may occur in estate administration leaving beneficiary(s) without access to the capital for a period of time.

If the proceeds are paid to a non-tax dependant, the executor must withhold 15% from the taxable component.

The executor is not required to withhold the Medicare levy from the payment of a superannuation death benefit.

Binding nominations and SMSFs

Recent case law[6] has provided the definitive position on BDBNs and SMSFs. The High Court confirmed that the trust deed of an SMSF is the primary authority for the making of member nominations, and the decision also provided confirmation of the ability for the deed to provide the authority to make an existing pension reversionary. The law has been confirmed so, in the first instance, a thorough review of the SMSF's trust deed is required *before* a member nomination is made. If the deed incorporates the requirements of reg 6.17A SISR, the trustee is bound by the same requirements as large funds.

Importantly, an SMSF deed should provide a "tie-breaker" where the member nomination includes both the option of a BDBN and a reversionary beneficiary nomination. Where there is doubt in the deed, a competing nomination may cause the death benefit decision-making to revert back to trustee discretion.

Reversionary versus non-reversionary pensions

The automatic reversion of a superannuation pension following the death of the primary beneficiary is a "peace of mind" strategy as it provides for continuity of superannuation payments without immediate administrative intervention.

The pension continues based on the deceased's pension settings up until 30 June in the year of the death.

From 1 July of the financial year after the primary beneficiary passed away, the pension settings are based on the reversionary beneficiary's age and the market value of the pension. However, the pension is in the name of the beneficiary and, if the terms of the pension are not restrictive, the reversionary beneficiary may simply commute the pension and take the proceeds. There is a common misconception that the death benefit can be pooled in an accumulation account but, if a reversionary pension is commuted, partially or fully, the capital must leave the superannuation fund.

The only exception to this rule is where a reversionary member requests the roll-over of the capital to another superannuation fund and agrees to immediately start a new death benefit pension.[7]

A key difference with a non-reversionary death benefit pension is that, when a member dies, their pension ceases immediately, and no minimum pension is required in the income year of the death.[8]

On the other hand, if a reversionary pension continues, the minimum pension is required to be paid by June 30 in the year of death. The other difference is the reporting against the beneficiary's transfer balance account (TBA). A death benefit pension that has not reverted is credited to the beneficiary's TBA as at the commencement of the pension, compared with the 12-month grace period for a reversionary pension.

Table 3 provides a comprehensive summary.

In conclusion – to nominate or not

There is no one strategy for the structuring of superannuation death benefits as it depends on a raft of individual factors and contingencies.

The wishes of the superannuation member will vary according to their personal circumstances, in addition to the priorities and objectives that they have for capital distribution following their death.

Tax is often a key driver of death benefit structuring decisions; however, asset protection can outweigh tax as a priority for others. The needs of the beneficiaries are also key determinants for designing an optimal death benefit strategy.

Superannuation and tax law must also be considered.

Rules of thumb

The following "rules of thumb" are provided to stimulate thought around some of the key planning considerations for building appropriate superannuation succession strategies and serve to highlight the flexibility that SMSFs provide for members.

Table 3. Non-reversionary pension versus reversionary pension

Non-reversionary pensions	Reversionary pensions
Timing	
The deceased's pension ceases on the date of death. The death benefit pension commences when the death benefit is cashed by the trustee. The law requires this to be "as soon as practicable" after the member's death.	The pension reverts (eg to the surviving spouse) automatically on the deceased member's death. This is the date "cashed" for the death benefit. The pension retains its character as a death benefit permanently, ie it can never form a part of the recipient's accumulation balance. However, it can be rolled over to another superannuation fund to commence a new death benefit pension. Subject to the fund's trust deed, the beneficiary can commute the death benefit pension and have the capital paid as a lump sum.

Non-reversionary pensions	Reversionary pensions
Minimum pension payments required	
No pension payment is required in respect of an account-based pension in the financial year of death due to an administrative concession afforded by the ATO.	A minimum pension payment is required in the financial year of death. The payment is based on the deceased's pension factor for the financial year of death. Thereafter, the pension factor is as per the beneficiary's age as at the start of the financial year, as well as the beneficiary's total superannuation balance.
Extension of the ECPI exemption	
A non-reversionary pension ceases when a member dies. However, the ECPI tax exemption can continue after death until the death benefit is "paid". The trustee is required to make the payment as soon as it is practicable as either a lump sum or a new pension. The ECPI calculation includes the period between death and the trustee decision on the death benefit payment. There is no definitive guidance on what "as soon as practicable" means. However, if payment of a lump sum or commencement of a new pension is delayed beyond six to eight months, there should be sound reasons and not merely tax considerations or convenience. Any new pension is subject to the recipient beneficiary's TBC.	A reversionary pension does not cease on the death of the primary beneficiary and therefore the ECPI percentage continues to apply to the capital unless the minimum annual pension is not drawn. If the pension ceases due to the minimum pension not being drawn, the trustee must ensure that the death benefit capital is paid as soon as practicable as either a lump sum or a new death benefit pension. The 12-month grace period for TBA reporting no longer applies. If the pension is required to be partially commuted to bring it down to the level of the beneficiary's TBC, the pension is still running and the ECPI% is not impacted.
Transfer balance account	
If a death benefit pension is paid, the TBA credit occurs when the pension commences. The TBA credit value is the market value of the pension capital at the time the death benefit pension starts (on the date the trustee commences the pension). If the beneficiary has a pension in force: • in a growth market, this is a marginally more adverse outcome than a reversionary pension as the recipient's TBA is credited for the current market value of the pension capital; or • in a declining market, this is marginally more positive than a reversionary pension.	The TBA credit occurs 12 months after the deceased member's death. TBA credit value is the market value of the pension capital at the time of the deceased member's death. In a growth market, this is positive as the value of the assets may have increased above the corresponding credit value in the recipient's TBA. In a declining market, this is an adverse outcome as the recipient's TBA is credited at the date of death valuation which is higher than the current market value of the pension capital.
Centrelink and Department of Human Services	
Asset test eligibility grandfathering for certain Centrelink concessions is lost for the fresh pension in relation to: • the Age Pension; and • the Commonwealth Seniors Health Care Card.	Asset test eligibility grandfathering for certain Centrelink concessions is preserved for the pension in relation to: • the Age Pension; and • the Commonwealth Seniors Health Care Card.
Practical considerations	
Additional documentation and administration required includes: • commutation documentation; • a statement of advice may be required in relation to the commencement of a death benefit pension; and • pension commencement documentation. If a lump sum is paid to the LPR, a testamentary disposition (ie of the superannuation proceeds) from the estate may be delayed due to probate or challenges against the estate.	The pension continues automatically, and the reversionary pensioner has immediate access to cash flow. This may save considerable attendances and costs.
Tax-free versus taxable component	
Broadly, providing nothing other than investment earnings are being added to the income stream on death, the taxable versus tax-free components of the pension are maintained.	The continuation of the pension on death means that the taxable versus tax-free components are preserved.
Life insurance in an SMSF	
If a life insurance policy is held in the SMSF and premiums were being paid from the deceased's pension account, proceeds will broadly form part of the taxable component.	If a life insurance policy is held in the SMSF and premiums were being paid from the deceased's pension account, the proceeds will broadly take on the proportions of the pension interest as at the date of the pension's commencement.

1. For an SMSF, where both members of the couple are alive, the need for nominations and specific superannuation death benefit planning is not as critical. This assumes that both are each other's LPR and that there is no obvious disfunction that may require more bespoke planning.

Keeping the superannuation death benefit structuring fluid allows the eventual survivor to respond to changes in the legislative environment and their own family circumstances.

Where individuals are members of a superannuation fund other than an SMSF, utilising the fund's nomination process is recommended to provide instructions to the trustee. The fund's range of options should be well understood.

2. Where superannuation is held via an SMSF, additional considerations are required following the death of the first of the couple.

Superannuation succession planning is recommended and the nomination of the member's LPR is critical to the success of the death benefit payment process.

Binding nominations create certainty and, providing they are made in accordance with the provisions in the trust deed, should withstand the risk that the death benefit is paid against the member's wishes.

3. A reversionary pension creates administrative ease for the survivor at a time when their grief is at its highest, and this may be reason enough to use this strategy.

In a rising market, a reversionary pension may result in the survivor's TBC being expanded and therefore more capital can potentially remain in the superannuation environment. On the other hand, if there is less optimism about the market direction, a decision about the survivor's optimal pension commutation point will be required. Either strategy involves some judgment, and even guesswork.

If the beneficiary has a pension running at the time of death of the primary beneficiary, a prudent strategy may be to commute the survivor's pension as at the date of death to remove market risk, as well as to limit the level of pension drawings required to be paid in the financial year.

The downside of this option in an SMSF is the exempt pension income percentage will be lower, which may result in a higher level of tax paid in the superannuation fund.

4. A non-reversionary pension stops on the death of the primary beneficiary and the trustee must decide on the death benefit payment in accordance with the trust deed and any nominations on file. This option provides discretion to sync the timing of the survivor's commutation and the commencement of the death benefit pension, which may be beneficial for TBC maximisation.

5. Superannuation death benefits destined for the estate should be done in conjunction with a review of the member's will, as the terms will decide the ultimate beneficiary.

A surviving spouse is entitled to receive superannuation death benefits tax-free, regardless of the (tax) components and regardless of how the benefit is paid to them. However, where superannuation is directed to the estate, care is required to ensure that the superannuation does not "pool" with other estate capital and have its tax effectiveness diluted. For example, this may require the inclusion of a specific testamentary trust that nominates the spouse as the sole capital beneficiary. Legal advice should be sought for will construction.

Superannuation paid to the LPR for distribution to a non-tax dependant avoids the imposition of the Medicare levy — a 2% savings in tax against the taxable component.

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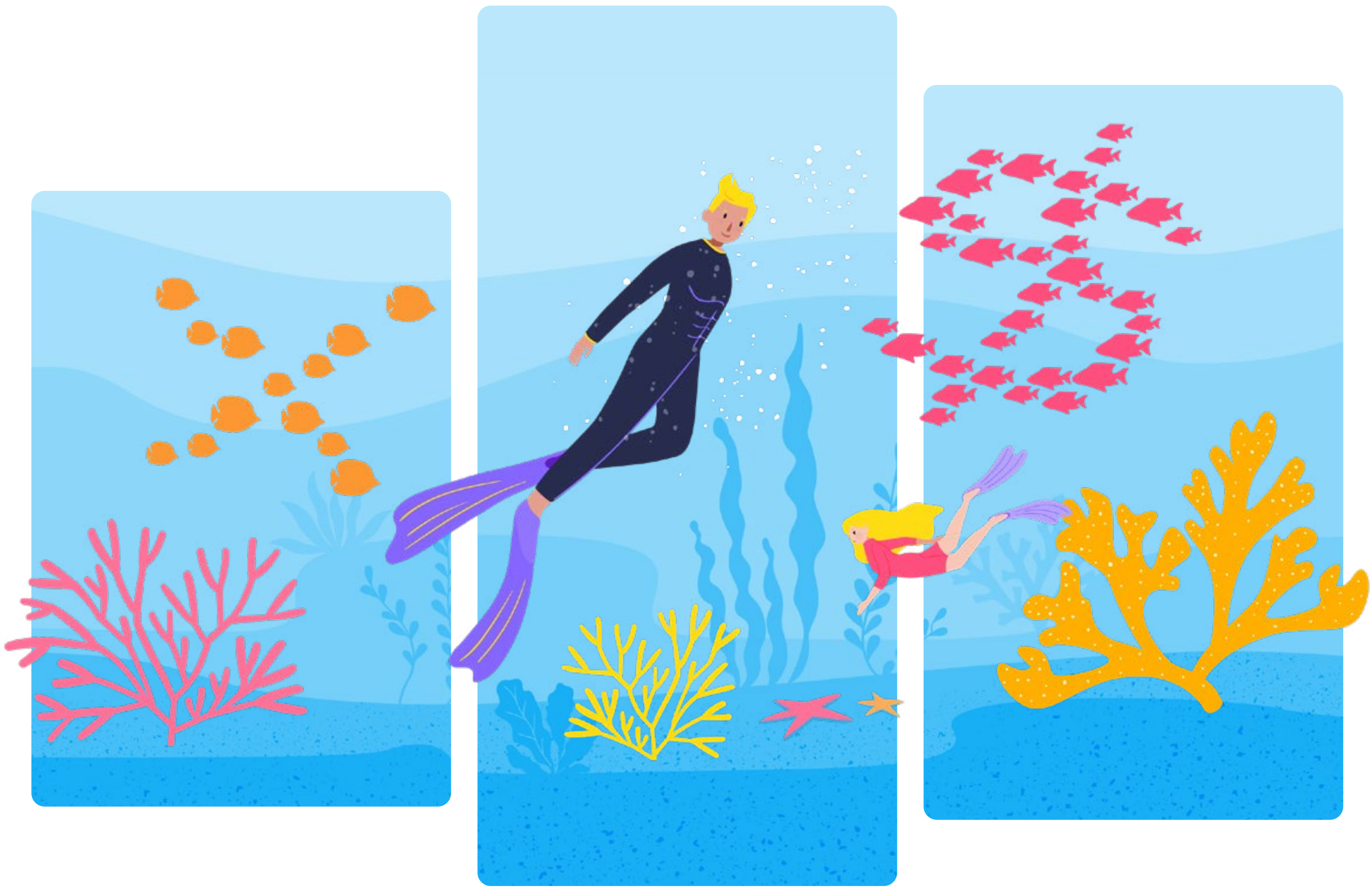
4 S 10 SISA. "Legal personal representative" is defined for a deceased member, a disabled member or a member with an EPOA.

5 *Hill v Zuda Pty Ltd* [2022] HCA 21.

6 *Hill v Zuda Pty Ltd* [2022] HCA 21.

7 Reg 6.21(3) SISR.

8 TR 2013/5.



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Reversing the onus of proof in tax matters

by Richard Bobb, CTA, Chartered Accountant, Encountr Tax Advisory

This article is designed to provoke a dialogue on the merits of levelling the playing field in certain tax disputes, and it offers a potential pathway to achieving that goal. Tax reform is an ongoing process and reformation of the "onus of proof" provisions in the *Taxation Administration Act 1953* is due for some further consideration as part of levelling the playing field. In March 2015, the House of Representatives Standing Committee on Tax and Revenue recommended the reversal of the onus of proof in certain circumstances, namely, where the Commissioner alleged fraud or evasion. This was set out in the Committee's report, *Tax disputes*. The then Commonwealth Government's response, however, was to give these recommendations "short shrift" and, consequently, they were never adopted. The author's view is that the Committee's recommendations were meritorious and the article offers some alternative solutions if the current Commonwealth Government maintains the same position as the former government.

Introduction

This article will focus on the legal burden of proof, in Commonwealth taxation matters, arising from disputes between taxpayers and the Commissioner.[1] Where the term "onus" is used instead of "burden", and vice versa, it is acknowledged that these are interchangeable terms with the same meaning for the purposes of this article. Also, any reference to the "Commissioner" or the "Australian Taxation Office" or the "ATO" are similarly intended to be interchangeable.

The Commissioner is responsible in administering and collecting a range of Commonwealth taxes. This article, however, will be limited in scope to income tax, as assessed under either the *Income Tax Assessment Act 1936* (Cth) (ITAA36) or the *Income Tax Assessment Act 1997* (Cth).

When addressing the legal burden of proof, this article will not extend to cover the evidential burden and certain legal presumptions concerning the law of evidence.[2]

It is hoped that the content of this article will be the genesis of reforming the tax law on the issue of the legal burden of proof in tax matters.

The onus of proof in tax matters

A taxpayer has always had the onus of proof in tax proceedings, regardless of whether it is:

- a review of an objection decision under Pt IVC of the *Taxation Administration Act 1953* (Cth) (TAA53);
- a review under the *Administrative Decisions (Judicial Review) Act 1977* (Cth); or
- an application for declaratory relief pursuant to s 39B of the *Judiciary Act 1903* (Cth).

This article is in two parts. The first part sets out the current position around the onus of proof in tax matters, and the second part offers, in the author's opinion, suggested sensible reform.

At the outset, it should be stated that the onus of proof is a different concept to the standard of proof, as it forms part of the taxpayer's burden. The taxpayer's onus of proof under ss 14ZZK and 14ZZO TAA53 comprises two parts:

1. establishing, with evidence, the underlying facts on which the law is to operate (and in this regard, the standard of proof to which each fact must be proved is relevant); and
2. that the operation of the law, when applied to those facts, establishes that the assessment is excessive.

Various court decisions over the years have provided useful commentary on the taxpayer's burden of proof, but the sufficiency of evidence to overcome the burden of proof has very recently been articulately and succinctly set out by Steward J in *FCT v Cassaniti*.[3] His honour had this to say about the *sufficiency* of evidence to overcome the burden of proof:

> "Contending that evidence was 'insufficient' in the face of three sworn affidavits of the respondent, together with the exhibits attached thereto, and her answers in cross examination, may suggest that a taxpayer bears a special burden of proof. However, other than the necessity to scrutinise evidence given by the taxpayer him or herself with care, no such special burden exists. This is a case in which the taxpayer seeks declarations. The following propositions, derived from the judgment of Hunt J in *Allied Pastoral*, apply equally to a tax appeal made to this Court pursuant to s 14ZZ of the TAA as well as to other forms of revenue proceedings, such as here, the seeking of declarations against Commissioner:
>
> (1) first, where the onus is on the taxpayer (whether pursuant to s 14ZZO of the TAA or otherwise) the degree or standard of proof required is that which ordinarily applies in civil proceedings. The direction given to a jury in civil cases aptly describes that onus by reference to a pair of scales and to the arguments of each party being placed at each end. As Hunt J said in *Allied Pastoral*:
>
> > … if the plaintiff succeeds … in weighing down those scales ever so slightly in his favour then he has discharged the burden he carries …

(2) secondly, for that purpose it is not obligatory for a taxpayer, in order to discharge his burden of proof, to call all material witnesses and to produce all material documents which support her or his or its position;

(3) fourthly, there is no requirement that evidence can only be accepted as admissible and probative if it is corroborated;

(4) fifthly, the tribunal of fact is free to accept the evidence of the taxpayer alone if it finds the taxpayer to be truthful;

(5) finally, it would usually be prudent to corroborate the evidence of a taxpayer. It is also prudent to adduce contemporaneous objective evidence. But prudence should not be confused with the requirements of the law."

In *Ma v FCT*,[4] Burchett J offered one possibly acceptable approach to discharging the burden in an asset betterment case:

> "… if a taxpayer denies any undisclosed source of income, provides acceptable evidence of how he spends his time, and demonstrates a reasonable explanation for any appearance of the possession of assets, he will generally discharge his burden of proof unless some positive reason is shown why he is to be disbelieved. Any other view would introduce a degree of arbitrariness into liability for tax."

In *FCT v Dalco*,[5] the High Court held that, to succeed, the taxpayer must not merely show an error in the Commissioner's method of determining the assessable income, that is, by showing he calculated the assessable income on a wrong basis; rather, it must show that the amount of the assessment is wrong. Brennan J (Mason CJ agreeing) explained it in the following terms:[6]

> "Unless the amount of the assessment is found to be excessive in the sense of being greater than the taxable income on which tax ought to have been levied, the taxpayer fails on his appeal."

The author is particularly grateful to Mr Heydon Miller of counsel for his scholarly 2016 paper, *Prove it – evidence in indirect tax matters*, and that part of his paper that lays out the legal burden from the objection stage through to the Administrative Appeals Tribunal and then to the Federal Court.[7]

Reversing the onus of proof: issues for consideration

It is felt that the time is right to consider some possible areas to reform the law around the taxpayer's onus of proof in Pt IVC TAA53 proceedings.

Where the Commissioner appeals from the tribunal/lower court

1. There is no particular justification to maintain the taxpayer's burden of proof where a taxpayer has been successful, at first instance.

2. The usual position, in private civil litigation, is that the person who wishes to commence proceedings carries the burden of proof. A successful plaintiff in civil proceedings does not continue to carry the burden of proof if the unsuccessful defendant chooses to lodge an appeal. It is submitted that there should be no difference if the Commissioner loses to the taxpayer and then decides to appeal.

3. Application of the rules of civil litigation should apply equally to all civil litigants, regardless of whether the Commissioner is a party to the proceedings or not.

4. The above viewpoints accord with a sense of procedural fairness, and do not place the Crown in a privileged position vis-à-vis other civil litigants.

Where the Commissioner considers there has been fraud or evasion

1. There is a case to be made that, where a serious allegation is made, such as some act or omission said to constitute fraud or evasion, the Commissioner bear the onus of proof, rather than the taxpayer.

2. The reason for reversing the usual onus of proof in tax matters, in the first instance, is because the allegation:

a. is very serious (and should not be made lightly) and has the capacity to extend (without limit) the limited amendment period, as defined;[8]

b. can potentially destroy (at worst) or impugn (at best) the public reputation of a taxpayer, notwithstanding that a taxpayer may seek remedy via the law of defamation;[9] and

c. covering the prospect of a huge historical expanse is, more likely than not, to cause enormous difficulties in retrieving outdated crucial records, and seeking the testimony of individuals who may have passed away or who may be unwilling to give supporting evidence due to a falling out or estrangement with the taxpayer.

3. In March 2015, the House of Representatives Standing Committee on Tax and Revenue published a report titled *Tax disputes* which made three separate recommendations for the ATO to revise its practice in issuing opinions on fraud or evasion, and a further recommendation for the Commonwealth Government to make changes to the law placing the burden on the Commissioner to prove fraud and evasion after the elapse of a certain period.[10] That recommendation appears below:

> "The Committee recommends that the Government introduce legislation to place the burden of proof on the Australian Taxation Office in relation to allegations of fraud and evasion after a certain period has elapsed."

The Commonwealth Government declined to act on that recommendation, noting in an unsigned, unattributed response released eight months after the report:[11]

> "The question of whether 'fraud' or 'evasion' exists is already adequately dealt with in tax-related litigation, as may be seen from the relatively small number of

reported cases on this question. In effect, the AAT and Federal Court currently consider whether the ATO position on this question is sustainable on the evidence before them. *Apart from review of such claims, a shift in the burden of proof to the ATO after a certain period has elapsed would be counter-productive and encourage sham behaviour by taxpayers associated with fraud and evasion.* It would also unnecessarily complicate the tax-related litigation process and unduly confuse concurrent collection processes for cases involving potential 'fraud' or 'evasion'." (emphasis added.)

With all due respect to the Commonwealth Government response, it is difficult to understand how the Administrative Appeals Tribunal or the Federal Court can provide administrative or judicial oversight unless the decision to form the opinion on fraud or evasion can be separately tested via an amendment to the *Administrative Decisions (Judicial Review) Act 1977* to remove these decisions from the Sch 1(e) exemption.

Moreover, it is difficult to understand how a shift in the burden of proof to the Commissioner can be said to encourage sham behaviour. No particulars are provided, nor any reasoning, for this statement.

Therefore, if the government of the day is not minded to reverse the onus of proof in matters involving alleged fraud or evasion, perhaps the suggested amendment to the *Administrative Decisions (Judicial Review) Act 1977* would be the second-best option.

Possible remedies and areas for reform

As it is clear from the Commonwealth Government's response to the House of Representatives Standing Committee on Tax and Revenue that the onus of proof will not be reversed in matters involving opinions formed by the Commissioner that there has been either fraud or evasion, the author has set out below some suggestions to ameliorate this position.

Evidence to support the opinion

In civil proceedings involving allegations of fraud, a lawyer is inclined to act with due regard to the evidence to support the allegation so as to ensure that there is a proper basis for the allegation being made. Likewise, if the Commissioner is to make a serious allegation that there has been either fraud or evasion, the Commissioner should be put to the test to support the allegations with all of the evidence that he will be relying on. So, while the onus of proof might still be with the taxpayer, the Commissioner's position will not simply be based on a citation of facts and the application of the tax law to those facts; rather, it will be a position that is supported with evidence that corroborates the position taken by the Commissioner. This would drive ATO conduct towards what would be expected in private practice and allow the taxpayer to scrutinise the evidence that has been gathered to support the opinion. The reason for this suggestion is because allegations of fraud or evasion should not be made lightly.

The suggestion above would be a significant change from the ATO practice where the Commissioner need not have any evidence if he decides to amend an assessment or issue a default assessment. In *Gauci v FCT*,[12] Mason J said:[13]

> "The Act does not place any onus on the Commissioner to show that the assessments were correctly made. Nor is there any statutory requirement that the assessments should be sustained or supported by evidence. The implication of such a requirement would be inconsistent with s. 190(b) for it is a consequence of that provision that unless the appellant shows by evidence that the assessment is incorrect, it will prevail."

National Fraud or Evasion Advisory Panel

The primary purpose of the National Fraud or Evasion Advisory Panel (the FE Panel) is to provide advice and guidance to authorised ATO staff who are considering the formation of an opinion that there has/have been act(s) and/or omission(s) constituting either fraud or evasion. The FE Panel's role is purely advisory. The FE Panel does not form the opinion. Instead, it provides advice and guidance that the opinion-maker must consider. The ultimate authority to form an opinion of fraud or evasion remains with the opinion-maker (as the authorised delegate of the Commissioner).

Attendance at FE Panel meetings

At present, the following ATO staff must attend the FE Panel:

- the opinion-maker (if known);
- the case officer or objection officer presenting the submission; and
- the case officer's team leader/manager and/or director.

There would be considerable merit if the taxpayer's representative could attend the FE Panel meeting to allow the FE Panel to receive a balanced view on the merits of the pre-advisory opinion. It would provide taxpayers the benefit of knowing that their "voice" was being heard and that the FE Panel had the benefit of receiving both viewpoints.

Composition of the FE Panel

The FE Panel will comprise at least three senior ATO staff at the EL2 level or above:[14]

- one member must be from the referring business line (but not a member of the case team) and one member must be from the Tax Counsel Network (TCN); and
- where the referring business line is Review and Dispute Resolution (RDR), the panel members will only be drawn from RDR and/or TCN who have not previously been involved in the case.

It is respectfully suggested that the FE Panel would function more efficiently, more independently and more robustly if an independent member (ie a non-ATO staff member with the requisite tax skillset) was to join the FE Panel at the expense of one of the three ATO staff members. This would enhance the value of the advice to be given by the FE Panel.

Removing the exclusion from judicially testing a decision

Finally, as mentioned above, the decision to opine that there is fraud or evasion should be allowed to be tested in a court of competent jurisdiction[15] before the issuing of an assessment or assessments that are predicated on the opinion.[16] The utility in this approach is that it prevents the taxpayer from being traumatised by the issuing of (amended) assessments that may consequently trigger a plethora of related and adverse issues (such as the commencement of debt recovering action (including legal proceedings), the potential to trigger a breach in a banking covenant, and/or an event of insolvency), while Pt IVC TAA53 proceedings are still on foot.

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References

1 The types of disputes covered by this article are limited to disputes relating to the issuing of tax assessments (including default assessments and amended assessments), and therefore do not include taxpayer grievances relating to the issuing of private tax rulings or administrative decisions (subject to judicial review) or applications for declarations.

2 An example can be found in *FCT v Cassaniti* [2018] FCAFC 212 and the reference to s 1305 of the *Corporations Act 2001* (Cth).

3 [2018] FCAFC 212 at [88].

4 [1992] FCA 359 at [9].

5 [1990] HCA 3.

6 [1990] HCA 3 at [16].

7 H Miller, *"Prove it – evidence in indirect tax matters"*, Level 22 Chambers, 28 to 29 April 2016, paras 40–51. Available at www.business.unsw.edu.au/About-Site/Schools-Site/Taxation-Business-Law-Site/Documents/Evidence_in_Indirect_Tax_Matters.pdf.

8 See item 5 of the table in s 170(1) ITAA36.

9 See *Jordan, Commissioner of Taxation v Second Commissioner of Taxation* [2019] FCA 1602. This case is not referable to the defamation proceedings, but was about the Commissioner seeking the right to inspect certain taxpayer records, necessary to defend himself against the claim of defamation.

10 House of Representatives Standing Committee on Tax and Revenue, *Tax disputes*, March 2015, ch 3, recommendation 7. Available at https://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id:%22publications/tabledpapers/97e7d31a-7ccd-4f3b-a136-0eb80b2d796e%22.

11 Australian Government, *Response to House of Representatives Standing Committee on Tax and Revenue report: Tax disputes*, December 2015, p 5. Available at www.aph.gov.au/Parliamentary_Business/Committees/House/Former_Committees/Tax_and_Revenue/Inquiry_into_Tax_Disputes/Government_Response.

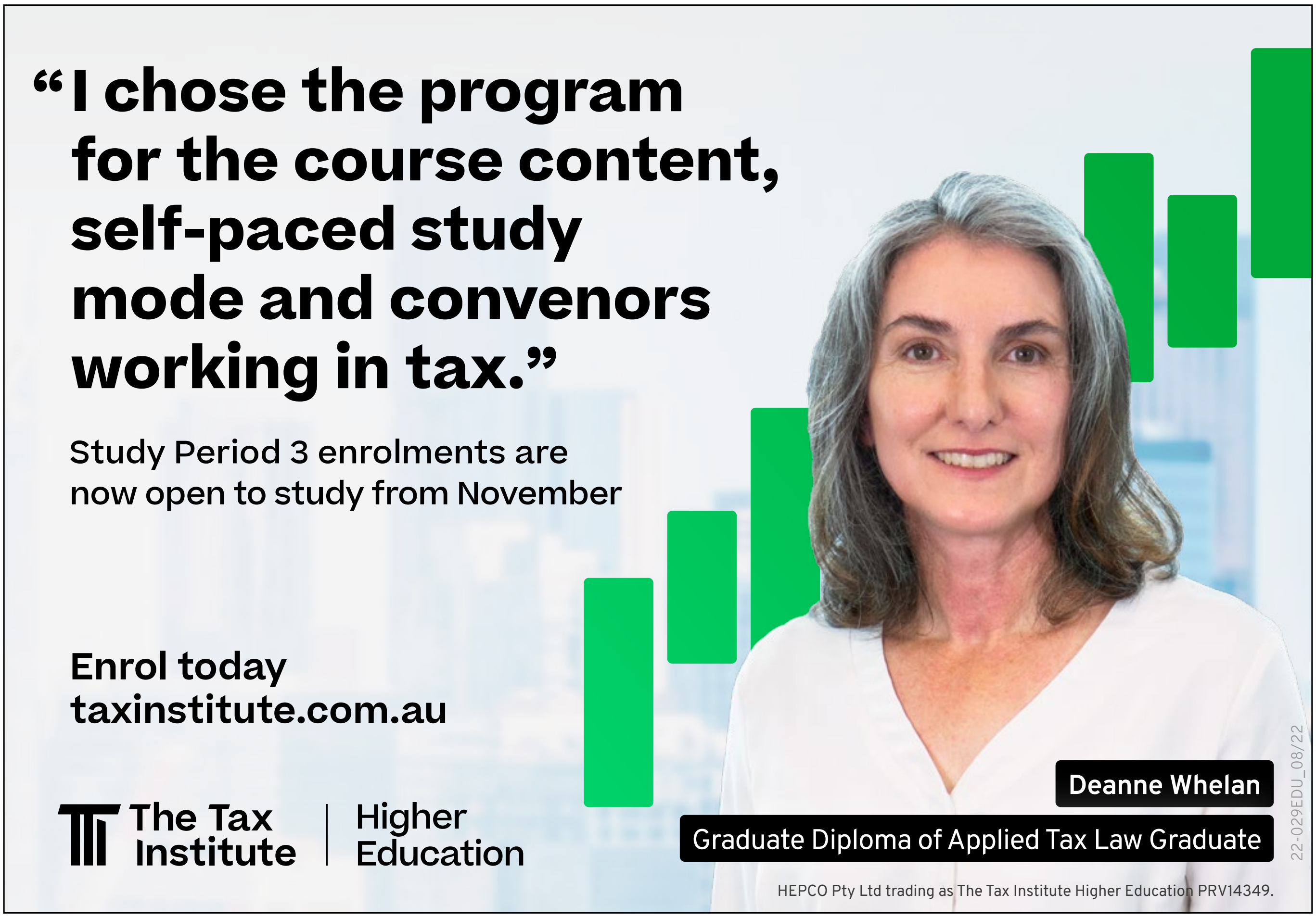
12 [1975] HCA 54 at [6].

13 The reference to s 190(b) was to that paragraph as it appeared in the ITAA36. To the extent relevant, ss 14ZZK(b) and 14ZZO(b) TAA53 effectively replaced s 190(b) and are in substantially the same terms as s 190(b) and have the same effect. In this respect, refer to the explanatory memorandum to the Bill that became the *Taxation Laws Amendment (No. 3) Act 1991*, which introduced Pt IVC into the TAA53.

14 PS LA 2008/6 sets out the qualifications and experience of ATO officers capable of forming the requisite opinion of whether fraud or evasion has been committed and the same for members of the FE Panel. "EL2" stands for Executive Level 2.

15 This would normally be the Federal Circuit Court of the Federal Court of Australia.

16 As stated above, an amendment to exclude the non-judicial review of these decisions from the operation of para (e) of Sch 1 to the *Administrative Decisions (Judicial Review) Act 1977* will be necessary.



A Matter of Trusts

by Philippa Briglia, Sladen Legal

Unit trusts, landholder duty and SMSF roll-overs

Where units in a landholding unit trust are acquired or transferred between SMSFs, the landholder duty provisions, including any applicable exemptions, should be considered.

This article is framed as a case study. The case study looks at landholder duty issues arising from a roll-over of member benefits from one self-managed superannuation fund (SMSF) to another, where the SMSF holds units in a private unit trust.

This scenario can arise where, for example:

- two spouses shared an SMSF and the spouses are separating. As part of the separation of their financial affairs, one spouse is exiting the "old" SMSF and rolling their member interests from the "old" SMSF to a new SMSF which they have established. As the "old" SMSF held units in a private unit trust, the roll-over of their member benefits involves a roll-over of the units, by way of in specie transfer; or
- there is a roll-over of member benefits as part of a group or family asset restructure, as shown in the case study facts below.

As the case study refers to property based in Victoria, the applicable provisions under the *Duties Act 2000* (Vic) (Duties Act) are referred to. It should be noted that similar principles may apply in other jurisdictions but that the particular legislation of that jurisdiction should be considered.

Case study background

The Gawn family has a number of SMSFs, including Gawn Super Fund 1 (Gawn SF 1) and Gawn Super Fund 2 (Gawn SF 2). The members of the SMSFs are:

- Max Gawn and his sons, Christian and Oliver, are the members of Gawn SF 1; and
- Max's third son, Jack, is the sole member of Gawn SF 2.

The members established two new SMSFs: the Gawn Super Fund 3 (Gawn SF 3) and the Gawn Super Fund 4 (Gawn SF 4). Max wanted to roll into an SMSF on his own, while his sons wanted to consolidate their benefits in a separate SMSF together.

Gawn SF 1 (directly via a custodian entity, Gawn Custodian 1 Pty Ltd) and Gawn SF 2 are the unitholders of the 123 Gawn Street Unit Trust (the unit trust), and hold the following units:

- Gawn SF 1 (directly and via Gawn Custodian 1 Pty Ltd) – 8,709,010 units; and
- Gawn SF 2 – 629,000 units.

Gawn SF 1 acquired units in the unit trust with the use of a borrowing under a limited recourse borrowing arrangement (LRBA) that satisfies the requirements of s 67A of the *Superannuation Industry (Supervision) Act 1993* (Cth) (SISA).

At the request of each of the members, it was agreed to roll over each of the member's member benefits as follows:

- Max rolled over all of his member benefits in Gawn SF 1 to Gawn SF 3;
- Christian and Oliver rolled over all of their member benefits in Gawn SF 1 to Gawn SF 4; and
- Jack rolled over all of his member benefits in Gawn SF 2 to Gawn SF 4.

Collectively, these are referred to as "the roll-overs".

The roll-overs were effected by transfers of units held by both Gawn SF 1 (directly and via Gawn Custodian 1 Pty Ltd) and Gawn SF 2 to Gawn SF 3 and Gawn SF 4 (via Gawn New Custodian Pty Ltd) in accordance with the value of the relevant member's member benefits.

The units transferred to Gawn SF 3 and Gawn SF 4 are held via Gawn New Custodian Pty Ltd. Gawn New Custodian Pty Ltd holds the units on separate bare trusts respectively for Gawn SF 3 and Gawn SF 4, as required by s 67A SISA.

The unit trust holds the real property known as 123 Gawn Street, Collingwood, Victoria (the property). The property has an unencumbered value of more than $1m and therefore the unit trust is a landholder for the Victorian landholder duty rules (s 71 of the Duties Act). As a result, the transfer of the units will trigger landholder duty unless an exemption applies.

After the roll-overs, both Gawn SF 1 and Gawn SF 2 ceased to have members and assets. Both superannuation funds are in the process of being wound up.

Following the roll-overs, Gawn SF 3 and Gawn SF 4 subscribe to further units in the unit trust in proportion to their existing unitholdings.

Issues for consideration:

- Will the roll-overs trigger landholder duty?
- If so, is there a relevant exemption which might apply?
- Can the receiving funds (being Gawn SF 3 and Gawn SF 4) acquire units from Gawn SF 1 and Gawn SF 2 under superannuation law?
- Will the subscription of further units in the unit trust by Gawn SF 3 and Gawn SF 4 trigger landholder duty?

Landholder duty

Landholder duty is a regime that was introduced to impose duty on acquisitions in landholding entities. Initially, the "land-rich" regime was introduced as an anti-avoidance measure because acquisitions in companies or unit trusts with lands were formerly not subject to duty.

Generally, in order to fall within the old "land-rich" regime, an entity not only had to have landholdings with an unencumbered/market value above a certain value (first limb), but also that their landholdings were valued at a certain threshold of the total assets of the entity (second limb).

Over time, the states and territories generally replaced the old "land-rich" regime with the new "landholder" duty regime, under which an entity will fall within the landholder duty regime once the first limb is met: if their landholdings are above a minimum value which is set out in each state and territory's legislation.

When is an entity a landholder?

Across all states and territories, a "landholder" is generally defined to include an entity comprising either a private company or unit trust scheme that has landholdings above a minimum legislated value.

Under s 71 of the Duties Act, for example, a landholder includes a private unit trust scheme or a private company that has landholdings in Victoria with a total unencumbered value of $1,000,000 or more.

Acquisitions

Section 77 of the Duties Act provides that a liability for landholder duty arises when a "relevant acquisition" is made. Section 78 of the Duties Act provides that a person makes a "relevant acquisition" if the person acquires an interest in a landholder that is of itself a significant interest in the landholder, or that amounts to a significant interest in the landholder when aggregated with other interests in the landholder acquired by the person, their associates, or another person in an associated transaction.

Section 79(1) of the Duties Act provides that a person will have an "interest" in a landholder if that person has an entitlement to a distribution of property from the landholder on a winding up of the landholder. Accordingly, where a unit trust meets the definition of "landholder", the unitholders in that unit trust will typically have an interest in that landholder.

For unit trusts, a person will have a "significant interest" in the landholder where, in the event of distribution of all of the property of the landholder, that person would be entitled to 20% or more of the property distributed (s 79(2)(a)).[1]

Importantly, for our current facts, s 80 of the Duties Act provides that a person acquires an interest in a landholder if the person obtains an interest beneficially, including if the person's interest in the landholder increases. This includes:

- the issue of a unit; and
- the redemption or cancellation of a unit.

Relevant exemptions to landholder duty

Various exemptions from landholder duty are available pursuant to s 89D.

Notably, where there is a pro rata increase of interests held by all of the unit or shareholders in a landholder, an exemption from duty applies under s 89D(d) of the Duties Act.

A separate exemption is available under s 40 of the Duties Act for superannuation fund to superannuation fund roll-overs.

Broadly, s 40 provides that no duty will be chargeable in respect of a transfer of dutiable property from one superannuation fund to another where:

- the transfer is made from a complying superannuation fund to another complying superannuation fund; and
- the transfer occurs in connection with a person ceasing to be a member of the fund from which the dutiable property is transferred, and the person becoming a member of the fund to which the dutiable property is transferred.

The combined operation of s 89D and 40 means that this exemption also applies to the landholder duty provisions.

The recent Supreme Court of Victoria decision of *Razzy Australia Pty Ltd v Commissioner of State Revenue*[2] (*Razzy*) is a seminal decision as it provides much sought after clarification on the application of various aspects of Ch 3 of the Victorian Duties Act which deals with landholder duty, including the application of ss 89D and 40.

In *Razzy*, a settlement deed was entered into between members of three SMSFs and entities connected with them, which, among other things, restructured the three superannuation funds of which the members were the only members.

As a result of this restructure, units in "private unit trust" schemes (which were "landholders" as defined in s 71(1) of the Duties Act) were redeemed and transferred between the superannuation funds and to a related trust.

The redemption resulted in an increase of the remaining unitholders' interests in the trusts. For each trust, one of the remaining unitholders was a fund nominated to receive the roll-over of each of the member's benefits. The Commissioner imposed duty on the basis that the increase in the percentage of units held in the landholding trusts by the remaining unitholders were relevant acquisitions of a significant interest in a landholder under s 78 of the Duties Act.

The court found that the acquisition of interests by the superannuation funds was exempt from duty under ss 89D(a) and 40(1)(c).

Importantly, the court also held that:

- the exemption did not require a direct transfer and could apply to transactions involving a redemption or an issue of units; and
- as the settlement deed expressly provided for the intended result to be achieved by both the redemption of units and the transfer of cash, the "in connection with" requirement under s 40(1)(c) was satisfied.

Analysis

This article now considers the application of the above provisions to the facts in the case study.

Q. Will the roll-overs trigger a relevant acquisition?

A. Yes. The acquisition of units by Gawn SF 3 and Gawn SF 4 as part of the roll-overs are relevant acquisitions under s 78 of the Duties Act. On that basis, a liability for duty arises under s 77 of the Duties Act.

Q. If so, is there a relevant exemption which might apply?

A. Yes. The transfer of units is a transfer of property from one superannuation fund to another under s 40 of the Duties Act that is occurring in connection with Max and his sons ceasing to be members of their respective SMSFs from which the units are being transferred. On that basis, no duty is chargeable under s 40(1).

Q. Can the receiving funds (being Gawn SF 3 and Gawn SF 4) acquire units from Gawn SF 1 and Gawn SF 2 under superannuation law?

A. At first blush, this would appear to be an acquisition of property from a related party of an SMSF, so there is a potential contravention of s 66 SISA.

As a preliminary point, it could be argued that s 66(1) has no application as the units will be acquired by Gawn New Custodian Pty Ltd in its capacity as bare trustee for Gawn SF 3 and Gawn SF 4. However, s 67A(2)(b) SISA provides that, in order for an LRBA to comply with s 67A, the asset acquired must be one that the superannuation fund trustee could acquire directly. Therefore, s 66 must be examined.

On the basis that the transferors of the units, being Gawn SF 1 and Gawn SF 2, are related parties of Gawn SF 3 and Gawn SF 4, s 66(1) would prohibit the acquisition of the units by Gawn SF 3 and Gawn SF 4 unless an exception applies.

One such exemption is contained in s 66(2A)(a)(iv) SISA, which includes the acquisition of an asset referred to in s 71(1)(j) SISA.

Section 71(1)(j) SISA provides that an asset will not be an in-house asset of the superannuation fund if that asset is included in a class of assets specified in the *Superannuation Industry (Supervision) Regulations 1994* (Cth) (SISR) to not be an in-house asset.

Regulation 13.22C SISR provides that an investment in a unit trust will not be an in-house asset provided the provisions of reg 13.22C(2) are satisfied at the time of the investment.

Therefore, provided the unit trust satisfies the conditions of reg 13.22C(2), s 66(1) of the Duties Act will not apply to the acquisition of units by Gawn SF 3 and Gawn SF 4 via Gawn New Custodian Pty Ltd as bare trustee.

Q. Will the subscription of further units in the unit trust by Gawn SF 3 and Gawn SF 4 trigger landholder duty?

A. Yes, but as the further units were issued in proportion to their existing unitholdings, an exemption applies under s 89D(d) of the Duties Act. Section 89D(d) provides that an acquisition of an interest in a landholder is an exempt acquisition if the interest concerned is acquired solely from a pro rata increase in the interests of all unitholders or shareholders.

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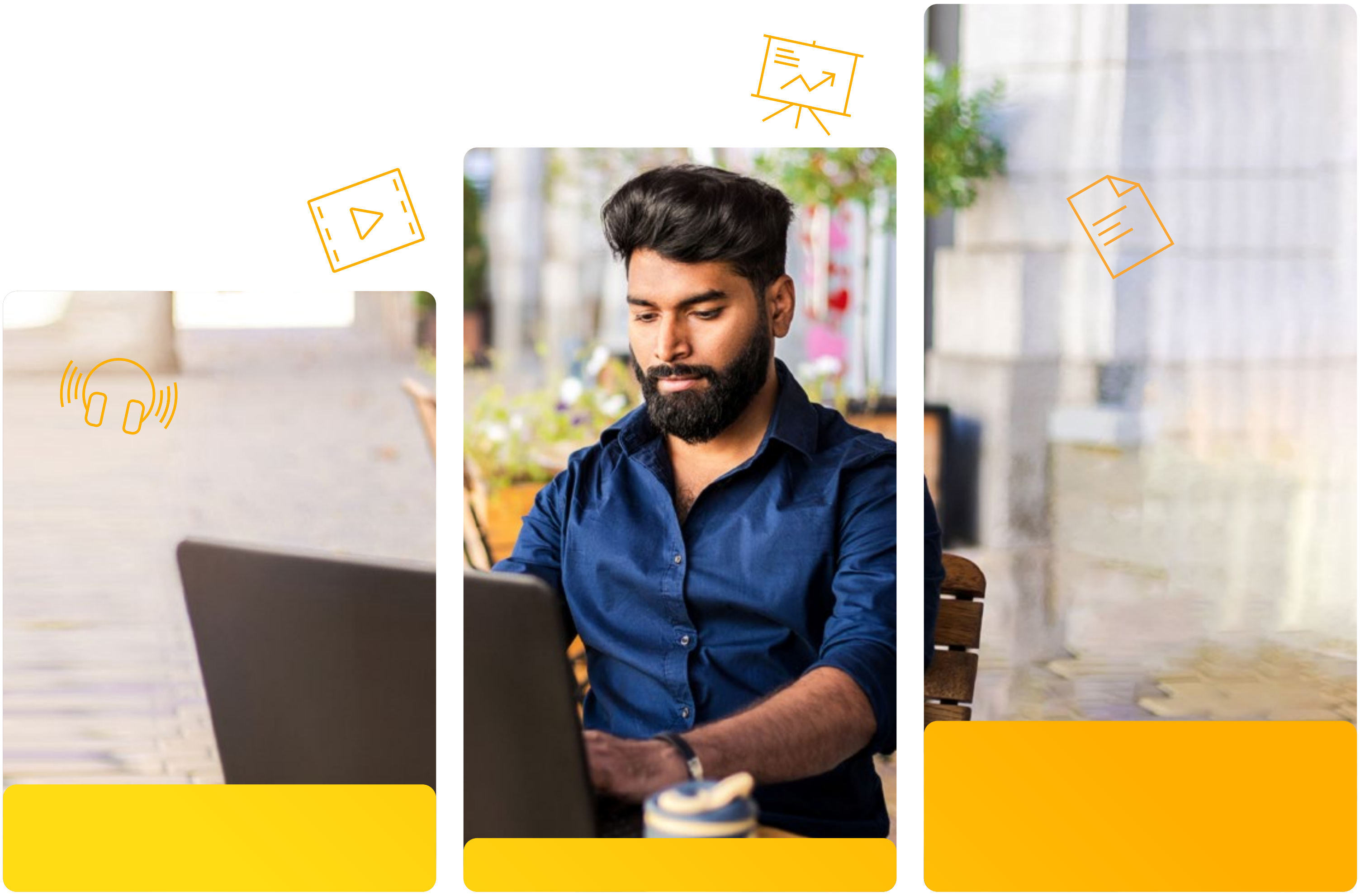
References

1 Note that the threshold is 50% for all other Australian states and territories, except for Queensland where the threshold is 0%.

2 [2021] VSC 124.



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Superannuation

by Cassandra Hurley, Daniel Butler, CTA, and William Fettes, DBA Lawyers

BDBNs: what to look out for and what to avoid

A well-drafted BDBN can be a powerful and important tool in a member's succession planning toolkit – it's important to do it right though as some risky practices have evolved.

A binding death benefit nomination (BDBN) is a direction made by a member to the superannuation fund trustee requiring the trustee to pay the member's superannuation death benefit in a certain way, eg to the member's dependant(s) and/or to their legal personal representative(s) (ie the executor(s) of the member's will).

BDBNs are usually set out in standard forms and are typically available for members of both large and small funds. This article will cover the most common advantages and disadvantages of BDBNs and provide a few tips on how to identify their best use.

BDBNs: small versus large funds

In an SMSF context, a BDBN depends on the wording in the particular fund's deed, as the BDBN rules in reg 6.17A of the *Superannuation Industry (Supervision) Regulations 1994* (Cth) (SISR) are not generally applicable to SMSFs. BDBNs can, for instance, where the deed is appropriately worded, also specify the manner of payment, eg lump sum or pension.

However, we often see SMSF deeds that include some or all of the BDBN rules in reg 6.17A, either expressly or implicitly (via the fund's general deeming clause that, broadly, may include any "applicable standard" that an SMSF must comply with to continue to be eligible for concessional tax treatment and more). SMSF deeds drafted in this way will significantly reduce the effectiveness, longevity and versatility of a purported BDBN, as BDBNs are a creature of the deed. Accordingly, undertaking a deed review or update is important when considering estate planning and BDBN drafting in an SMSF.

Regulation 6.17A applies to BDBNs made for most non-SMSF funds, including large public-offer retail or industry superannuation funds and small APRA funds. This means that a BDBN made by a member of one of these funds can generally only last for a maximum of three years (the three-year sunset period). Some funds offer non-lapsing non-binding nominations as an alternative to a BDBN so that members do not have to renew their nomination every three years. However, the non-binding nature (ie they do not have to be followed) of these alternative nominations means that members run the risk that the trustee may ignore their nominated wish (eg in certain circumstances some trustees will not follow these instructions, such as after the member divorces their spouse who is the nominated dependant or the spousal relationship ceases).

Benefits and uses

In an SMSF context, a BDBN used in conjunction with an appropriately drafted SMSF deed can provide a simple and effective solution for achieving greater certainty regarding what is to happen to a member's superannuation benefits on their death.

We now briefly consider certain popular BDBN strategies which illustrate how a well-drafted BDBN can be a powerful and important tool in a member's succession planning toolkit.

Avoiding payment to the estate

A BDBN in favour of a member's dependant(s) may be a sensible precaution to take where a member's deceased estate could face legal challenges, such as testator's family maintenance claims. In such cases, directing the trustee to pay the member's death benefit directly to their dependant(s), such as their spouse and/or children, avoids claims against the estate. Note that, in New South Wales, there is a concept of "notional estate" which can result in assets bypassing a person's estate (eg superannuation benefits being paid directly to a dependant spouse or child) being considered as part of their estate for testator's family maintenance purposes (as was the case recently in *Benz v Armstrong*[1]).

Similarly, an insolvent member may wish to consider making a BDBN directly to their dependant(s), rather than their estate, to protect their superannuation from creditors against their deceased estate. Making a BDBN may be a prudent strategy to put a death benefit beyond the reach of creditors, even though superannuation already has certain bankruptcy protection under s 116(2)(d) of the *Bankruptcy Act 1966* (Cth). For example, the bankruptcy protection is lost if the superannuation is paid via a deceased estate (see *Cunningham v Gapes*[2] where a distribution from a deceased mother's superannuation fund was distributed to her estate and lost its "excluded" protection).

Placing extra conditions on the money's use

Conversely, a member's family situation may warrant making a BDBN to pay any death benefit in favour of the member's estate (to their legal personal representative). For example, if a member has concerns about entrusting their surviving spouse or children with their superannuation benefit, they can leave the decision to their executor(s) to follow any directions in their will which may result in their superannuation benefit being managed in a discretionary testamentary trust with one or more independent executors. This may provide added accountability and overcome leaving the control of the superannuation benefit in the hands of the surviving spouse or children.

Problems and pitfalls

Having only been introduced from 1 July 1999, BDBNs are a relatively new legal instrument. The law in respect of BDBNs continues to develop and evolve over time, and many pitfalls exist for the unwary. Keeping pace with these developments and seeking appropriate advice from expert advisers is critical. Indeed, it was only in June 2022 that the High Court in *Hill v Zuda Pty Ltd*[3] confirmed that reg 6.17A SISR does not apply to BDBNs made in respect of SMSFs and clarified the law on this important point. Although this decision was consistent with prior decisions of various state Supreme Courts, it nonetheless represented a welcome confirmation of the legal position in support of SMSF BDBN strategies on an Australia-wide basis.

Additionally, as noted above, a standard form BDBN template is typically unique to the particular SMSF deed that it is supplied with. There are many versions and approaches applied between firms and states. When attempting a BDBN, it is vital that the deed supports the format, duration and terms of the BDBN so that it is valid and does what the member intends. It is therefore important to seek out a quality supplier with appropriate expertise to ensure that the risk of invalidity and any potential disputes are minimised.

Invalid deeds

The current deed and any related BDBN strategy that hinges off this purported current deed are likely to be invalid or on shaky ground if the deed has not been properly varied. This means that, if any prior deed of variation has not been varied according to the prior deed and any relevant conditions and consents in the variation power have not been complied with, the deed of variation is unlikely to be valid and enforceable. The prior variation power usually requires certain formalities to be complied with. Unless all of the formalities to vary the deed have been complied with in the fund's document trail history, the fund's latest deed may not be valid and effective. This, in turn, results in BDBNs and other strategies undertaken on the basis of an "invalid" deed being easily challenged.

Regrettably, and despite the critical importance of the deed foundation, most SMSF deeds these days are varied without proper checks on the prior document trail and on the formalities (eg the conditions and consents that must be satisfied) for each variation. Moreover, some suppliers provide a number of options to a BDBN, such as the ability to prepare an SMSF will or a death benefit rule to be used as an alternative to a BDBN. Further, some suppliers encourage advisers and clients to vary the deed themselves without any input from a qualified lawyer. These developments are giving rise to considerable risk, especially as there is no case law authority for the concept of what an SMSF will or a death benefit rule is (in contrast to the well-established case law over many years as settled recently by the High Court on BDBNs). Indeed, many popular terms do not have a clear meaning. For instance, the High Court in *CPT Custodian Pty Ltd v Commissioner of State Revenue*[4] stated that the term "unit trust", like "discretionary trust", in the absence of an applicable statutory definition, does not have a constant, fixed normative meaning.

If the SMSF has existed for some time and has undergone variations from time to time, particularly without using experienced SMSF lawyers, a deed history review is recommended. Such a review should encompass the original deed of establishment, any subsequent deed of variation, and any deeds of change of trustee, as well as any other documents that may have varied the deed (eg trustee resolutions). Moreover, the review should be conducted by an experienced adviser, preferably an SMSF lawyer, to see if remedial work is required to help ensure that the SMSF's "deed chain" is as resilient to challenge as possible. Remedying any issues in a timely manner is generally far more cost-effective than being exposed to future legal challenge as any legal dispute could end up costing several hundred thousand dollars and result in considerable lost time and uncertainty.

Sloppy wording

SMSF deeds are not generic documents and many SMSF deeds are unsatisfactory, especially in relation to BDBNs. Despite the High Court's confirmation that reg 6.17A SISR does not apply to an SMSF, there are still many SMSF deed suppliers that provide BDBNs with a three-year expiry date, regardless of their clients' needs, and many of these are easily challenged due to poor wording.

Examples of phrases that continue to increase the risk of disputes, especially between the trustee and potential beneficiaries, include "the BDBN is only binding if it is to the trustee's satisfaction". This type of wording can easily give rise to argument if, say, the trustee is the second spouse who decides to reject the BDBN when their spouse dies. References to discretion or vague/undefined terms (including "trustee of my estate") are avoidable and can be discussed with members prior to drafting.

Other key risk points are when notice and service requirements are unnecessarily included in BDBNs. Such requirements should be avoided.

Conclusion

BDBNs are a powerful and important tool in a member's succession planning toolkit.

We recommend that SMSF deeds be obtained from a quality law firm that has expertise in the field of SMSFs, succession planning and tax. Unless documents are boing obtained from a qualified supplier, there are numerous risks for an adviser and end-user client.

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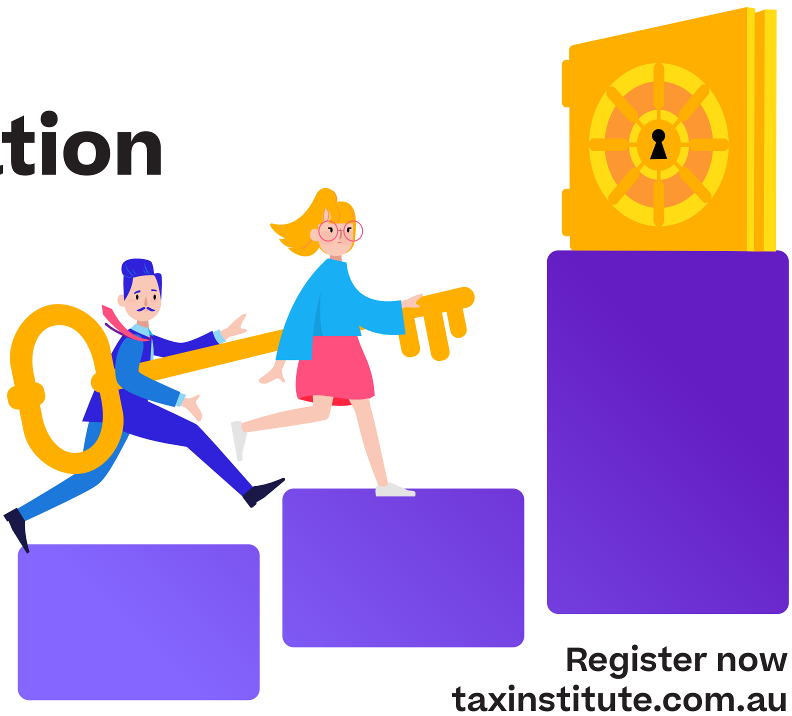

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Alternative Assets Insights

by Jonathan Malone, CTA, and
Jayde Thompson, CTA, PwC

Multinational tax integrity proposals

The government's proposed multinational tax integrity and enhanced tax transparency measures are some of the most significant and wide-reaching tax integrity measures seen for many years.

Overview

The government's proposed multinational tax integrity and enhanced tax transparency measures were first announced as part of the Labor Government's 2022 election commitment platform.

On 5 August 2022, the federal Treasury released a discussion paper[1] to consult by 2 September 2022 on the implementation of proposals to:

- amend Australia's existing thin capitalisation rules to limit net interest deductions for multinational enterprises (MNEs) based on 30% of earnings before interest, taxes, depreciation and amortisation (EBITDA) (ie an earnings-based "safe harbour" test) in line with the Organisation for Economic Cooperation and Development's (OECD's) recommended approach under action item 4 of the base erosion and profit shifting (BEPS) action plan;
- introduce a new rule limiting an MNE's ability to claim tax deductions for payments relating to intangibles and royalties that lead to insufficient tax paid outside of Australia; and
- ensure enhanced tax transparency by MNEs through measures such as: public reporting of certain tax information on a country-by-country basis; mandatory reporting of material tax risks to shareholders; and requiring tenderers for Australian Government contracts to disclose their country of tax "domicile".

Although these measures were first announced by the government as part of its election commitments to apply from as early as 1 July 2023, the discussion paper remains silent on the proposed commencement dates. There is still a long way to go before these measures are to be legislated, and this consultation is the first opportunity that taxpayers have to comment on the proposals and provide Treasury with feedback on the practical issues associated with these measures. The discussion paper does not include details of how these proposals would apply, but rather raises a series of questions relating to the manner and form in which the proposals could be implemented.

Changing the thin capitalisation rules

The government has committed to adapting Australia's thin capitalisation rules to align with the OECD's recommended approach under action 4 of the BEPS action plan. Broadly, this approach limits net interest deductions to 30% of EBITDA in place of the existing safe harbour debt test. According to the discussion paper:

> "The policy intent of a fixed ratio rule based on earnings is to ensure that an entity's interest deductions are directly linked to its economic activity and the entity's taxable income, which can help protect against tax planning practices. Compared to the current assets-based safe harbour, the OECD recommended approach recognises that 'thinly capitalised' entities with high debt-to-asset ratios can still use various tax planning strategies to shift profits out of Australia (for example, by maximising debt-deductions via relatively high interest rate loans)."

The discussion paper poses a question as to whether the EBITDA test should be based on a tax or an accounting ratio. The OECD's best practice approach adopts a tax basis for determining EBITDA (that is, a modified calculation based on taxable income), with a recommendation that countries set their benchmark fixed ratio within a range of 10% to 30%. The good news for Australian taxpayers under this proposal is that the government has opted for a fixed ratio at the top end of this range (ie 30%).

The government recognises that entities can be highly geared on commercial terms, allowing them to claim higher levels of deductions. To accommodate this, and in a welcome move, the government is proposing to retain the current arm's length debt test (although it is open to modifying the existing test to address compliance and integrity issues, and the ordering of how the rules apply is not yet clear) and may adopt some form of specific group ratio rule (the discussion paper notes that this could be the existing worldwide gearing test and/or a new earnings-based group ratio rule) to provide some flexibility for highly leveraged groups.

It is proposed that the fixed ratio rule will target "general entities" as defined in the current thin capitalisation legislation. Financial entities and authorised deposit-taking institutions (ADIs) would, in the interim, continue to be subject to the existing thin capitalisation rules and are proposed to be excluded from the fixed ratio (namely, EBITDA) rule. However, there is also a specific consultation question asking whether there should be any changes to the existing rules applicable to financial entities and ADIs.

While the discussion paper notes that the government will draw on approaches adopted by comparable international jurisdictions (such as the United Kingdom, Canada, France, Germany and the United States) in implementing the fixed ratio rule, it is lacking in the detail that is needed to answer many questions that taxpayers are likely to have regarding these proposals.

For example, while the discussion paper contemplates a de minimis threshold to exclude low-risk entities from the interest limitation rule (similar to the existing A$2m de minimis threshold), it makes no comment on the potential to carry forward or carry back denied interest deductions or excess interest capacity, which is a common feature of similar rules in other jurisdictions.

The discussion paper also makes no mention of the proposed start date for these new thin capitalisation rules (which has been announced previously as applicable from 1 July 2023), and whether there would be any transitional measures for existing funding arrangements. This is important as taxpayers will need more information to prepare for any potential change in the after-tax cost of existing and proposed financing arrangements and to prepare for volatility in the after-tax outcome if there is no carry-forward/back of any excess interest when the new rules take effect.

Payments relating to intangibles and royalties

The government is proposing a specific new integrity rule to deny deductions for payments relating to intangibles and royalties paid to low or no-tax jurisdictions or that lead to insufficient tax being paid outside of Australia. While the discussion paper acknowledges that Australia's existing rules, including the transfer pricing rules, general anti-avoidance provisions, principal purpose tests (or similar rules) in Australia's bilateral tax treaties and the controlled foreign company rules, go some way in tackling the integrity concerns relating to intangibles and royalties, it argues that Australia's tax framework needs a specific measure targeting these integrity issues.

The discussion paper sets out some policy design issues for consultation, including:

- **taxpayers in scope:** the discussion paper contemplates limiting the new integrity rule to significant global entities, and possibly even further to corporate tax entities that are significant global entities;
- **payments in scope:** this includes issues such as whether both royalties and "embedded royalties" (ie a concept which is not defined in tax law but apparently arises where there is a bundled supply of tangible goods and/or services and no component is separately recognised as a royalty, although the bundle is asserted to have the characteristics of a royalty) are within scope, and whether any other types of payments should be covered by this policy. The discussion paper specifically discusses risks identified in TA 2018/2 relating to "embedded" royalties, and TA 2020/1 relating to the migration or mischaracterisation of Australian activities connected with the development, enhancement, maintenance, protection and exploitation of intangible assets.

  The discussion paper also seeks views on whether the proposal should cover payments to both related and unrelated parties, noting that "[t]o ensure integrity risks are appropriately captured, it may be necessary to apply the measure to arrangements that involve both related and unrelated entities. This would also more effectively build upon, and be consistent with, other aspects of Australia's tax law framework". The impact on the cost of doing business in Australia will be just one of the many issues associated with any new policy approach and scope in this area; and
- **low or no-tax jurisdictions, or insufficient tax:** the discussion paper highlights a range of options (including existing concepts in the tax law) that could be used to identify "low or no-tax jurisdictions" (a concept that, historically, Treasurers have been reluctant to define), or situations where payments lead to insufficient tax, and seeks views on which option may be appropriate for this measure. These options include taking concepts from the existing hybrid mismatch targeted integrity rule (the so-called "low-rate lender rule"), the OECD's Pillar Two Global Anti-Base Erosion Rules minimum tax rate, the existing sufficient foreign tax test in the diverted profits tax, identifying intellectual property tax-preferred regimes, or developing a new bespoke list of low-tax jurisdictions for this measure.

There is no mention of a "purpose test" for this measure, which has the potential to considerably increase the scope of payments caught. From as far back as 2019, the then Opposition explained that any reforms in this area will be combined with a "dominant purpose" test so that the measure is targeted for the integrity of the tax system. It will be important to understand whether this is a feature of the rules even though it does not appear in the discussion paper, given the potential scope becomes much broader without a purpose qualification.

The treatment of deductions relating to intangibles, software and royalties has been a focus area of the ATO for some time, and this new proposal is the latest measure to specifically target profit shifting via these types of payments. The proposal is said to be consistent with actions taken by other jurisdictions, and the discussion paper provides an overview of some of these actions.

Similar to the interest limitation rule discussed above, there is still much detail to come. The discussion paper makes no mention of the proposed start date (previously announced as 1 July 2023) or any transitional measures that might be appropriate for existing arrangements.

Multinational tax transparency

Tax transparency is high on the government's agenda, and the election commitments which address new transparency measures are just one part of an overall transparency agenda. The discussion paper notes the existing tax transparency measures that are embedded into Australia's tax law, as well as the Voluntary Tax Transparency Code and the Global Reporting Initiative. Before considering the specific election commitment transparency initiatives, the discussion paper poses a general question as to whether any specific features could be introduced to improve how multinationals publicly report tax information.

In relation to the commitment to require large multinationals to publicly report tax information on a country-by-country basis (such as high-level data on the amounts of tax paid in the jurisdictions they operate, and the number of employees in these jurisdictions), a wide range of matters are raised. A general question is posed as to whether the "significant global entity" definition is the appropriate threshold at which any form of enhanced public reporting of tax information would apply and whether it should apply to a broader range of entities.

When it comes to the information that would be publicly reported, the discussion paper seeks views around the approaches adopted by the European Union, the Global Reporting Initiative's new tax standard GRI 207: Tax, or by legislating the Voluntary Tax Transparency Code as a basis for mandating public country-by-country reporting in Australia. It also seeks views on the form and administrative aspects of any public reporting, which is an important consideration for affected taxpayers when it comes to considering the compliance aspects of the obligation.

Another aspect of the government's increased tax transparency initiative is that it will require companies to disclose to shareholders "material tax risk" to assist shareholders to better understand their investments and any tax structuring arrangements of the company. The discussion paper seeks stakeholder views on how this disclosure could be made and what sort of "risk" such disclosure should address. For example, it flags the potential for high-risk arrangements that are identified in the ATO's key practical compliance guidelines or where taxpayers invest in low-tax jurisdictions as the sort of arrangements that listed companies should disclose to shareholders.

The final aspect of the transparency initiatives raised in the discussion paper is to require that tenderers for Commonwealth Government contracts worth more than A$200,000 (inclusive of GST) disclose their country of tax domicile. This would supplement the existing requirement for tenderers with contracts that have an estimated total value of over A$4m (including GST) to obtain a statement of tax record from the ATO to evidence satisfactory engagement with the tax system in respect of their tax registration, payment and lodgment obligations. It remains to be seen whether the concept of tax domicile introduces a new definition and test that differs from tax residency, noting that clarification of Australian tax residency definitions remains subject to legislative reform.

More yet to come

The government's other multinational tax initiatives, including Australia's implementation of the OECD two-pillar solution to address the tax challenges of the digitalisation of the economy and the creation of a public registry of beneficial ownership to improve transparency on corporate structures to show who ultimately owns (or controls) a company or legal vehicle, are yet to come.

The takeaway

With a potential start date as early as 1 July 2023, there is not much time for the details of these measures to be developed and legislated, and for affected taxpayers to plan ahead for their upcoming application. The time frame to respond to the discussion paper is limited, with comments due to be made in response to the discussion paper by 2 September 2022. Accordingly, now is the time for affected taxpayers to raise concerns and respond to the issues on which clarity is needed, particularly when it comes to the practical application of the proposed measures.

The government will issue and consult further on exposure draft legislation prior to introducing any legislation into parliament.

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Reference

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