The Tax Institute

Tax Update

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Contents

1. **Tax Update Pitstop** 5

2. **Cases** 6

2.1 Thomas and Naaz – payroll tax relevant contract arrangements 6

1.1 Jamsek – employee vs contractor for superannuation guarantee 8

2.2 DQTB – agistment activities did not constitute carrying on a business 10

2.3 Konebada – input tax credits for legal services 14

2.4 Godolphin – land tax primary production exemption 17

2.5 Embedded Claims – shares did not vest in trustee in bankruptcy 19

2.6 Camilleri – tax agent providing state taxes advice 21

2.7 Frigger – superannuation assets in bankruptcy 24

2.8 Appeal updates 27

2.9 Other tax and superannuation related cases in period of 2 March 2022 – 4 April 2023 28

3. **Legislation** 30

3.1 Progress of legislation 30

3.2 Treasury Laws Amendment Bill – various measures 30

3.3 Consultation on thin capitalisation measures 30

3.4 Consultation on minor and technical amendments 32

3.5 Consultation on multinational tax integrity measures 32

3.6 Consultation on financial reporting by public companies 33

3.7 Withholding Variation for Personal Services Income 34

3.8 Requirement to lodge tax return 34

4. **Rulings** 35

4.1 GST treatment of financial supplies 35

4.2 GST treatment of ATM service fees, credit card and debit card surcharges 35

4.3 Victorian land tax primary production exemption 35

4.4 Victorian land tax primary production in urban zone exemption 37

4.5 Update to Victorian Revenue Ruling interest and penalty tax on payroll tax default 38

4.6 Western Australian remission of penalty tax for late payment 39

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5. Private binding rulings ... 41

5.1 Input tax credits and temporary full expensing ... 41

5.2 Small business restructure roll-over ... 43

5.3 CGT - deed of surrender of remainder interest ... 44

5.4 Commercial property – demolition expenses ... 45

5.5 CGT and value shifting ... 47

5.6 Proposed members' voluntary liquidation and pre-CGT assets ... 49

6. ATO and other materials ... 53

6.1 Deductions and FBT for electric vehicle home charging ... 53

6.2 Consultation on taxation of super balances over $3 million ... 54

6.3 SMSF rectification directions ... 54

6.4 ATO approach – penalty for failure to keep or retain records ... 55

6.5 Victorian taxes on foreign property Investors ... 56

6.6 Tax consequences on sales of small scale land subdivisions ... 57

6.7 New lodgment deferral function coming soon ... 59

6.8 Queensland land tax concessions for build-to-rent developments ... 59

6.9 Revenue NSW Shared Equity Home Buyer Helper – Financial Assets & Excess Savings 59

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1. Tax Update Pitstop

The Tax Update Pitstop provides a quick reference to the top 5 tax matters from the month as determined by our experts.

Tax Update Matter	Impact Summary	Further Detail
Thomas and Naaz	The Court of Appeal of the Supreme Court of New South Wales has held that an arrangement under which doctors perform work for patients out of a facility provided by a facilities provider involves a supply of services from the doctors to the facilities provider and, as a result, the arrangement is a relevant contract for payroll tax. The decision confirms the existing position adopted by Revenue NSW and other Revenue offices, although there is continuing uncertainty as to which health practices are caught and which are not.	Page 6
Jamsek	The Full Federal Court has held that the extended meaning of employee in section 12(3) of the *Superannuation Guarantee (Administration) Act 1992* (Cth) (a contract wholly or principally for the labour of a person) only applies to contracts with natural person service providers. The decision also confirms that a contract which provides a right a delegation will not be a contract wholly or principally for the labour of a person.	Page 8
Camilleri	The Supreme Court of New South Wales was asked to consider whether a person (an accountant) who provides duties advice in New South Wales is engaging in legal practice in New South Wales such that only legal practitioners can provide such advice. The Supreme Court refused to answer the question given the accountant was not a party to the proceedings, but there remains a significant question as to whether non-legal practitioners are permitted to provide advice and other services in relation to tax matters that are not covered by the *Tax Agents Services Act 2009* (Cth).	Page 21
Consultation on thin capitalisation measures	The Commonwealth government has proposed significant changes to the thin capitalisation rules, which will have an impact on cross border debt arrangements. The proposed changes have been released for consultation.	Page 30
Victorian surcharges and treaty obligations	The Victorian State Revenue Office has refused follow the approach of New South Wales concerning the impact on the duty and land tax surcharge provisions of Australia's treaty obligations.	Page 56

2. Cases

2.1 Thomas and Naaz – payroll tax relevant contract arrangements

Facts

Thomas and Naaz Pty Ltd operates medical centres in New South Wales.

Thomas and Naaz entered into written agreements with medical practitioners who worked at the medical centres. The written agreements were supplemented by informal arrangements. The medical practitioner agreed to pay 30% plus GST of total billings to Thomas and Naaz. The medical practitioners' billings were 'bulk billed' which meant that Medicare would pay the medical practitioner the entirety of the benefit for the services rendered to a patient in discharge of the patient's liability to the medical practitioner.

Thomas and Naaz employed reception and administrative staff, and nurses. The administrative staff dealt with Medicare in respect of the services provided by the medical practitioners, with the result that the payments from Medicare were paid into a bank account in the applicant's name. The administrative staff then identified which payments were attributed to each medical practitioner, and paid 70% of the amounts received to the particular practitioner, retaining the other 30% for Thomas and Naaz. These administrative steps were not documented and formed part of the informal agreement between Thomas and Naaz and the medical practitioners.

However, three medical practitioners received the payments from Medicare directly, and then paid 30% to Thomas and Naaz.

The Chief Commissioner assessed payroll tax on the basis that the 70% paid by Thomas & Naaz to medical practitioners was 'taxable wages' for the purposes of the *Payroll Tax Act 2007* (NSW) (**PTA**). The Chief Commissioner accepted that the medical practitioners were not employees, but contended that the relevant contract provisions in Division 7 of Part 2 of the PTA applied.

The Chief Commissioner submitted that Thomas and Naaz was a person to which, and under a relevant contract, the services of the medical practitioners were supplied for or in relation to the performance of work, with the result that Thomas and Naaz was taken to be an 'employer', and that the medical practitioners performed work for or in relation to which services were supplied to the applicant under a relevant contract, with the result that the medical practitioners were taken to be employees. Therefore, the 70% of the Medicare benefits paid by Thomas and Naaz to the medical practitioners (except for the three who received their own claims) were amounts deemed to be wages under section 35(1) of the PTA.

Thomas and Naaz applied to the NSW Civil and Administrative Tribunal for a review of the decision of the Chief Commissioner. At first instance, the NCAT referred to the rights and obligations under the agreement, including at all times to act to promote the interest of the medical centre, the records of all services were the sole property of Thomas and Naaz, the medical practitioner was to abide by operating protocols issued by Thomas and Naaz from time to time, to meet roster commitments, sign on and sign off and be physically present during rostered sessions, not take any action to channel patients away from the centre, to give notice before taking any leave, and a restrictive covenant placed on the medical practitioner for two years.

The NCAT concluded that a relevant contract arrangement existed between Thomas and Naaz and the medical practitioners as the medical services provided by the medical practitioners were a necessary party of Thomas and Naaz's medical centre business, and the medical practitioners provided these services to the patients and to Thomas and Naaz. The NCAT also found that there was a clear relationship between the provision of these medical services and the payments to the medical practitioners.

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Thomas and Naaz appealed to the Appeal Panel who dismissed the appeal on the basis that the challenges did not give rise to questions of law. Thomas and Naaz filed an application for leave to appeal with the Court of Appeal of the Supreme Court of New South Wales. Thomas and Naaz's appeal to the Court of Appeal had to be confined to being an appeal on a question of law, and Thomas and Naaz were required to make its case for leave to appeal to be granted.

Issues

1. Was there an error in finding that the medical practitioners supplied services to Thomas and Naaz?
2. If so, does this error give rise to a question of law?

Decision

The Court of Appeal firstly considered what Thomas and Naaz contended was the first step in the analysis, which was whether the medical practitioners provided services to Thomas and Naaz. The Court of Appeal acknowledged that this was an unusual first step as ordinarily the first issue to consider is whether a question of law arises.

The Court of Appeal considered it 'perfectly plain' that the medical practitioners provided services to Thomas and Naaz. The Court of Appeal made the following observations:

1. Thomas and Naaz was running a business and central to this was that people would attend the medical centres to receive medical treatment. Therefore, Thomas and Naaz employed administrative and reception staff, and nurses to achieve this end;
2. there was no source of income for the wages of nursing and reception and administrative staff other than the 30% of the receipts from Medicare (and other government agencies) generated by the medical practitioners;
3. examining this issue from the perspective of a prospective purchaser reveals that the purchaser would be acquiring the valuable contractual rights enjoyed by Thomas and Naaz in respect of the contracts with the medical practitioners. That is, promises that the medical practitioners would attend the premises at certain times and observe the restrictive covenants;
4. the medical practitioners provided valuable contractual promises to Thomas and Naaz, which were conducive to the conduct of Thomas and Naaz's business. The performance of those promises required positive actions by the medical practitioners on a continual basis while the contract was in force. This was a provision of services from the medical practitioners to Thomas and Naaz; and
5. it does not matter that Thomas and Naaz did not receive medical treatment by the medical practitioners, and that the patients were not patients of the medical centre. The medical practitioners still provided services to Thomas and Naaz.

Therefore, regardless of whether there was an identifiable question of law, the Court of Appeal concluded that the medical practitioners supplied services to Thomas and Naaz and the NCAT's approach was 'entirely orthodox'.

The Court of Appeal also stated that, even if 70% of the amounts received by the applicant were owned beneficially by the medical practitioner, it would not prevent the amounts being payments for the purposes of section 35(1) of the PTA. In reaching this conclusion, the Court of Appeal relied on the decision of the Victorian Court of Appeal in *Commissioner of State Revenue v The Optical Superstore Pty Ltd* [2019] VSCA 197.

The Court of Appeal then considered whether any finding of law had been made out by Thomas and Naaz. The Court of Appeal concluded that there was no question of law arising in this case. Therefore, leave to appeal was not granted.

COMMENT – there are two aspects of this decision that require consideration. Firstly, the question is whether the conclusion that the medical practitioners were providing services to Thomas and Naaz arose due to the particular features in this case (which included rostered hours and restraint provisions in the contract) or whether the case supports a broader position. While the Court did refer to the particular contractual provisions, it also referred to the broader features, including that Thomas and Naaz only earned income from the

performance of work by the medical practitioners. Accordingly, we consider it difficult to confine the decision to the particular features of the contracts between the medical practitioners and Thomas and Naaz.

Secondly, in this case, no amount was included in the taxable wages for the three doctors who receive payments from patients directly. The correctness of this approach was not considered in this case as this had simply been accepted by Revenue NSW at audit. This raises the question as to whether, if medical practitioners are paid directly, the amounts they receive are not taxable wages. In our view, given the issue was not properly considered in this case, we do not consider that such a conclusion can be drawn from the case. In other cases, Revenue NSW has made it clear that it does not consider that, if the medical practitioner collects directly form patients, this prevents payroll tax from applying.

Citation *Thomas and Naaz Pty Ltd v Chief Commissioner of State Revenue* [2023] NSWCA 40 (Meagher JA, Leeming JA and Griffiths AJA, New South Wales)
w http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/nsw/NSWCA/2023/40.html

1.1 Jamsek – employee vs contractor for superannuation guarantee

Martin Jamsek and Robert Whitby were delivery truck drivers. In 1977, Martin and Robert commenced their employment as truck drivers for the predecessor company of ZG Operations Australia Pty Ltd.

In 1986, Martin and Robert's work arrangements were changed at the insistence of the company that had, up until then, been their employer. Martin and Robert were each required by their employer to form partnerships with their spouses. The employer would then engage the partnerships as independent contractors to provide the truck driving services to the company.

As part of the change of their work status from employees to contractors, Martin and Robert purchased their own trucks. They borrowed money to fund the purchase of the trucks.

From 1977 to 2017, Martin and Robert worked for the one business, although the particular entities that engaged them changed a number of times over the years.

Generally, it was always Martin and Robert that performed the work for the partnerships. However, in 2000, a friend of Martin drove his truck and Mark’s partnership paid the friend. Otherwise, there was no delegation.

In 2017, the company terminated the arrangements with Martin and Robert due to 'financial conditions'. Martin and Robert commenced proceedings in the Federal Court claiming that they were employees for the purpose of the *Fair Work Act 2009* (Cth), the *Long Services Leave Act 1955* (NSW) and *Superannuation Guarantee (Administration) Act 1992* (Cth) (**SGAA**).

Earlier proceedings

At first instance, the Federal Court found that Jamsek and Whitby were not employees within the ordinary meaning of that term, nor were they employees within the expanded meaning of the term in section 12(3) of the SGAA.

On appeal, the Full Federal Court held that Martin and Robert were employees of ZG Operations within the ordinary meaning of that term and, on that basis, did not consider whether they fell within the extended meaning of the term in section 12(3) of the SGAA.

On appeal to the High Court, the High Court held that Martin and Robert were not employees within the ordinary meaning of the term and remitted Martin and Robert's cross-appeal to the Full Federal Court. The cross-appeal concerned whether Martin and Robert were employees under section 12(3) of the SGAA. The High Court declined to rule on this issue.

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When the matter was remitted to the Full Federal Court, the Commissioner of Taxation was joined as a party to the proceedings.

Section 12(3) of the SGAA relevantly provides as follows:

> *(3) If a person works under a contract that is wholly or principally for the labour of the person, the person is an employee of the other party to the contract.*

Martin and Robert argued that the Federal Court at first instance was wrong to find that there was no contract for the purposes of section 12(3) of the SGAA for the following two reasons:

1. a partnership is not a separate legal entity and, consequently, the contract was directly with Martin and Robert; and
2. the text of section 12(3) of the SGAA does not require the contract to be made with the natural person either solely or otherwise. Rather, section 12(3) required that 'a person works under a contract…' Martin and Robert both worked under the relevant contracts which regulated their working activities. This included times of work, annual leave, rosters and rates of pay.

Martin and Robert also submitted that:

1. the Federal Court at first instance was wrong to find that the contracts 'were not principally' for the labour of Martin and Robert because the contracts also provided for the equipment being delivery vehicles;
2. section 12(3) of the SGAA is intended to apply even where a contract may have multiple purposes;
3. 'principally' means chiefly or mainly;
4. the Federal Court at first instance should have reached the conclusions that the main component of the value of the contract should be measured by the metric of money, rather than labour; and
5. the text of the contract in *Neale v Atlas Products* (1955) 94 CLR 419 (**Neale**) provided for an absolute right to delegate or employ other persons to provide the labour. Their contractual 'right' was highly controlled and required ZG Operations' permission which had only been given once in 30 years.

The Commissioner submitted as follows:

1. that Martin and Robert's construction of section 12(3) of the SGAA would lead to a result which could impact any unincorporated service provider such as a plumber, surveyor, accounting firm, doctor or barrister; and
2. that ZG Operations and the Commissioner rely upon the decision in *Neale* in relation to the right to delegate or employ other persons to undertake the labour such that the contract properly construed was not principally 'for' the labour of a person.

Issue

Was the Federal Court at first instance correct to find that Martin and Robert did not fall within the extended definition of 'employee' pursuant to section 12(3) of the SGAA?

Decision

The Full Federal Court held that the Federal Court at first instance was correct to find that Martin and Robert did not fall within the extended definition of 'employee' pursuant to section 12(3) of the SGAA.

<u>'Contract' element</u>

In coming to its decision, the Full Federal Court reasoned as follows in respect of what was required for the 'contract':

1. it requires a bilateral exchange of promises of labour and payment between two sides of the contract;
2. it only has application where the putative 'employee' is an identified natural person who is a party to the contract in their individual capacity;

3. section 12(3) of the SGAA is not satisfied where a contract is properly characterised as being for the provision of a result; and
4. while at common law a partnership is not a separate legal entity, section 72(1) of the SGAA alters that position for the purposes of the SGAA. The purpose of section 72 is to deal with the imposition of obligations, liabilities and penalties upon a partnership, as an employer. It does not extend to rendering a partnership a legal person for the purpose of treating it as a party to a contract, as a putative 'employee', under section 12(3) of the SGAA.

'For the labour of' element

The Full Federal Court reasoned as follows in respect of the meaning of the phrase 'for the labour of':

1. the question of what the contract was 'for' from the perspective of the putative employer is to be determined by reference to the terms of the contract;
2. a contract that leaves the contractor free to do the work himself or to employ other persons to carry it out is not wholly or principally for the labour of the person. In this respect, the Full Court reasoned that '[i]t does not matter that "the contractor has himself performed the bulk of the work under the contract or that it was the expectation of the parties that he would do so if, in truth, the contract did not create the relationship of master and servant"';
3. the contracts were for the provision of labour and equipment being the trucks rather than being contracts whereby the drivers undertook to produce a given result;
4. the fee structure under the contracts provided for payment based on hours worked, rather than items delivered;
5. the provision of the delivery service under the contracts required the use of a substantial capital asset, the trucks, for which the partnerships were wholly responsible;
6. the partnerships were able to delegate the work to a substitute driver, albeit with agreement;
7. properly characterised, the benefit received by ZG Operations under the contracts was not divided into two separate components, one being labour to drive and the other being the use of a truck; and
8. properly characterised, the benefit received by ZG Operations was a delivery service which included a labour component which was not the 'principal benefit'.

In a separate judgment, Wigney J observed that the size of the capital commitment represented by the need to provide functional and properly maintained delivery trucks meant that labour could not be said to be the principal or predominant component in the circumstances at hand.

COMMENT – this decision is important in two respects. Firstly, it confirms that a contract between a principal and a non-natural person service provider will not be covered by the extended meaning of employee in section 12(3) of the SGAA. However, care still needs to be exercised in drafting contract to ensure it does not, on its proper construction, result in a contract between the principal and the natural person who performs the work: see *Roy Morgan Research Pty Ltd v Commissioner of Taxation* [2010] FCAFC 52.

Secondly, the decision confirms the approach in *Neale* that a mere contractual right to delegate will be sufficient to prevent the contract being for the labour of a person. It is unclear whether this will still be the case if the exercise of the right to delegate requires the consent of the principal, though that was the case here. For a decision where the principal's consent was a factor in determining that someone was paid for their labour see *JMC Pty Limited v Commissioner of Taxation* [2022] FCA 750.

Citation *Jamsek v ZG Operations Australia Pty Ltd (No 3)* [2023] FCAFC 48 (Perram, Wigney and Anderson JJ, Sydney)
w http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/FCAFC/2023/48.html

2.2 DQTB – agistment activities did not constitute carrying on a business

Facts

DQTB and KHMQ are individuals.

Legal expenses

DQTB and KHMQ were formerly employed by the same organisation. In November 2016, DQTB's position in that organisation was made redundant. The exact details of the cessation of KHMQ's employment were not clear. DQTB brought an action against her former employer seeking damages for losses arising from 'adverse action' taken by the employer against DQTB. The damages sought were calculated in relation to:

1. past economic loss (plus interest on this amount);
2. future economic loss; and
3. future expenses and past special damages (relating to personal expenses such as costs of medication).

The claim was heard in the Federal Court and DQTB was unsuccessful other than in respect of a minor award of damages of $1,000. During the income year ended 30 June 2017, DQTB incurred legal expenses of approximately $9,925.

Agistment expenses

DQTB holds tertiary-level qualifications in veterinary science, but is not a licensed veterinarian. DQTB has been published in scientific journals for works relating to sheep and their reproduction.

DQTB was diagnosed with a major depressive disorder. DQTB's psychiatrist suggested that DQTB return to activities relating to her scientific background as it could be therapeutic and form part of her rehabilitation. Following the advice of her psychiatrist, DQTB considered the idea of running a sheep farm with KHMQ and sought advice from a financial advisor with KHMQ.

DQTB and KHMQ acquired a property in Tasmania in early 2017 for $450,000. At the time of settlement, the Tasmanian property comprised 75.42 hectares and included a dwelling and shed. DQTB and KHMQ also acquired chattels including a tractor and two generators from the vendor at a price of $30,000. Following settlement, DQTB and KHMQ constructed fencing at a cost of $42,720, which was completed in the 2017 income year, and also added several large dams and large water tanks.

On 10 May 2017, a company was incorporated. The company is owned by DQTB and KHMQ and at the time of incorporation, DQTB was the secretary and KHMQ was the sole director. The adviser provided that one of the purposes behind establishing the company was to '*run the farming business and hold any intellectual property …*'.

DQTB and KHMQ decided that the company would conduct a grazing business on the Tasmanian property whereby the company would agist stock on the Tasmanian property. It was agreed that the company would pay an agistment fee in the amount of $20,000 per annum to DQTB and KHMQ as the owners of the Tasmanian property. The agistment fee of $20,000 per annum was set by KHMQ based on what would be affordable by the company.

DQTB and KHMQ allegedly provided loan funding to the company to enable it to pay the agistment fees. The loan was not documented.

Towards the end of the 2017 tax year, KHMQ prepared an agistment 'contract'. The 'contract' provided:

1. for payment of an agistment fee of $20,000 per year;
2. that there would be no apportioning or pro rating of the annual fee for part years – which is relevant to the 2017 income year; and
3. for the provision of stock-proof fencing.

The 'contract' document appeared to have been signed by KHMQ both as director of the company and on behalf of the property owners. The document was not signed by DQTB and she claimed that she was not aware of the 'contract' until she was preparing to respond to the Commissioner's audit.

Even though the agistment occurred for only a few months in the 2017 income year, the full amount of $20,000 was charged to the company.

Income tax returns

DQTB claimed deductions for legal expenses in her income tax return for the income year ended 30 June 2017. DQTB prepared her tax return personally, without assistance from a tax agent or advisor.

DQTB also claimed deductions for 'work-related expenses' included expenses for dinners and wine for employees and contractors of DQTB's former employer.

DQTB and KHMQ claimed deductions for expenses incurred in relation to the agistment activities in the income year ended 30 June 2017, on the basis that they were carrying on a business of providing agistment and full care animal husbandry and veterinary services to the company they owned.

The Commissioner conducted an audit of DQTB and KHMQ's tax affairs for the income year ended 30 June 2017. The Commissioner denied the deduction claims and issued amended income tax assessments for the income year ended 30 June 2017 to DQTB and KHMQ. The Commissioner also assessed DQTB for an administrative penalty at a rate of 50% of the alleged shortfall on the basis of recklessness.

DQTB and KHMQ objected to the amended assessments. The Commissioner disallowed the objections.

DQTB and KHMQ applied to the AAT for review of the objection decisions.

In relation to legal expenses, the Commissioner did not dispute that DQTB was entitled to a deduction for the proportions of the claim that were for past economic loss and interest on past economic loss. However, the Commissioner submitted that the proportion of the expenses relating to claims for future economic loss were not deductible as they were capital in nature and the proportions relating to future expenses and past special damages were not deductible as they were private or domestic in nature.

DQTB did not challenge the denial of the 'work-related expenses' claim.

In relation to agistment-related expenses, DQTB and KHMQ argued that the activities carried out by them on the Tasmanian property amounted to carrying on a business.

The Commissioner argued that the activities carried out by DQTB and KHMQ on the Tasmanian property were in the nature of a hobby. The Commissioner referred to the decision in *Fletcher v Federal Commissioner of Taxation* [1991] HCA 42 and argued that the deductions allowable are limited to the amount of the agistment income of $10,000 derived by each of them in the 2017 income year.

The distinction between mere agistment and agistment with management and care of animals was made by Senior Member Associate Professor Fayle in *WT94/60-63 and Commissioner of Taxation* [1995] AATA 582 at paragraph [29] (emphasis added):

> *Agisting another's livestock does not ordinarily constitute the carrying on of a business.* ***Agistment fees ordinarily are in the nature of rent****. However,* ***where a land owner is charged with the management, maintenance and care of the animals agisted then it is possible that the person is carrying on a business, the reward for which is the agistment fee.*** *This is more likely if the level of the agistment fee depended on the effective management, maintenance and care of the animals. For example, if a land owner agreed with the owner of a herd of cattle to ensure their good health,* ***proper veterinary care and husbandry*** *of the progeny, marketing of their bodily produce and maintenance of the herd, then that land owner may be carrying on a business of primary production …*

DQTB and KHMQ claimed that the agistment fee was in return for making the land available for agistment as well as providing some animal husbandry services and veterinary care, but the Commissioner argued that there was insufficient evidence to prove such arrangements between DQTB and KHMQ and the company.

Evidence was obtained from Mr John Tuskin, who has 35 years' experience in the agricultural service industry evidence, that an annual fee of $20,000 was not an uncommercial amount to charge for agistment on the Tasmanian property.

Issues

1. Were DQTB and KHMQ entitled to claim deductions for agistment-related expenses on the basis that they were carrying on a business?
2. Was DQTB entitled to claim deductions for legal expenses in relation to action against a previous employer?
3. Should the 50% penalty assessed to DQTB be remitted?

Decision

Deductions for agistment-related expenses

The AAT noted that, whether the company carried on a business was not directly in issue, however, the nature and extent of the company's activities are relevant to determining whether DQTB and KHMQ carried on an agistment services business, as the purported business was intertwined with the business purportedly carried on by the company.

The AAT did not accept that DQTB and KHMQ agreed to provide any particular level of care in return for the agistment fee. As DQTB was not a licenced veterinarian, she could not provide veterinary services. Additionally, the AAT found that the external veterinary services were provided to the company and not provided to DQTB and KHMQ. Noting that there is no special rule to determine whether providing agistment arrangements constitutes carrying on a business, the AAT considered the following indicia:

1. the existence of a profit-making purpose;
2. the scale of the activities;
3. the commercial character, or otherwise, of transactions; and
4. whether the activities are systematic and organised, often described as carried out in a business-like manner.

The AAT found that:

1. while it could be argued that the company had a profit-making purpose, the Senior Member was unable to reach any degree of satisfaction that DQTB and KHMQ turned their minds to the question of profitability of the agistment arrangements as there was no evidence of any calculations to determine whether the agistment fee would generate a profit for DQTB and KHMQ after allowance for expenses;
2. the agistment activities were on a relatively small scale, with the company being the only client;
3. the $20,000 agistment fee paid by the company for only a few months in the 2017 income year exceeded commercial rates. Additionally, the arrangements concerning payment of the agistment fee were also uncommercial as the amount of $20,000 was advanced to the company from DQTB and KHMQ. The advance was not documented and there are no agreed repayment terms; and
4. DQTB and KHMQ conducted activities to some extent in a business-like manner, but there was a high degree of informality, especially in relation to payment of the agistment fee. Additionally, DQTB and KHMQ did not have a business plan.

The AAT held that DQTB and KHMQ were not carrying on a business.

Deductions for legal expenses

The AAT accepted that past economic loss and interest on past economic loss amounted to 16.97% and 0.93% respectively of the total claim. These percentages provided a reasonable basis for apportioning the expenses claimed and a deduction should be allowed for the amount of approximately $1,776 calculated by reference to these percentages of the legal fees of $9,925.

However, the AAT found that DQTB had not successfully proved that the expenses in relation to the claims for future losses, future expense or past special damages should be deductible.

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Remission of penalty

The AAT found that the base penalty should be proportionately adjusted to take account of the allowable deduction for some of the legal expenses.

The AAT considered that the 50% penalty was harsh in respect of the deduction claimed for legal fees, as this is a technical area. In relation to the legal expenses issue, a penalty in the order of 10% of the shortfall was found to be appropriate, on the basis that there was no evidence that DQTB undertook any inquiries to determine the correct tax treatment.

The AAT considered a penalty of 30% of the shortfall to be appropriate in relation to the agistment-related expenses claim. This was based on weighing DQTB's personal circumstances and health issues and the difficult question of determining when a business is carried on against the fact that substantial deductions were claimed without DQTB taking steps to satisfy herself of the validity of the claims.

As no evidence was led in relation to the work-related expense claims, no remission was found to be appropriate.

After the adjustment for allowable legal expense deductions, the base penalty remaining was remitted by $5,000.

COMMENT – it is not clear why the agistment expenses part of this case was run purely on whether DQTB and KHMQ were carrying on a business, but it may be related to their ability to claim primary production write-offs such as those in Subdivision 40-F of the ITAA 1997. For instance, to be able to write off expenditure in full on a fencing asset (and here $42,720 was spent on fencing) section 40-525(4) requires that the 'capital expenditure you incurred on the construction, manufacture, installation or acquisition of the fencing asset must have been incurred primarily and principally for use in **a primary production business** that you conduct on land in Australia'.

Citation *DQTB and Commissioner of Taxation (Taxation)* [2023] AATA 515 (Senior Member R Olding, Brisbane)
w http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/AATA//2023/515.html

2.3 Konebada – input tax credits for legal services

Facts

Konebada Pty Ltd is the trustee for the William Lewski Family Trust, which was established for the benefit of William Lewski and his family. William controlled the trust and was a director of the trustee with his son, Ari Lewski. The William Lewski Family Trust was part of the Lewski Family Group which consisted of the members of William's family and related entitles.

Both William and Konebada Pty Ltd as trustee for the William Lewski Family Trust were registered tax agents. Konebada Pty Ltd as trustee for the William Lewski Family Trust had taken over William's consultancy and tax agent practice. This practice engaged William to provide consultancy services the Lewski Family Group as well as members of the general public.

The consultancy practice that was carried on by Konebada Pty Ltd as trustee for the William Lewski Family Trust also provided advice regarding residential aged care and home care businesses. These businesses were carried on by members of the Lewski Family Group.

In October 2017, the Konebada Pty Ltd (in its capacity as trustee for the William Lewski Family Trust) entered into various deeds titled '*Litigation Funding Agreements*'. The litigation funding agreements were between the

trust as a 'litigation funder' and various members of the Lewski Family Group as 'beneficiaries'. Under these agreements the trust agreed to pay the litigation costs of the beneficiaries.

These litigation funding agreements related to court or tribunal proceedings involving members or entities of the Lewski Family Group. Konebada Pty Ltd was not a party to any of these proceedings. Konebada Pty Ltd would engage the lawyers and other professional advisors in relation to these proceedings on behalf of the beneficiaries. William, as the director of the trustee, would give instructions to the advisors and then pass on the advice to the relevant beneficiaries. Konebada Pty Ltd (in its capacity as the trustee of the William Lewski Family Trust) was also paid the invoices of the advisors.

Konebada Pty Ltd also paid invoices for fees provided by lawyers and other professional advisors that were not related to litigation.

Konebada Pty Ltd (in its capacity as the trustee of the William Lewski Family Trust) was claimed input tax credits for fees paid for the services of the lawyers and other advisors in respect of the litigation services and the other services for the period of 1 January 2015 to 31 December 2017.

The Commissioner of Taxation issued amended assessments for each quarterly period form 1 January 2015 to 31 December 2017. These amended assessments disallowed the input tax credits claimed.

Konebada Pty Ltd objected to the amended assessments issued by the Commissioner. The Commissioner disallowed the objection and upheld the amended assessments.

Under the GST Act, a taxpayer can claim input tax credits for invoices paid for professional services if the professional services were acquired by the taxpayer within the meaning of section 11-5(a) of the GST Act. The supplies to the taxpayer must also be a taxable supply within the meaning of section 11-5(b) of the GST Act. The professional services must also be acquired by the taxpayer in carrying on an enterprise.

Konebada Pty Ltd argued that the services of lawyers and professional advisors were taxable supplies acquired by the trust. In respect of the litigation services, the services were simultaneously a supply to the beneficiaries under the Litigation Funding Agreements and to the William Lewski Family Trust. In regard to the other services, the services were provided exclusively to the William Lewski Family Trust it used to provide advice to the relevant member or entity of the Lewski Family Group.

Konebada Pty Ltd also argued that both of these services were acquired by the trust in the course of carrying on an enterprise, being the provision of litigation, tax, regulatory and legal consultancy services to the Lewski Family Group. The trust claimed that it received distributions, fees and dividends for these services.

The Commissioner argued that the William Lewski Family Trust did not acquire the services as the services were supplied to the members or entities of the Lewski Family Group. The Commissioner also contended that, even if the trust had acquired the services, the services were not acquired in carrying on an enterprise. This was because the arrangement between the William Lewski Family Trust and the members of the Lewski Family Group lacked the necessary commercial character to be considered carrying on an enterprise.

Issues

1. Did the William Lewski Family Trust acquire the services of the lawyers or other advisors by way of a taxable supply?
2. Did the William Lewski Family Trust acquire the services of lawyers or other advisors in carrying on an enterprise?
3. Did the William Lewski Family trust acquire the services of lawyers or other advisors relate to making supplies that would be input taxed as financial supplies?

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Decision

Did the William Lewski Family Trust acquire the services of the lawyers or other advisors by way of a taxable supply?

The Court noted that, while the William Lewski Family Trust was required to pay the litigation costs of the beneficiaries, the Court considered that the William Lewski Family Trust was not obliged to retain the lawyers or other advisors under the litigation funding agreements.

However, the Court considered evidence provided by lawyers engaged by the William Lewski Family Trust. This evidence demonstrated that there was a pre-existing arrangement between the trust and the service providers whereby the trust engaged the advisors on behalf of the beneficiaries. The trust would then be invoiced from the professional service providers and would pay those invoices. This arrangement existed outside of the Litigation Funding Agreements.

The Court concluded that there was an arrangement whereby the William Lewski Family Trust obtained services of lawyers and advisors which were provided to the beneficiaries at the request of the William Lewski Family Trust.

Therefore, the William Lewski Family Trust acquired a service which was the provision of legal advice or services for the beneficiaries and the supply acquired by the trust was also a taxable supply.

Did the William Lewski Family Trust acquire the services of lawyers or other advisors in carrying on an enterprise?

For the William Lewski Family Trust to claim credits for the services of lawyers or advisors that it had acquired, the services must have been acquired by the trust in the course of carrying on an enterprise.

In this respect, the Court distinguished between the acquisition of services while carrying on an enterprise and the acquisition of services in carrying on an enterprise. For input tax credits to be claimed, the acquisition of services must be in carrying on an enterprise. It is not sufficient that the services were acquired during a period when an enterprise was being carried on. Rather, the services acquired must be used for the purposes of the enterprise.

The Court considered that there was not sufficient connection between the services provided by the trust to the Lewski Family Group and the generation of income. Therefore, the activities of the William Lewski Family Trust did not have a sufficient commercial purpose to be considered carrying on an enterprise of providing litigation consulting services or a business of receiving and disseminating advice.

Furthermore, the Court found that there was no evidence that the William Lewski Family Trust was paid a fee or other consideration for the procurement of professional services. The litigation funding arrangement could not be considered in the nature of trade. This arrangement resulted in the trust incurring significant costs in the absence of an entitlement to fees for the services provided by the trust to the beneficiaries in the arrangements. Even if the trust was to receive a share in the litigation proceeds, it would be unlikely that such a payment would be sufficient to reimburse the trust for all the costs incurred in the proceedings (an award for taxed costs was unlikely to equal or exceed actual costs).

The Court concluded that the William Lewski Family Trust did not acquire the services of lawyers or other advisors in carrying on an enterprise.

Because of this conclusion, it was not necessary to consider the issue of whether the professional services would be input taxed as financial supplies.

The Court ultimately held that because the acquisition by the William Lewski Family Trust of professional services was not made in carrying on an enterprise, the trust was not entitled to claim input tax credit in respect

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of invoices paid for the services. Therefore, the decision of the Commissioner to disallow the objection to the amended assessments was upheld.

Citation *Konebada Pty Ltd ATF the William Lewski Family Trust v Commissioner of Taxation* [2023] FCA 257 (Hespe J)
w https://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/FCA/2023/257.html

2.4 Godolphin – land tax primary production exemption

Facts

Godolphin Australia Pty Ltd operated a business that involved the breeding, sale and racing of thoroughbred racehorses. The most profitable part of the business was the sale of covering services by stallions. This involved Godolphin receiving a fee for the use of stallions to impregnate mares owned by others.

One of the activities conducted by Godolphin was the 'education' or 'breaking in' of racehorses. This begins when the horses are around 2 years old and lasts until the horse retires from racing at around 5 to 6 years of age. Godolphin commences training around 120 horses each year.

Around 95% of the male horses that Godolphin breeds are neutered once the racing prospects of the horse has been assessed. Godolphin sells around 70% of the horses that it breeds.

Godolphin owned four properties which it used to conduct this business. Godolphin was assessed for land tax by the Chief Commissioner in respect of two of these properties.

Godolphin sought review of the decision of the Chief Commissioner to refuse to apply the primary production exemption for land tax to the two properties owned by Godolphin.

Under section 10AA(3)(b) of the *Land Tax Management Act 1956* (NSW) an exemption to land tax applies where the land's dominant use is for primary production. For this exemption to apply the land must be rural land or non-rural land that has a significant commercial nature and is used for the purpose of profit on a continuous basis.

At first instance, the main issue that the Court considered was whether the dominant use of the land by Godolphin was for the maintenance of animals for the purpose of selling them, their natural increase or their bodily produce for the purposes of section 10AA(3)(b) of the *Land Tax Management Act*.

The Court held that Godolphin operated an integrated operation which involved the maintenance of horses for both horse racing and the sale of progeny and that all the parcels of land should be subject to the primary production land tax exemption. The Court upheld Godolphin's objection.

The Chief Commissioner appealed the decision of the Court.

The Chief Commissioner contended that the dominant use of the land was for breeding, educating and training thoroughbred horses, and spelling them between races, with a view to achieving success in horse racing. This was distinguished form the use of the land for breeding for sale and other stud activities which was ancillary to the use of the land for horse racing. Therefore, the primary production exemption did not apply as the dominant use of the land was not for the purposes of maintaining animals for sale.

Godolphin argued that the land was 'used for primary production' because under its business model, the racing of horses was complementary to the breeding services, broodmare and progeny. Godolphin contended that '*the purpose of sale and the purpose of racing are two aspects of a single composite purpose*'. Godolphin argued that the requirement concerning 'dominant use' related only to the activities on the land (being the maintenance of animals) and that it was not necessary to consider whether the dominant purpose of the animals maintained

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was for the purposes of sale. The heading of their submissions on this point was "Dominant use, not dominant purpose".

Issues

1. Does the requirement of 'dominant use' only concern the activities on the land and not the purpose of the use of the land?
2. Was the dominant use of the properties owned by Godolphin the maintenance of animals for the purpose of selling those animals or their bodily produce?

Decision

Meaning of 'dominant use' and 'purpose'

The Court considered that whilst the terms 'use' and 'purpose' were commonly connected, they were distinct terms. The term 'use' concerns the physical activities conducted on the land whereas the term 'purpose' considers the reason why those physical activities are conducted on the land.

The test for the purpose of the primary production exemption involves a consideration of both use and purpose. The relevant consideration for the primary production exemption is whether the dominant use of the land is for primary production. In other terms, the dominant physical activities on the land must be carried out for primary production purposes (being the maintenance of animals for the purpose of selling them or their natural increase or bodily produce).

Were the properties owned by Godolphin used for the dominant use of the maintenance of animals for the purpose of selling those animals?

The Court first considered the use of the land, being the activities conducted by Godolphin on the properties. The activities conducted by Godolphin on the land largely involved the maintenance of animals for the purpose of both racing horses and selling horses.

The Court then considered the purpose for which these activities were conducted on the properties. For the exemption to apply, the dominant use of the land must be the maintenance of animals for the purpose of selling the animal, its progeny and its produce. This required the racing purpose to be ancillary to this sale purpose or if these two purposes were distinct, the sale purpose to be less dominant.

Although breeding and the value of stallions for covering services was affected by the racing success of the stallions, it could not be said that the sale purpose and the racing purpose were integrated. Considering industry practice, it was clear that these were two distinct purposes.

The Court considered the activities conducted on the properties and the area of land on which those activities were conducted. On one of the properties, the majority of the land was used for keeping breeding mares and yearlings for a period of time. The other property was used to keep stallions, educating facilities and training racehorses including a racing track. Only 10% of the land was used for covering services. Therefore, the majority of the land was devoted to racing activities, not the sale and covering activities.

The Court also considered the intensity of the activities conducted on the land, including from a financial perspective. Most of Godolphin's employees conducted racing activities. From a financial perspective, although the revenue from the sale purpose did exceed the value of the prize money from racing, this was not material. However, the Court considered that it could not be concluded that the breeding services were the dominant economic driver. In particular, horse racing had more motivations beyond a mere economic reward.

Godolphin's marketing was also dominated by the racing success of the stallions. A large factor in deciding whether mares should be serviced by stallions of Godolphin was the racing success of the stallions as this was indicative of genetic stock.

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The Court considered that, although Godolphin had demonstrated that activities conducted on the land were directed to the sale purpose, Godolphin failed to establish that this was the dominant purpose. Considering the activities, area of the land on which the activities were conducted, intensity of the activities and the resources directed towards the purpose, the dominant use of the properties owned by Godolphin was for the racing purpose.

Therefore, the Court held that the primary production exemption did not apply to the two parcels of land used for maintaining racehorses and the appeal of the Chief Commissioner was allowed.

Citation *Chief Commissioner of State Revenue v Godolphin Australia Pty Ltd* [2023] NSWCA 44 (Kirk JA, Simpson AJA, Griffiths AJA)
w http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/nsw/NSWCA//2023/44.html

2.5 Embedded Claims – shares did not vest in trustee in bankruptcy

Facts

On 4 March 2019, Mr Philip Kapp was declared a bankrupt.

On or around 23 March 2020, Embedded Claims Pty Ltd (**Embedded**) was incorporated. At the time of its incorporation, the shareholders were Aeris Capital Pty Limited (**Aeris**) as to 50 shares and Litigation Finance (Australia) Pty Ltd (**Litigation Finance**) as to the remaining 50 shares. Mr Patrick Dale was the sole director and company secretary of Embedded.

Embedded was a joint venture vehicle of Patrick and Philip. Patrick's interest in the joint venture consisted of the 50 shares in Embedded held by Aeris and Philip's interest in the joint venture consisted of the 50 shares in Embedded held by Litigation Finance.

In or around October 2020, Embedded applied to the National Australia Bank (**NAB**) to open a bank account. NAB informed Patrick in early November 2022 that the process to open the account had been delayed because there were compliance issues arising from NAB's 'know your customer' policies.

On 9 November 2020, Philip sent an email to Patrick (copying in his wife, Mrs Maryann Kapp) which read:

> *Patrick,*
>
> *I spoke to the NAB re what they need to get our account open. I can't fix Litigation Finance in time, so:*
>
> 1. *I have transferred the 50 shares to the James Trust (the ultimate holding trust)*
> 2. *Maryann is one of the trustees of the James Trust; accordingly she owns the shares non-beneficially (as trustee)*
> 3. *I have managed to update the ASIC records accordingly - so company records and ASIC records are correct*
> 4. *I moved the registered office of EC to 50 Clarence Street and have updated records*
> 5. *NAB wants a copy of the James Trust Share Certificate. Attached for your signature!! I will get M to sign before we go to NAB.*

The records of Embedded were updated by the lodgement of an ASIC Form 484 on the same day which recorded a reduction in the shares held by Litigation Finance in Embedded from 50 shares to nil and an increase in the shares held by Maryann in Embedded from nil to 50 shares which she did not hold beneficially. The changes were recorded as having occurred on 6 November 2020.

On 26 November 2020, Patrick spoke with an officer of NAB, who informed him that NAB was still having problems opening the account as they could not verify the ultimate beneficial ownership of the 50 shares in

Embedded. There were a number of email exchanges between Patrick and Philip on 26 November 2020, including an email from Patrick to Philip stating that:

> *… In order for NAB to approve the account they are saying that it is OK for Maryann to not beneficially hold the EC shares (as it is currently) however the James Trust would need to be amended to reflect her as the sole trustee - at the moment the James trust has three trustees.*
>
> *Alternatives would be to amend the trust to show Maryann as the sole trustee or to change the EC shareholding to simply be in Maryann's name as the beneficial owner (the easy and quick option IMO) …*

On the same day, Patrick reportedly said to Philip in a telephone conversation words to the effect *'I don't mind whether you transfer the shares to Maryann or you provided that it gets the bank account opened as soon as possible'*. Several hours later, Maryann sent an email to Philip stating, *'Wouldn't the quickest and easiest option be to simply amend the [Embedded] shareholding to be just in my name?'*.

On 27 November 2020, an ASIC Form 484 was lodged (**27 November Form 484**) whereby, Maryann's non-beneficial ownership of 50 shares in Embedded was reduced to nil and Philip's shareholding in Embedded increased from nil to 50 shares. These changes were recorded as having occurred on 26 November 2020 and noted that Philip's shares were held by him beneficially.

On 17 February 2021 50 shares in Embedded were transferred from Mr Kapp to Litigation Finance as the legal and beneficial owner.

Embedded and Aeris together sought orders from the Federal Court rectifying the ASIC record. They claimed Litigation Finance took its transfer from Philip at a time when the shares formed part of the bankrupt estate of Philip and that his trustees in bankruptcy should be recorded as the holders of the shares.

<u>Primary judgment</u>

Only the first of the two questions identified to be answered by the primary judge in the initial proceedings was considered on appeal, being whether Philip became beneficially entitled to 50 shares in Embedded on 26 November 2020. The primary judge answered the question 'no', meaning the shares **did not** vest in the trustees in bankruptcy pursuant to section 58(1)(b) of the *Bankruptcy Act 1966* (Cth) as after acquired property.

The primary judge, noting that the evidence was sparse, identified three possibilities for what in fact occurred:

1. Philip was unconcerned by legal formalities and simply adjusted the corporate records to meet his convenience so that the alterations to the share register do not reflect any underlying reality;
2. Maryann, as trustee of the James Trust, renounced the trust's interest in the 50 shares and having done so, transferred them to Philip; or
3. Maryann, as trustee of the James Trust, transferred the shares to Philip without limitation.

The primary judge considered that either scenario (1) or (3) was more likely than not correct, but did not determine which, because they both led to the same conclusion that Philip was never beneficially entitled to the 50 shares in Embedded. In reaching that conclusion, the primary judge noted that Maryann held the shares as trustee of the James Trust and could not simply transfer trust property to a third party (importantly, this fact was not disputed on appeal).

<u>Appeal</u>

Embedded Claims appealed the decision of the primary judge, arguing that the primary judge assigned no, or no material, evidentiary weight to the 27 November Form 484 and ought to have found that Maryann transferred the 50 shares in Embedded to Philip beneficially. Embedded Claims also sought to advance a further possibility for what in fact occurred that was not considered by the primary judge, namely that Maryann as trustee of the James Trust made an in-specie distribution of the shares to Philip as a beneficiary of the James Trust in accordance with the terms of the James Trust.

Issue

Was Philip ever beneficially entitled to the 50 shares in Embedded?

Decision

The Court dismissed the appeal and made no order as to costs.

The Court reached its decision based on eight reasons, including the following reasons:

1. the email Maryann sent to Philip on 26 November 2020 focussed on what would be quick and easy and was not consistent with a trustee acting properly and with due deliberation as to whether trust property (the shares in Embedded), could be transferred to Philip beneficially;
2. Philip previously used the corporate records of Embedded to effect changes which did not reflect any actual transactions;
3. there was no indication of any concern on the part of Maryann (or Philip) to give effect to the James Trust or that the alternatives being considered by Maryann and Philip were informed by the terms of the James Trust;
4. only Philip dealt with NAB in order to open the bank account, despite Maryann holding the shares in Embedded as trustee of the James Trust;
5. Patrick's conversation with Philip on 26 November 2020 did not occur by reference to any trust obligations; and
6. NAB was not informed that there was a distribution of shares to Philip, nor did Philip explain to NAB how the transfer of shares occurred in accordance with the terms of the James Trust. The Court found this to be significant as NAB was previously informed that Maryann held the shares as trustee of the James Trust.

COMMENT – as occurs with journal entries, updates to ASIC records are intended to record transactions, not to be transactions in themselves, and there must be an underlying change that actually occurs. In some instances a change cannot occur without other things, such as director's approval, occurring. In respect of the transfer of a share, there should be a share transfer under section 1071B of the *Corporations Act 2001* for a share transfer to be registered.

Citation *Embedded Claims Pty Ltd v Litigation Finance (Australia) Pty Ltd* [2023] FCAFC 30 (Markovic, Colvin and Thawley JJ, New South Wales)
w http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/FCAFC/2023/30.html

2.6 Camilleri – tax agent providing state taxes advice

Facts

Carol Galea, Reno Camilleri and Peter Camilleri commenced proceedings in the Supreme Court of New South Wales against John Camilleri (in his capacity as executor) in respect of claims arising out of the estate of the Late Patricia Camilleri.

Patricia died on 21 October 2014. Patricia left a Will dated 20 September 2010 and a Codicil dated 15 November 2013, probate of which was granted to John on 14 August 2013.

From early 2014 (including prior to Patricia's death), the family engaged in various litigation proceedings in respect of Patricia's estate.

Various professional advisors were involved in the proceedings, including Christopher Batten, a director and principal of MGS Private Pty Ltd (**MGS**) who was an accountant, chartered tax advisor and registered tax agent. Other advisors included John Mann and Kyle McCabe, solicitors of Turner Freeman (who acted for the estate), and various solicitors from Elderlaw Legal Services, who acted for Carol, Peter and Reno.

On 11 April 2018, Christopher Batten, on behalf of MGS, provided John (in his capacity as executor) with an engagement agreement. The engagement agreement did not set out the terms of the services to be provided. It instead provided that Christopher's charge out rate was $900 (excl GST) with a disclaimer as follows:

> *In appropriate cases, having regard to urgency, responsibility, special expertise or care and skill and other similar factors, I may charge fees at a higher rate not exceeding 150% of the rates quoted above.*

Christopher provided advice to John in respect of various matters concerning:

1. John and Martin's personal interests;
2. taxation related advice to John and Martin in respect of the purchase of a Londonderry property;
3. work and advice related to John and Martin's attempts to obtain a stamp duty exemption for the appropriation by them of a property at Wingara Glen.

The matters in relation to which Christopher completed work and advice in respect of the *Duties Act 1997* (NSW) are set out below.

On 26 July 2018, Christopher sent a memo to Turner Freeman referring to the draft deed provided to him on 25 July 2018 and making the following comments: '*Each party should be free to obtain their own advice, at their own cost, in relation to income tax and stamp duty and to put to the executor any arrangement that may legally reduce the incidence of income tax and/or stamp duty*.'

On 26 November 2018, Christopher provided Turner Freeman with advice in respect of transfer duty.

On 5 July 2019, Turner Freeman wrote to Elderlaw indicating that the principal delay in John's ability to finalise administration of the estate is that he was awaiting the outcome of a number of applications relating to taxation and duty which he had provided instructions to Christopher to make.

On 12 July 2019, Elderlaw responded to Turner Freeman indicating that Elderlaw's clients wished to see records of correspondence with Christopher and any final or draft application and the advice that he had sent to Turner Freeman or John.

On 2 August 2019, Turner Freeman emailed Christopher requesting provision of an update as to the status of the applications for exemption of stamp duty and any other applications being made on behalf of the estate.

On 5 August 2019, a formal letter was sent by Turner Freeman to Christopher requesting an urgent response and an update of the status of the applications.

On 9 August 2019, Turner Freeman responded to Elderlaw by letter noting that they were still awaiting completion of work to be completed by Christopher and emphasised that completion of the administration of the estate could not occur until Christopher had provided his advice both as to CGT and stamp duty issues. Reference was made to the fact that Christopher was on extended leave due to personal reasons.

On 10 August 2019, Christopher sent a letter to Mira Brewster, a Senior Technical Advisor with the Duty Services Unit at Revenue NSW. Further, on 10 August 2019, Christopher sent a letter to the Commissioner of Taxation seeking an application for a private ruling and an application for exercise of discretion pursuant to section 152-80(3) of the ITAA 1997 in respect of an Arndell Park property.

On 15 August 2019, Christopher emailed Mira the letter he had previously sent to her noting that the matter was 'a little urgent'. On the same day, Mira emailed Christopher noting that the matter had been allocated a reference number and, in particular, that the letter had only been received by the Duty Services Unit on 14 August 2019 and it would take approximately 3 to 4 weeks for the matter to be assessed.

On 26 September 2019, Karen Lamont from Revenue NSW raised a requisition.

On 27 September 2019, Christopher sent an email to the firm who represented the estate, requesting them to arrange for John and Martin to sign attached applications for exemption pursuant to section 274 of the Duties Act before appropriate witnesses in respect of their receipt as transferees of property.

On 25 November 2019, Christopher provided a letter of advice to John as executor regarding the five residuary properties. The letter, among other things, stated that Revenue NSW had sent a requisition on 26 September

2019 and that, now that the ATO had provided its ruling in respect of the Londonderry property, further information could be provided to Revenue NSW.

During the period commencing 11 April 2018 to 6 April 2022, MBS issued four invoices totalling $122,912.50, including invoice number 1720 issued on 30 November 2019 in the sum of $49,747.50.

Invoice 1720 contained certain time entries as follows:

Line	Date	Description	Amount
2	26/11/2018	Reading Tay v Chief Commissioner of State Revenue [sic] and letter to Kyle McCabe [sic] concerning transfers and section 63 (1) (a) (iii) of the Duties Act 1997 post the Tay decision.	$3,375.00
7	10/08/2019	Drafting submission to Mira Brewster concerning the application of section 63(1)(a)(iii) of the Duties Act 1997	$9,450.00
11	26/11/2019	Drafting letter to John Camilleri concerning the state of the rulings from the ATO and application to Revenue NSW as to section 63 of the Duties Act 1997.	$2,700.00

The representatives for Carol, Reno and Peter submitted that some or all of the work completed by Christopher (as a tax agent) was in the nature of legal work and that, pursuant to section 10(2) of the *Legal Profession Uniform Law* (NSW) (**Uniform Law**), Christopher was not entitled to recover fees performed for that work and that the estate should be entitled to a reimbursement for such fees.

Section 10 of the Uniform Law relevantly provides (with **emphasis**):

(1) An entity must not ***engage in legal practice*** *in this jurisdiction, unless it is a qualified entity. Penalty: 250 penalty units or imprisonment for 2 years, or both.*

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

The representatives for John made reference to the *Tax Agent Services Act 2009* (Cth) (**TAS Act**) which he argued allowed tax agents to provide tax agent services which extend to the matters in that definition. 'Tax Agent Services' is defined within section 90-5 of the TAS Act as follows (with **emphasis**):

(1) A tax agent service is any service:

(a) that relates to:

*(i) ascertaining liabilities, obligations or entitlements of an entity that arise, or could arise, under a ** ***taxation law****; or*

(ii) advising an entity about liabilities, obligations or entitlements of the entity or another entity that arise, or could arise, under a taxation law; or

(iii) representing an entity in their dealings with the Commissioner; and

(b) that is provided in circumstances where the entity can reasonably be expected to rely on the service for either or both of the following purposes:

(i) to satisfy liabilities or obligations that arise, or could arise, under a taxation law;

(ii) to claim entitlements that arise, or could arise, under a taxation law.

(2) A service specified in the regulations for the purposes of this subsection is not a tax agent service.

The terrm 'taxation law' is defined within section 995-1 of the ITAA 1997 as follows:

(a) an Act of which the Commissioner has the general administration (including a part of an Act to the extent to which the Commissioner has the general administration of the Act); or

(b) legislative instruments made under such an Act (including such a part of an Act); or

(c) the Tax Agent Services Act 2009 or regulations made under that Act.

Issue

Did the work carried out by Christopher in relation to the Duties Act involve Christopher impermissibly engaging in legal practice in contravention of section 10 of the Uniform Law?

Decision

At the request of Christopher, the Court granted to him a certificate pursuant to section 128 of the *Evidence Act 1995* (Cth) which provides privilege in respect of self-incrimination in other proceedings.

The Court declined to decide the issue on the basis of procedural fairness. Specifically, that:

1. Christopher was not joined to the proceedings and did not have the rights of a party to the proceedings;
2. there was a contestable issue regarding whether Christopher's work and advice in respect of the application for exemption under the Duties Act involved Christopher impermissibly 'engaging in legal practice'.

COMMENT – it is clear that the Tax Agent Services Act does not authorise a tax agent to advise on Acts that are not administered by the Federal Commissioner of Taxation. Whether providing advice on the operation of State law, or completing forms in connection with State law obligations constitutes engaging in legal practice was not decided in this case.

Citation *Galea v Camilleri; The Estate of Patricia Camilleri* [2023] NSWSC 206 (Meek J, Sydney)
w http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/nsw/NSWSC/2023/206.html

2.7 Frigger – superannuation assets in bankruptcy

Facts

Angela Frigger and Hartmut Frigger are husband and wife. Angela is a retired accountant and registered tax agent. They were the trustees of the Frigger Superannuation Fund (FSF) which is a self-managed superannuation fund.

Angela and Hartmut were declared bankrupt in July 2018. Kelly-Anne Trenfield was appointed as their trustee in bankruptcy.

On 25 July 2018 trustee in bankruptcy gave instructions to BankWest and the Bank of Queensland to prevent payments being made out of accounts held in the names of Angela and Hartmut. On 26 July 2018, the trustee in bankruptcy claimed an interest in two residential properties held in Angela's name.

Section 116 of the *Bankruptcy Act 1966* (Cth) provides that certain property, including property held on trust for another person or an interest of the bankrupt in a regulated superannuation fund, does not form part of the property that may be divided among the bankrupt's creditors.

Angela and Hartmut alleged that a number of bank accounts, residential properties and share portfolios were assets of their superannuation fund and were not divisible assets in their bankrupt estate.

The assets that were alleged to be FSF assets were:

1. two Bank of Queensland bank accounts;
2. a CommSec Trading account and share portfolio; and
3. residential properties located at Union Street, Bayswater and at Cale Street, Como.

This case has a long procedural history with over 13 judgments, in which Angela and Hartmut sought to prove that these assets were assets of the superannuation fund and challenged freezing orders and other actions taken by the trustee in bankruptcy in relation to the assets.

<u>Bank of Queensland accounts</u>

At the time of the primary decision relating to the bank accounts, the first Bank of Queensland account was in Hartmut's sole name and the second Bank of Queensland account was in Angela's sole name.

The funds of the second Bank of Queensland account came from two HSBC accounts.

The funds of the first Bank of Queensland account came from the second Bank of Queensland account.

There was one invoice for rent from a property in Campbell Street, Hobart (which was confirmed to be a FSF asset by the bankruptcy trustee) directing payment into one of the HSBC accounts. This was the only evidence relied upon by Angela and Hartmut that the Bank of Queensland accounts were FSF assets.

At first instance, the Court concluded that there was no evidence as to when the first Bank of Queensland account and the second Bank of Queensland account were designated as being FSF accounts and that a change of account name was not satisfactory evidence to prove either account was an FSF asset.

In *Frigger v Trenfield (No 10)* [2021] FCA 1500) the Court made the following observations as to the creditability of witnesses:

1. Hartmut did not give or provide any evidence;
2. Angela and the bankruptcy trustee provided all of the evidence throughout the proceedings;
3. that Angela was not a reliable or truthful witness, as she had altered documents in order to improve and support her case.

The Court then considered the particular issues that arose with respect of each disputed asset.

The first Bank of Queensland account and the second Bank of Queensland account

The issue was whether there was an objective manifestation of intention to declare the assets to be FSF assets. Angela and Hartmut argued that the money in the accounts was originally money earnt from rental income from two properties in Perth and Hobart, which had been confirmed to be FSF assets.

Tracing of the accounts was undertaken and confirmed that the funds within both the first Bank of Queensland account and the second Bank of Queensland account were not assets of the FSF.

There was no evidence to show that when the first Bank of Queensland account was opened by Hartmut, he opened the account as trustee for the FSF. Instead, the evidence suggested that it had been opened as an asset of Hartmut personally.

The Court concluded that Angela and Hartmut failed to discharge their onus of proof.

CommSec Portfolio

In determining that the CommSec Portfolio was not an FSF asset, the Court held that:

1. the financial statements, audit reports, annual returns and PPSR registration were prepared after the bankruptcy, were 'self-serving' and were not reliable evidence;
2. there is nothing on the face of any document issued by CommSec to indicate that the shares are assets of the FSF;
3. Angela and Hartmut failed to produce one record from any share registry to prove that they were holding the shares as trustees of the FSF;
4. only four securities within the CommSec Portfolio had been notified of the FSF TFN before the commencement of bankruptcy;
5. the remaining securities which had been notified of the FSF TFN occurred after the sequestration date; and
6. Angela and Hartmut failed to discharge the burden of proof.

Residential properties

Each of the residential properties was held in Angela's name as the registered proprietor. Each property was subject to a declaration of trust which were signed by Angela (as trustee) and Angela and Hartmut (as beneficiaries). The declarations of trust were not notified in a caveat against either property.

No evidence before the Court provided context in relation to the declarations of trust. There was one piece of evidence which was a document purporting to be minutes of meeting of the FSF (also dated 14 July 2014) confirming that the there was an *in-specie* transfer to the FSF for no consideration by Angela. The Court found that this document was not reliable and had been fabricated by Angela.

Due to the fraudulent minutes of meeting provided by Angela, all further evidence provided by Angela in respect of the residential properties was considered to be unreliable evidence.

The declarations of trust were accepted, but the terms of the declaration were ambiguous. The FSF was not mentioned at all in either declaration of trust. The Court found that there was an intention to create a trust of each property, but it was a separate trust to that of the FSF.

The Court found that in any case, the bankruptcy trustee had an absolute caveatable interest in the residential properties on the ground that in specie contributions of those properties by Angela to the FSF constituted contraventions of section 66 of the *Superannuation Industry (Supervision) Act 1993* (Cth) (**SIS Act**).

Angela and Hartmut appealed to the Full Federal Court .

Issue

Were the disputed assets owned by the FSF and “vested” in Angela and Hartmut as part of their allocated pensions?

Decision

Was the BankWest account an asset of the FSF?

The Full Federal Court held that the evidence produced showed that the BankWest account was in Angela's name, and at no time was she the sole trustee of the FSF and Angela was well aware that assets of a superannuation fund needed to be held in the names of the trustees.

The BankWest account was never reported as a trust asset and the mere nickname given to the account (Frigger Super Fund) does not constitute sufficient evidence to suggest that it is in fact an FSF asset.

The BankWest account had been used for a variety of purposes which did not support any inference that the money paid out retained its character as trust money;

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Were the Bank of Queensland accounts assets of the FSF?

The Full Federal Court agreed with the primary judge's findings that Angela was not a credible witness and agreed that it was necessary for Angela and Hartmut to establish that the assets were superannuation fund assets through documentary evidence.

The Full Federal Court held that Angela and Hartmut failed to provide fundamental evidence of a manifest intention that they used the BankWest account for FSF purposes and accordingly, could not establish that the funds in the first Bank of Queensland account and the second Bank of Queensland account were FSF funds. There was insufficient evidence to establish that Angela and Hartmut, as trustees of the FSF, formed an intention to allocate funds and assets to the FSF before the sequestration order.

Were the residential properties held on trust for the FSF?

The Full Federal Court observed that an asset may be treated as contributed to a superannuation fund if three things are satisfied:

1. a person intended to contribute the asset to a superannuation fund; and
2. the asset in question is capable of being contributed to a superannuation fund; and
3. the person effected the contribution of the asset such that it is held in the superannuation fund.

The onus was on Angela and Hartmut to prove that they intended for the assets to be held for the benefit of the beneficiaries of the FSF.

The Full Federal Court held that no documents that were tendered in evidence demonstrated individually or collectively an intention to contribute the residential properties *in specie* to the FSF before January 2019. The declarations of trust were ambiguous and did not create a trust relationship between Angela and Hartmut and the FSF.

Accordingly, the Full Federal Court agreed with the primary judge and confirmed that the primary judge's decision that the disputed assets were not part of the FSF and the bankruptcy trustee should remain as trustee of the bankrupt estate.

The Full Federal Court dismissed the appeal with costs.

COMMENT – this case largely turned on the evidence (or lack of it) but there are a couple of things worth noting. The Federal Court at first instance appeared to consider that, if the in-specie contributions of the real property were a breach of section 66 of the SIS Act, this was a reason for concluding that Angela did not hold them on trust for the members. The Full Court did not consider it necessary to make such a finding. It is difficult to see why the potential application of section 66 of the SIS Act, which does not invalidate transactions, could have the result indicated in the first instance decision.

The lack of clarity as to the ownership of the bank accounts, amongst other problems, gives rise to a potential breach of section 52B(2)(c) of the SIS Act, which requires trustees to keep the money and other assets of the fund separate from any money and assets that are held by the trustee personally

Citation *Frigger v Trenfield (No 3)* [2023] FCAFC 49 (Allsop, Anderson and Feutrill JJ, Western Australia)
w http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/FCAFC/2023/49.html

2.8 Appeal updates

The taxpayers have applied to the High Court for special leave to appeal against the decision of the Full Federal Court in *Hyder v Commissioner of Taxation* [2023] FCAFC 29.

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In Hyder, multiple taxpayers were issued with alternative assessment in relation to, in part, the same income for the same income years. While the taxpayers were successful in establishing that the Commissioner's conduct in not deferring recover of the assessments was oppressive, the Court also refused to quash the assessments issued to the taxpayers.

2.9 Other tax and superannuation related cases in period of 2 March 2022 – 4 April 2023

Citation	Date	Headnote	Link
Ziolkowski and Commissioner of Taxation (Taxation) [2023] AATA 292	2 March 2023	TAXATION – application for reinstatement – income tax assessment and penalty decision – extensive non-compliance with directions – citizen of Australia and United States of America	http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/AATA/2023/292.html
Potts and Commissioner of Taxation (Taxation) [2023] AATA 415	16 March 2023	PRACTICE AND PROCEDURE – JURISDICTION – Commissioner of Taxation – Tax assessment decisions – where Applicant requested Tribunal review of the decisions to impose shortfall penalties – where relevant notices do not provide Tribunal jurisdiction to review the imposition of such penalties – application dismissed for no jurisdiction	http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/AATA/2023/415.html
Bloom and Commissioner of Taxation (Taxation) [2023] AATA 417	20 March 2023	Taxation – Income tax – taxpayer's onus to prove assessment is excessive or otherwise incorrect – lack of substantiation – whether administrative penalties were correctly applied at 75% – whether administrative penalties were correctly increased by 20% – decision under review affirmed	http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/AATA/2023/417.html
Sunlite Australia Pty Ltd v Commissioner of Taxation [2023] FCAFC 43	21 March 2023	TAXATION - appeal against decision of the Australian Administrative Appeals Tribunal - where Commissioner conducted an audit and issued amended assessments - where Commissioner disallowed objection - where Tribunal upheld Commissioner's decision save as to the shortfall penalty - where appeal brought under s 44 of the Administrative Appeals Tribunal Act 1975 (Cth) - where applicant contends that the Tribunal erred in its construction of s 355-205 Income Tax Assessment Act 1997 (Cth) - where applicant contends that as a result of error in construction the Tribunal failed to determine the main issue - where respondent disputes both grounds - where respondent maintains that proceedings are incompetent as applicant seeks to raise new matters - where applicant claims entitlement to notional deduction pursuant to Income Tax Assessment Act Division 355 - where tax offset may be available for R&D entities which incur R&D expenditure - consideration of meaning of entity under Income Tax Assessment Act - consideration of circumstances in which Court on appeal from Tribunal may make factual findings - appeal dismissed	https://www8.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/FCAFC/2023/43.html
YTL Power Investments Limited v Commissioner of Taxation [2023] FCA 258	24 March 2023	PRACTICE AND PROCEDURE – application for summary dismissal of proceeding – where applicant commenced proceeding by originating application seeking declaratory relief under s 39B of the Judiciary Act 1903	http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/FCA/2023/258.html

		(Cth) – where notice of assessment issued after proceedings commenced – where the Commissioner sought summary dismissal on basis that the applicant had no reasonable prospect of successfully obtaining the declaratory relief sought – whether proceeding should be summarily dismissed	
Li v Chief Commissioner of State Revenue [2023] NSWCATAD 81	31 March 2023	TAXES AND DUTIES – Dutiable transactions – Liability – Cancelled transfers of dutiable property – Application for reassessment and refund of duty – Application lodged outside the statutory time limit – No discretion to extend the time limit	https://www.caselaw.nsw.gov.au/decision/18730a0431dbdabea512c939

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3. Legislation

3.1 Progress of legislation

Title	Introduced House	Passed House	Introduced Senate	Passed Senate	Assented
Treasury Laws Amendment (2022 Measures No. 4) Bill 2022	23/11	30/11	1/12		
Treasury Laws Amendment (2023 Measures No. 1) Bill 2023	16/02	9/03	9/03		
Treasury Laws Amendment (Refining and Improving Our Tax System) Bill 2023	22/03	29/03	30/03		

3.2 Treasury Laws Amendment Bill – various measures

On 22 March 2023, Treasury Laws Amendment (Refining and Improving Our Tax System) Bill 2023 was introduced into Parliament. The bill is intended to make a number of changes to various laws, including:

1. amending the *International Tax Agreements Act 1953* to include provision for the Icelandic Convention. The purpose of the Icelandic Convention is to eliminate the double taxation with respect to taxes on income and the prevention of tax evasion and avoidance between Australia and Iceland;
2. amending the ITAA 1997 to extend the income tax treatment that applies to the Future Fund Board to its 100% subsidiaries incorporated in Australia;
3. improving the governance, reduce complexity and boost integrity of the Deductible Gift Recipient framework; and
4. amending the *Excise Act 1901* and the *Customs Act 1901*, respectively, so that an eligible business entity liable for excise duty for excisable goods or customs duty for excise-equivalent foods (such as fuel and alcohol) can align their excise returns and customs returns with the return period for other indirect taxes that are reported through the BAS.

w https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r6996

3.3 Consultation on thin capitalisation measures

On 16 March 2023 Treasury released '*Treasury Laws Amendment (Measures for Future Bills) Bill 2023: Thin capitalisation interest limitation*' as an exposure draft. Among other things, the proposed legislation is intended to align Australia's thin capitalisation rules with the approach recommended by the OECD.

The thin capitalisation rules are intended to limit debt deductions for multinational enterprises to prevent profits being shifted out of Australia. The current rules are based on an entity's debt-to-equity funding ratio, looking at the entity's assets.

The bill does not propose to amend the current $2 million associate-inclusive *de minimis* threshold for the thin capitalisation rules application.

The exposure draft proposes the following legislative changes:

1. a new 'general class investor' definition for the purposes of the thin capitalisation rules. The new definition consolidates the existing general classes of entities, namely 'outward investor (general)', 'inward investment vehicle (general)' and 'inward investor (general)';
2. new thin capitalisation earnings-based tests (discussed below); and

3. a special deduction for debt deductions that were disallowed under the fixed ratio test over the previous 15 years. The deduction will be available to general class investors, but only in certain circumstances. If the deduction applies, the entity will be allowed to claim debt deductions that have been previously disallowed within the past 15 years when they are sufficiently profitable in an income year if their fixed ratio earnings limit exceeds their net debt deductions in the income year.

General class investor

An entity is a 'general class investor' for an income year provided:

- it is not, for all the year, a financial entity or an ADI that is either an outward or inward investing entity; and
- on the assumption that the entity were a financial entity, it would be either an outward or inward investing financial entity that is not an ADI

The effect of this is that the following entities, which are not financial entities or ADIs, will be general class investors:

- an Australian entity that carries on a business in a foreign country at or through a permanent establishment or through an entity that it controls;
- an Australian entity that is controlled by foreign residents; and
- a foreign entity having investments in Australia.

Earnings based tests

The new earnings-based tests may disallow all or part of a general class investor's debt deductions for an income year, based on the entity's earnings or profits. This is a change from the existing thin capitalisation rules which disallow an amount of an entity's debt deductions based on the quantum of debt held by the entity relative to its assets.

All entities which do not meet the definition of a general class investors (i.e. financial entities or ADIs) will continue to be subject to the existing thin capitalisation tests, with the exception of the arm's length debt test.

Entities can choose which earnings-based test to apply for all of its debt deductions for an income year (though some restrictions apply). Once the choice has been made, it cannot be revoked.

The new earnings-based tests are as follows:

Fixed ratio test

The fixed ratio test will be the default test. This test will disallow net debt deductions that exceed a specified proportion (30%) of an entity's tax EBITDA. An entity's tax EBITDA is calculated by adding back deductions for interest, decline in value, capital works and prior year tax losses to the entity's taxable income or tax loss.

This test will replace the existing safe harbour debt test. Under the existing safe harbour debt test, debt deductions in excess of 60% of the average value of the entity's Australian assets are disallowed.

Group ratio test

The group ratio test is only available if the entity is a member of a relevant worldwide group. This test will disallow debt deductions to the extent that the entity's net debt deductions exceed the group ratio earnings limit for the income year.

The group ratio test will replace the existing worldwide gearing debt test for all general class investors. Under the existing worldwide gearing debt test, an entity's Australian operations may be geared up to 100% of the gearing of the worldwide group to which the Australian entity belongs.

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External third-party debt test

The external third party debt test will disallow all debt deductions which are not attributable to third party debt and that satisfy certain other conditions. The external third party debt test operates effectively as a credit assessment test, in which an independent commercial lender determines the level and structure of debt finance it is prepared to provide an entity. As the debt finance is provided by an independent third party, it is assumed to satisfy arm's length conditions.

The external third party debt test will replace the existing arm's length debt test for all entities previously subject to the arm's length debt test. Under the existing arm's length debt test, debt deductions are disallowed where the amount of the entity's debt exceeds the amount of debt that could have been borrowed by an independent party carrying on comparable operations as an Australian entity.

This Bill will commence on the first 1 January, 1 April, 1 July or 1 October to occur after the day after it receives Royal Assent.

Comments on the exposure draft are due to Treasury by 13 April 2023.

w https://treasury.gov.au/consultation/c2023-370776

3.4 Consultation on minor and technical amendments

On 15 March 2023, Treasury released exposure draft legislation and regulations to make minor technical amendments to the SIS Act, the GST Act, the TAA, the *Australian Securities and Investments Commission Act 2001* (Cth), the *Corporations Act 2001* (Cth) and the *Competition and Consumer Act 2010* (Cth). Proposed amendments will update names of acts, remove references to repealed sections, amend typographical errors, amend incorrect numbering of provisions and amend incorrect references.

Other minor changes include updating the definition of 'year of income' in section 10(1) of the SIS Act so that it has the same meaning as in the ITAA 1936.

The GST Act and the TAA will be amended to clarify that the entity that is liable to pay GST on a taxable supply is entitled to the credit for the GST paid by the purchaser. These amendments will apply to supplies to which subsection 14-250(2) in Schedule 1 to the TAA applies, whether those supplies were made before, on or after the commencement of the amendment. This means the amendments will apply retrospectively in relation to supplies of land for which any of the consideration (other than consideration provided as a deposit) was first provided on or after 1 July 2018. Under the current law the credit is available to the entity that makes the taxable supply, which may be a different entity.

Comments on the exposure draft were due to Treasury by 4 April 2023.

w https://treasury.gov.au/consultation/c2023-373997

3.5 Consultation on multinational tax integrity measures

On 31 March 2023, Treasury released '*Treasury Laws Amendment (Measures for Consultation) Bill 2023: Deductions for payments relating to intangible assets connected with low corporate tax jurisdictions*' as an exposure draft.

The draft bill proposes to introduce an anti-avoidance rule into the ITAA 1997 to deter Significant Global Entities (SGEs) from avoiding income tax by structuring their arrangements so that income from exploiting intangible assets is derived in a jurisdiction where no or low corporate tax rates apply, while tax deductions for payments attributable to intangible assets made by the SGE to an associate are claimed in Australia. The

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proposed anti-avoidance rule would prevent the SGE from claiming tax deductions for such payments. A no or low corporate tax rate is a rate of less than 15%.

If introduced, these proposed amendments will operate in respect of payments or credits an SGE makes to an associate, as well as liabilities incurred by an SGE from an associate, on or after 1 July 2023.

Comments on the exposure draft are due to Treasury by 28 April 2023.

w https://treasury.gov.au/consultation/c2023-382169

3.6 Consultation on financial reporting by public companies

Treasury is currently seeking consultation on the proposed '*Treasury Laws Amendment (Measures for Future Bills) Bill 2023: Financial reporting by public companies*'.

The transparency measures are intended to start on or after 1 July 2023 and will require all Australian public companies to provide a 'consolidated entity statement' as part of their annual financial reporting obligations. The form of the consolidated entity statement will vary as follows:

1. if the accounting standards require the public company to prepare financial statements in relation to a consolidated entity, the consolidated entity statement must include disclosures about entities within the consolidated entity at the end of the financial year including the following information:
    - (a) the names of each entity at the end of the financial year;
    - (b) whether the entity was a body corporate, partnership or trust at the end of the financial year;
    - (c) whether at the end of the financial year, the entity was any of the following:
        - (i) a trustee of a trust within the consolidated entity,
        - (ii) a partner in a partnership within the consolidated entity;
        - (iii) a participant in a joint venture within the consolidated entity;
    - (d) if the entity was a body corporate, where the entity was incorporated or formed;
    - (e) if the entity is a body corporate, the public company's percentage ownership of each of those entities that are body corporates at the end of the financial year; and
    - (f) the tax residency of each of those entities during the financial year; or
2. if the accounting standards do not require the public company to prepare financial statements in relation to a consolidated entity, the public company must provide a statement to that effect.

Under the transparency measures, general reporting obligations will continue to apply and directors, chief executive officers and chief financial officers will also have to declare that the consolidated entity statement is, in their opinion, a true and correct at the end of the financial year.

The transparency measures will require Australian public companies (listed or unlisted) to disclose information regarding the number of subsidiaries and the country of domicile. The amendments are intended to:

1. increase transparency of corporate structure;
2. enhance scrutiny of company arrangements; and
3. encourage behavioural change of companies in relation to tax obligations including tax governance practices, tax planning strategies and simplification of group structures.

Comments on the exposure draft are due to Treasury by 13 April 2023.

w https://treasury.gov.au/consultation/c2023-373630

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3.7 Withholding Variation for Personal Services Income

On 15 March 2023, the Deputy Commissioner of Taxation made the *Taxation Administration (Withholding Variation for Personal Services Income) Legislative Instrument 2023*, which varies to nil the amount a personal services entity (PSE) is required to pay to the Commissioner, when it receives alienated personal services payments, in certain circumstances.

The legislative instrument continues the existing arrangements under the previous legislative instrument *Variation of withholding for personal services income* (dated 15 March 2013), which is due to sunset and will be replaced by this instrument.

When does the instrument apply?

The Legislative Instrument, which commenced on 1 April 2023, provides that a PSE is not required to withhold and remit to the Commissioner under section 13-5 of Schedule 1 to the TAA (in respect of attributed PSI) in cases where:

1. the PSE receives an alienated personal services payment that relates to one or more individuals' personal services income;
2. the PSE pays salary or wages to the individual or individuals within 14 days after the end of the 'PAYG payment period' in which it receives the alienated personal services payment; and
3. the salary or wages paid by the PSE is equal to or greater than either
   (a) 70%; or
   (b) a 'net personal services income percentage',
   of the gross personal services income (exclusive of GST) received by the personal services entity during the PAYG payment period.

If a PSE elects to use the net personal services income percentage, it should calculate the percentage using amounts from the previous income year in the following way:

1. subtract any allowable deductions (excluding salary or wages paid in accordance with subsection 86-15(4) of the ITAA 1997) for the previous income year from the personal services entity's gross personal services income (exclusive of GST) for the previous income year;
2. divide the result by the personal services entity's gross personal services income (exclusive of GST) for the previous income year; and
3. multiply the result by 100 to give a percentage.

w https://www.ato.gov.au/law/view/document?docid=OPS/LI202315/00001
w https://www.ato.gov.au/law/view/document?docid=ESO/ESLI202315/00001

3.8 Requirement to lodge tax return

The ATO has published draft legislative instruments LI 2023/D7 and LI 2023/D8 which formally confirm that taxpayers are required to lodge income tax returns for the income year ending 30 June 2023.

Comments on the draft instruments are due to the ATO by 14 April 2023.

w https://www.ato.gov.au/law/view/document?docid=OPS/LI2023D7/00001
w https://www.ato.gov.au/law/view/document?docid=OPS/LI2023D8/00001

4. Rulings

4.1 GST treatment of financial supplies

The ATO has issued an addendum to Goods and Services Tax Ruling GSTR 2002/2. The Ruling explains what is a financial supply for the purposes Division 40 of the GST Act.

The addendum amends GSTR 2002/2 to reflect changes in the GST law, including changes applicable to cross-border supplies and to digital currency. The update also contains a new buy-now pay-later example (at paragraph 42A to 42C of the Ruling), that applies the ATO's longstanding view on what constitutes consideration for an interest-free loan. It effectively sets out that an interest free loan is a financial supply.

The addendum contains a number of updates to Schedule 2 of the Ruling to indicate when certain foreign currency denominated products and overseas payment products are GST-free, includes references to new public guidance released relating to financial supplies and modernise parts of the ruling.

ATO reference *GSTR 2002/2A10*
https://www.ato.gov.au/law/view/document?docid=GST/GSTR20022A10/NAT/ATO/00001&PiT=20230322000001

4.2 GST treatment of ATM service fees, credit card and debit card surcharges

The ATO has issued draft ruling GSTR 2014/2DC1 which sets out proposed miscellaneous minor revisions to GSTR 2014/2. The draft ruling explains the GST treatment of fees payable for ATM services, surcharges imposed by a merchant to a customer for credit card or debit card transactions for a supply of goods and services, and surcharges imposed on a customer for credit card transactions for the payment of taxes or fees payable to government agencies.

The Ruling is intended to apply both before and after its date of issue. The draft update was issued as a draft for public comment until 21 April 2023.

The key updates are to reflect changes to the definition of 'ATM' or 'ATM Terminal' (set out in the Issuers and Acquirers Community (IAC) Code Set Volume 6 ATM System Code (IAC ATM System Code)), changes in Reserve Bank of Australia rules for merchant surcharging, and the Reserve Bank of Australia designation of prepaid cards.

ATO reference *GSTR 2014/2DC1*
https://www.ato.gov.au/law/view/document?docid=DGC/GSTR20142DC1/NAT/ATO/00001

4.3 Victorian land tax primary production exemption

The State Revenue Office of Victoria has issued *Ruling LTA-010 Exemption for primary production land* which provides the Commissioner of State Revenue's interpretation of the key terms and elements relating to the primary production exemption in relation to sections 64, 65 and 66 of the *Land Tax Act 2005* (Vic).

The Land Tax Act imposes land tax on all taxable land in Victoria each year unless an exemption or concession applies. Land will be exempt where it is used primarily for primary production or used solely or primarily for the

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business of primary production, or land being prepared for use for primary production, depending on the location of the land.

Primary production

Section 64(1) of the Land Tax Act defines primary production as:

1. cultivation for the purposes of selling the produce of cultivation (whether in a natural, processed or converted state); or
2. the maintenance of animals or poultry for the purpose of selling them or their natural increase or bodily produce; or
3. the keeping of bees for the purpose of selling their honey; or
4. commercial fishing, including the preparation for commercial fishing or the storage or preservation of fish or fishing fear; or
5. the cultivation or propagation for sale of plants, seedlings, mushrooms or orchids.

The ruling provides examples of each type of primary production the Commissioner will accept in applications for the exemption.

Secondary production

Secondary production is defined as the activity of processing or converting the primary produce into derivative items. Land used for secondary production activities, or the retail sale of products derived from secondary production is ineligible for the primary production exemption. If a secondary production activity occurs on the same land as primary production, the primary production activity must be the primary use of the land for the exemption to apply.

Used primarily for primary production

The ruling specifies that considering if land is 'used primarily' for a particular purpose requires an objective consideration of all activities carried out on the land, together with the taxpayer's evidence intention. The mere intention to use the land does not qualify for the exemption. Where there are multiple uses on the land, the Commissioner will weigh up each use against the other to determine what the primary use of the land is. There are a number of factors that the Commissioner considers in making this determination, including but not limited to:

1. the area of land over which each use extends;
2. the actual intensity of the primary production activities compared to the potential intensity of that use or capacity of the land;
3. its continuity and capabilities of the land for any other use;
4. the scale, extent and intensity of each use;
5. the extent to which land is put to uses that are unrelated;
6. the relative economic and financial significance of competing uses, including the amount of capital expenditure, current expenditure, revenue and profit attributed to each use;
7. the length of time that each use has been conducted on the land; and
8. time labour and resources spent in using the land for each purpose.

If there has been temporary inactivity on the land (which is usually used for primary production), the short-term break must be demonstrated to be part of a primary production cycle for the exemption to still apply. For example, crop rotation.

Partial primary production exemption

Section 65(2) allows for land located outside greater Melbourne, where only part of the land is used for primary production, to be apportioned and for that part of the land to be exempt.

Section 66 allows for parcels of land to be regarded as separate parcels and exempt if they are occupied separately from other land in the parcel.

Office of State Revenue Victoria reference *LTA-010*
w https://www.sro.vic.gov.au/legislation/land-tax-exemption-primary-production-land

4.4 Victorian land tax primary production in urban zone exemption

The State Revenue Office of Victoria has issued *Ruling LTA-011 Primary production exemption for land in urban zone* which clarifies the Commissioner's interpretation of the requirements for the land tax exemption under section 67 of the *Land Tax Act 2005* (Vic). For the exemption to apply, the land must be used solely or primarily for a business of primary production by the landowner and there must be a direct connection between the landowner, the business of primary production and the subject land. Additionally, the following conditions must be met:

1. the land must satisfy the location requirement and usage requirements by the owner; and
2. the landowner must satisfy the relevant ownership criteria.

The location of the land must be:

1. wholly or partly in greater Melbourne, and
2. wholly or partly in an urban zone.

Used solely or primarily for the business of primary production

The word 'solely' should be taken to mean 'used only… for'. Whether an activity amounts to a business depends on a number of indicators which must be considered in combination and as a whole. Such indicators include:

1. whether the activity has a 'significant commercial character' (some of the other factors below also form part of this factor);
2. whether the landowner has more than just an intention to engage in business;
3. whether the landowner has a purpose of profit as well as a prospect of profit from the activity
4. repetition and regularity of the activity;
5. whether the activity is of the same kind and carried on in a similar manner to that of the ordinary trade in that line of business;
6. whether the activity is carried out on in a systematic way and business-like manner such that it is directed at making a profit (including the keeping of books and records);
7. the size, scale and permanency of the activity (including the volume of operations and the amount of capital employed), although it is acknowledged that a person can carry on a business in a small way; and
8. whether the activity is better described as a hobby or form of recreation or a sporting activity.

Principal Business

The ruling also notes that in order for the exemption to apply, the business must be the principal business of the owner (except for a natural person in certain circumstances and a trustee of a family superannuation fund). The word 'principal' is taken to mean 'chief, first or highest in rank or most important'. If there are multiple business and no one business can be considered as 'principal', the principal business of primary production on land exemption will not apply.

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The ruling also sets out the ownership tests for all owner types as well as the evidentiary documentation required to establish whether the relevant ownership test is met.

Office of State Revenue Victoria reference *LTA-011*
w https://www.sro.vic.gov.au/legislation/land-tax-primary-production-exemption-land-urban-zone

4.5 Update to Victorian Revenue Ruling interest and penalty tax on payroll tax default

On 28 March 2023, the State Revenue Office of Victoria (SRO) issued version 5 of Revenue Ruling PTA-036. The ruling explains how interest and penalty tax is applied to a range of payroll tax defaults and should be read in conjunction with Revenue Ruling *Taxation Administration Act 1997* (Vic) (TAA) TAA-007v4.

When a payroll tax default occurs, the TAA provides for interest and penalty tax to be applied.

1. The interest rate consists of two components:
   (a) market rate to reimburse the Government for financing costs incurred due to late payment of tax;
   (b) premium rate of 8% per annum to deter late payment and ensure that defaulting taxpayers are not advantaged over taxpayers paying on time.

2. The penalty tax on the amount of unpaid tax is in addition to interest and is categorised into:
   (a) late payments; or
   (b) shortfalls.

Voluntary disclosure

The updates to the ruling have added details regarding the impact of a voluntary disclosure on the application of penalties. If a taxpayer makes a voluntary written disclosure which enables the Commissioner to determine the extent and nature of the default:

1. *after* an investigation has commenced, the taxpayer is entitled to a 20% reduction in penalty tax however, if a taxpayer conceals information after an investigation has commenced, the penalty tax will be increased by 20%;
2. *before* an investigation has commenced, the taxpayer is entitled to an 80% reduction in penalty tax so that tax is reduced to:
   (a) 5% where the taxpayer failed to take reasonable care; or
   (b) 15% where the taxpayer intentionally disregarded the law.

Voluntary disclosure before an investigation is encouraged and the Commissioner will remit the higher of either the penalty tax in full or the premium interest rate of 8% per annum leaving the taxpayer to pay the lesser of the two options.

The ruling provides a new Example 4 and Example 5 illustrating reduction in penalties due to a voluntary disclosure before an investigation starts in the case where penalty tax exceeds premium interest and vice versa.

The ruling applies to a voluntary disclosure that occurs on or after 1 April 2023.

State Revenue Office Victoria reference *Revenue Ruling PTA-036v5*
w https://www.sro.vic.gov.au/legislation/interest-and-penalty-tax-5

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4.6 Western Australian remission of penalty tax for late payment

On 4 April 2023, Revenue WA released Commissioner's practice TAA 20.4 on when penalty tax for late payment will be remitted.

TAA 20.4 applies from 4 April 2023 and replaces TAA 20.3.

The updated ruling includes additional information for corporate taxpayers under voluntary administration or liquidation.

Revenue WA reference *Commissioner's practice TAA 20.4*
w https://www.wa.gov.au/system/files/2023-04/CP-TAA-20.pdf

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5. Private binding rulings

5.1 Input tax credits and temporary full expensing

Facts

The taxpayer owns a property that has been used by the taxpayer to operate a pastoral primary production business for over 20 years.

The taxpayer is registered for GST.

The taxpayer is a small business entity.

The taxpayer built a second standard size dwelling on the property adjacent to his or her own residence to be used by a casual employee who worked in the farming business. The employee's spouse also lived in the dwelling.

The dwelling enabled employee and his or her spouse to perform more work for the farm business. It also enabled the employee to be present on the farm in the event of frequent minor emergencies where the taxpayer is absent.

The taxpayer has found it hard to attract and retain employees.

The taxpayer entered into a residential tenancy agreement for the dwelling with the employee and their spouse as tenants.

Questions

1. Is the dwelling plant, under section 45-40 of the ITAA 1997?
2. Can an immediate deduction be claimed for the dwelling under the temporary full expensing measures?
3. Is the taxpayer entitled to input tax credits under section 11-20 of the GST Act for the construction of the dwelling to be leased to an employee?

Decision

<u>Question 1</u>

The ATO ruled yes, the dwelling is plant under section 45-40 of the ITAA 1997. The reason is that the dwelling is a structural improvement on land used for pastoral operations, where the improvement is used for residential purposes, providing accommodation for a farm employee.

<u>Question 2</u>

The ATO noted that the dwelling is a depreciating asset as is it has a limited life. As the dwelling is plant and its construction cost is not capital works to which Division 43 applies, the cost of the dwelling is not excluded from the temporary full expensing measures.

The ATO noted that a depreciating asset is defined in section 40-30(1) of the ITAA 1997 as an asset that has a limited effective life and can reasonably be expected to decline in value over the time it is used except land, trading stock and intellectual property that is not listed in section 40-30(2) of the ITAA 1997. However, section 40-30(3) of the ITAA 1997 provides that Division 40 applies to improvements to land and fixtures on land as if they were separate assets from the land whether removable or not.

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While buildings and structural improvements to which Division 43 of the ITAA 1997 (capital works deductions) applies are specifically excluded from Division 40, capital expenditure on plant is specially excluded from being construction expenditure for Division 43.

The ATO notes that, for small business entities using the simplified depreciation rules in Subdivision 328-D of the ITAA 1997, temporary full expensing is provided through modifications to those rules by section 328-181 of the *Income Tax (Transitional Provisions) Act 1997* (**IT(TP)A**) or, alternatively, if the conditions are met, through the usual temporary full expensing measures in Subdivision 40-BB of the IT(TP)A.

The ATO noted that assets leased or expected to be leased predominantly on a depreciating asset lease are excluded. A depreciating asset lease is an agreement under which the entity that holds the depreciating asset grants a right to use the asset to another entity. The ATO noted that the dwelling is a depreciating asset lease as the lease with the employee and his or her spouse confers upon them the right to use the dwelling.

However, the taxpayer would still be eligible for temporary full expensing if the conditions in Subdivision 40-BB of the IT(TP)A are satisfied.

This required the taxpayer to be an eligible entity and the dwelling to be an eligible asset.

The ATO noted that an entity is eligible for temporary full expensing under Subdivision 40-BB of the IT(TP)A if:

- its aggregated turnover is less than $5 billion aggregated turnover under section 40-155 of the IT(TP)A (**eligible entity test**); or
- the taxpayer is a corporate tax entity and satisfies a test based on total income under section 40-157 of the IT(TP)A (**alternative income test**).

In this case, the taxpayer satisfied the eligible entity test.

An asset will be an eligible asset if the eligible entity starts to hold an eligible asset between 2020 Budget Time (7.30pm on 6 October 2020) and 30 June 2023, and starts to use the asset for a taxable purpose in that period, unless the asset is an excluded asset. The ATO noted that the following assets are excluded

1. eligible work-related items (including portable electronic device, computer software, protective clothing, briefcases, and tools of trade) for the purposes of section 58X of the FBT Act;
2. capital works for which amounts can be deducted under Division 43 of the ITAA 1997;
3. deductible under former provisions of the income tax law relating to Australian films;
4. without the relevant connection to Australia, if the entity will not use that asset principally in Australia for the principal purpose of carrying on a business in Australia, or the asset will never be located in Australia;
5. whose decline in value is worked out under Subdivisions 40-E of the ITAA 1997 (about low-value pool and software development pools) or Subdivision 40-F of the ITAA 1997 (about primary production water facilities, horticultural plants, fodder and fencing assets);
6. to which a balancing adjustment event happens to an asset in the same income year that temporary full expensing would otherwise apply to first or second elements of the asset's cost.

The ATO was satisfied that the dwelling was not covered by an exclusion and started to be used for a taxable purpose between the 2020 Budget time and 30 June 2023. Accordingly, the ATO ruled that the taxpayer was entitled to apply the temporary full expensing measures to the cost of the dwelling.

<u>Question 3</u>

The ATO noted that an entity is entitled to the input tax credit for any creditable acquisition that it makes and one of the requirements is that the entity must acquire the thing solely or partly for a creditable purpose.

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Creditable purpose is defined in section 11-15 of the GST with section 11-15(2)(a) of the GST Act providing that an entity does not acquire a thing for a creditable purpose to the extent that the acquisition relates to making supplies that would be input taxed.

The ATO noted that the constructions costs were for the construction of a residence which has been leased to the employee.

Section 40-35 of the GST Act includes that a supply of premises by way of lease, hire or licence is input taxed where the supply is of residential premises (as defined in section 195-1 of the GST Act) to be used predominantly for residential accommodation.

Residential premises is defined to include land or a building that is occupied as a residence, or for residential accommodation; or is intended to be occupied and is capable of being occupied, as a residence, or for residential accommodation.

The ATO considered that the dwelling is a standard residence that includes a kitchen, laundry, living area, bedrooms, toilets and bathrooms to provide shelter and living facilities and, accordingly has the physical characteristics suitable and capable of providing residential accommodation, and so is residential premises.

As the taxpayer is making an input taxed supply of the residential premises, the acquisitions they made to construct the residential premises were considered to be acquisitions that relate to the making of an input taxed supply and so are not claimable.

ATO reference *Private Binding Ruling Authorisation Number 1052055333945*
w https://www.ato.gov.au/law/view/document?docid=EV/1052055333945

5.2 Small business restructure roll-over

Facts

Shares in a company that carries on a business are owned by two individuals:

A decision was made to restructure to help with business, systems and also with succession planning by separating the different business divisions into separate entities to simplify reporting and business systems.

Three new companies were set up and the shares in all 3 companies are owned by a family trust, which is being used for asset protection purposes. The 3 companies would receive the assets of the original company that are attributable to a relevant location. The assets consist of mainly plant and equipment but also include goodwill, intellectual property and everything required to run each business separately from each location.

The appointers and primary beneficiaries of the trust are two individual shareholders of the original company.

The trustee of the trust is one of the individuals.

The trust has a family trust election in place and the test individual is the other individual.

All entities involved in the transactions are Australian residents.

Question

Will the transfer of the assets from the original company to the newly formed companies satisfy the requirements of the small business restructure roll-over in Subdivision 328-G of the ITAA 1997?

Decision

The ATO ruled no.

The ATO noted that the conditions for the small business restructure rollover are set out in section 328-430(1) of the ITAA 1997 as follows:

1. the transfer of the asset is, or is part of, a genuine restructure of an ongoing business; and
2. each party to the transfer is either a small business entity, or affiliate of or connected with a small business entity, or a partner in a partnership that is a small business entity; and
3. there is no material change in the ultimate economic ownership of the transferred asset; and
4. the asset being transferred is an active asset of the relevant small business entity at the time of the transfer; and
5. both the transferor and each transferee are residents of Australia; and
6. both the transferor and each transferee choose to apply the roll-over.

They key requirement here is that there be no material change in the ultimate economic ownership of the transferred asset.

The ATO noted that there is a savings rule for discretionary trusts in section 328-430(1)(c) of the ITAA 1997 which provides that a transaction does not have the effect of changing the ultimate economic ownership of an asset, or any individual's share of that ultimate economic ownership, if:

(a) either or both of the following applies:

*(i) just before the transaction took effect, **the asset was included in the property of a non-fixed trust that was a family trust**;*

*(ii) just after the transaction takes effect, **the asset is included in the property of a non-fixed trust that is a family trust**; and*

(b) every individual who, just before the transfer took effect, had the ultimate economic ownership of the asset was a member of the family group (within the meaning of Schedule 2F to the Income Tax Assessment Act 1936) relating to the trust or trusts referred to in paragraph (a); and

(c) every individual who, just after the transfer takes effect, has the ultimate economic ownership of the asset is a member of that family group.

The ATO noted that the saving rule for discretionary trusts does not apply here as the assets being transferred were not assets of the family trust before the transfer and were not asset of the trust after the transfer i.e. the transfers were transfers of assets from the original company to the 3 newly formed companies.

As the saving rule does not apply, the ATO considered the ultimate economic ownership test is not satisfied, and the small business restructure rollover is not available.

ATO reference *Private Binding Ruling Authorisation Number 1052085490528*
w https://www.ato.gov.au/law/view/document?docid=EV/1052085490528

5.3 CGT - deed of surrender of remainder interest

Facts

A person passed away leaving a Will (the **Will**).

An asset of the Estate included the deceased person's interest in real property.

The Will appointed three Trustees of the Estate (the **Trustees**).

The Will directed the Trustees to hold the real property on Trust for the children of one of the Trustees (the **Remaindermen**) as shall acquire the age of 18 years and granted a life interest over the Property to that Trustee (the **Life Tenant**).

Title to the property was transferred to the Trustees.

The Remaindermen are all 18 or over.

The Remaindermen, the Trustees and the Life Tenant executed the Deed whereby the Remaindermen agreed, for no consideration, to forego their benefit under the Will so that the Life Tenant received the Property absolutely.

Question

Will there be any CGT implications for the remaindermen listed in the Deed of Surrender of Remainder Interest upon the disposal of their interest in the Estate of the Deceased?

Decision

The ATO ruled no but did not provide any reasons for the decision.

COMMENT – while the outcome of this ruling is good for the rulee, it appears contrary to TR 2006/14 *Income tax: capital gains tax: consequences of creating life and remainder interests in property and of later events affecting those interests* where the ATO consider that there is a CGT event and that market value substitution applies to both the acquisition price of the interest and the disposal of the interest.

ATO reference *Private Binding Ruling Authorisation Number 1052087574605*
w https://www.ato.gov.au/law/view/document?docid=EV/1052087574605

5.4 Commercial property – demolition expenses

Facts

The taxpayer is in the business of leasing commercial property.

The taxpayer purchased a commercial property for the purpose of producing assessable income.

After purchasing the commercial property, the taxpayer obtained a quantity surveyor's depreciation report which provided a building valuation and the deductible building allowance and depreciable asset values.

The property was leased to a third party at the time the property was acquired.

The tenant requested that the taxpayer develop the existing site as the tenant required a bigger warehouse.

After an extensive design and tendering process with an appointed project manager a letter of intent was provided to a builder.

The tenant vacated the site to enable the demolition of the existing site and the construction of the bigger warehouse.

The site was not used for any other purpose between the period of the tenant vacating and construction commencing.

The taxpayer did not receive an amount for the salvage of the depreciating assets contained within the property at the date of destruction.

The taxpayer entered into a contract for the construction of a larger warehouse.

The tenant continued to lease the site during the demolition and build period with the intention of resuming occupancy once the development was completed.

Questions

1. Is the taxpayer able to deduct under Division 43 of the ITAA 1997 undeducted amounts of capital expenditure after voluntarily demolishing the commercial rental property?
2. Is the taxpayer able to immediately deduct under Division 40 of the ITAA 1997 undeducted amounts of depreciation after voluntarily demolishing the commercial rental property?
3. Is the taxpayer able to deduct from their assessable income the amounts incurred for the voluntary demolition of the commercial rental property?

Decision

Question 1

The ATO noted that, subject to certain conditions being satisfied, deductions for undeducted amounts of capital expenditure are available when a property is destroyed, even if the destruction is voluntary.

The conditions are as follows:

1. the taxpayer has been allowed, or can claim, a deduction under this Division, or former Division 10C or 10D of Part III of the ITAA 1936, for the area; and
2. there is amount of undeducted construction expenditure for the area; and
3. the taxpayer was using their area in the way that applied to it under Table in section 43-140 (Current year use) immediately before the destruction or if not, neither the taxpayer nor any other entity used the area for any purpose since it was last used by the taxpayer in that way.

The requirement in paragraph 3 above is that the property needs to have been used immediately prior to the destruction for the purpose of producing assessable income or that it had not been used since it was used for the purpose of producing assessable income for any other purpose.

The ATO noted that the taxpayer used the property for the purpose of producing assessable income up to the tenant vacating and then it remained unused till demolition commenced. Accordingly, they taxpayer met the requirements to deduct undeducted amounts of capital expenditure.

Question 2

The ATO noted that section 40-285(2) of the ITAA 1997 provides that a taxpayer can deduct an amount if:

1. balancing adjustment event occurs for a depreciating asset you held and:
   (a) whose decline in value you worked out under Subdivision 40-B; or
   (b) whose decline in value you would have worked out under that Subdivision if you had used the asset; and
2. the asset's termination value is less than its adjustable value just before the event occurred.

The termination value of a depreciating asset is defined in section 40-300 of the ITAA 1997. Where a depreciating asset is lost or destroyed, the termination value is the amount or value received or receivable under an insurance policy or otherwise for the loss or destruction.

The amount that can be deducted in the income year of the balancing adjustment event is the difference between the adjustable value and the termination value of the asset.

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Accordingly, as the taxpayer did not receive an amount from the builder for the salvage of the depreciating assets that were destroyed, the termination value of those assets was nil and the taxpayer could deduct the remaining adjustable value of each depreciating asset.

Question 3

The ATO noted that demolition expenses are not deductible as capital works under Division 43. However, it can still be taken into account in calculating the amount of a deduction where a person receives an amount for the destruction of the capital works.

If a person receives an amount for demolition of their area, they are required to reduce the amount that can be deducted for the destruction of the capital by the amount that they have received. However, any demolition expenses will offset the amount of the reduction.

In this case, as the taxpayer did not receive any amount for the destruction of the capital works, the demolition expenses they incurred are not taken into account in determining the amount of the deduction.

ATO reference *Private Binding Ruling Authorisation Number 1052078055944*
w https://www.ato.gov.au/law/view/document?docid=EV/1052078055944

5.5 CGT and value shifting

Facts

A Company was incorporated with each shareholder holding equal ordinary shares in the company.

The shareholders are related parties: Persons A and B are a couple, Persons C and D are a couple, and Persons A and C are siblings.

The Company purchased a commercial property.

To fund the purchase of the property, Persons A and B contributed an amount which was more than half of the total contribution as Persons C and D could not afford to contribute half. The majority of the funds were used for the deposit of the purchase of the property and the balance of the funds were kept for company operation and loan repayments. A loan was also taken to fund the purchase of the property.

The Company did not own any other assets at the time of the purchase of the property.

Shortly after settlement, after determining the amount of the funds each shareholder contributed to the purchase of the property, the shareholders agreed to change the ownership of the Company to reflect the unequal capital contributions.

The change in the member's ownership of the company was not updated with ASIC due to an administrative error.

The tax agent advised that all documents relating to the purchase of the property by the Company and the change in the ownership structure were destroyed in a natural disaster.

Financial statements for the recent years were provided. Financial statements for the earlier years were not available. The shareholders stated that the loan repayments to the shareholders over the years was in accordance with the new ownership of the Company. The shareholders provided statutory declarations to the ATO as to what had occurred.

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Question

Did the change in ownership of the Company give rise to the direct value shifting rules applying under Division 725 of the ITAA 1997 and cause CGT event K8 to occur under section 104-250 of the ITAA 1997?

Decision

The ATO ruled that the change in ownership of the Company did not give rise to a direct value shift under Division 725 of the ITAA 1997. Therefore, CGT event K8 did not happen.

Division 725 of the ITAA 1997 may apply if value is shifted under a scheme from equity or loan interests in a company or trust to other equity or loan interests in the same company or trust. This can occur, for example, by the issuing of new shares at a discount.

For there to be a direct value shift, the following requirements in section 725-50 of the ITAA 1997 need to be satisfied:

1. the control test;
2. the participants in the scheme test;
3. the cause of the value shift test;
4. the taxpayer is an affected owner of interests in the target entity; or
5. no exception applies.

Section 725-65(1) of the ITAA 1997 requires that the target entity did the thing to which the decrease in the market value of the down interest is reasonably attributable, and which is the issue of up interests at a discount.

An entity will control a company for value shifting purposes in the circumstances set out in section 727-355 of the ITAA 1997. Broadly, the tests require that an entity, either alone or together with its associates, can exercise or control at least 50% of the voting power in the company or has the right to receive at least 50% of the dividends or distribution of capital of the company (50% stake test). There is also a 40% stake test and actual control test to determine if an entity controls a company for value shifting purposes.

If the direct value shifting rules apply, this may give rise to CGT event K8 under section 104-250 of the ITAA 1997 whee a capital gain may happen where there is a down interest under section 725-245 of the ITAA 1997.

The direct value shifting rules in Division 725 apply to direct value shifts that happen under schemes entered into on or after 1 July 2002. Section 104-250 is effective from 24 October 2002.

In the present circumstances, the ATO concluded that Persons A and B controlled the Company for value shifting purposes as they held 50% of the issued shares in the Company both before and after the change in the shareholding.

The ATO concluded that the cause of the value shift under section 725-65 of the ITAA 1997 and the controlling entity test under section 725-355 of the ITAA 1997 were satisfied. The value shift was not likely to be reversed. However the ATO accepted that the shareholder's ownership of the company changed upon the shareholders' agreement in 19XX.

As the scheme was entered into before 1 July 2002, that is before Division 725 and section 104-250 were in effect, then Division 725 and section 104-250 of the ITAA 1997 do not apply.

ATO reference *Private Binding Ruling Authorisation Number 1052059628638*
w https://www.ato.gov.au/law/view/document?docid=EV/1052059628638

5.6 Proposed members' voluntary liquidation and pre-CGT assets

Facts

The Company is an Australian private company incorporated pre-CGT and is an Australian resident.

The Company is controlled by, and operated for the benefit of, a family and has always been controlled by members of the family.

There are different share classes of issue but it has always been the case that there is no distinction between the various share classes on issue in the Company such that all share classes are entitled to equal rights to dividends, rights to capital distributions and voting rights.

Since immediately before 20 September 1985, the Company's shareholdings have changed as follows:

1. the legal title of the share held by the advisor as nominee for a two children (Child A and Child B) were transferred to Child A and Child B respectively;
2. one individual (Individual A) passed away and their shares in the Company were transferred to another individual (Individual B) in accordance with their will. The shares became post-CGT shares.
3. Individual B passed away and their shares, including the inherited shares from Individual A, were transferred to Child A and Child B to be held jointly in accordance with the terms of their will. The shares became post-CGT shares.

A Unit Trust also holds shares in the Company. The Unit Trust was established by Trust Deed settled prior to 20 September 1985. The Unit Trust is an Australian resident unit trust.

The units in the Unit Trust are currently held by Child A and Child B, who currently hold 50% each of the total units on issue in the Unit Trust. Child A and Child B have continuously held the legal and beneficial ownership of their respective units since before 20 September 1985.

The Unit Trust has the ability to distribute both the income of the trust and the capital of the trust to its unitholders.

There have been no changes to the unit-holdings of the Unit Trust since 20 September 1985.

There has not been an amendment to the Trust Deed that causes a practical effect of a change to the underlying interests in the trust assets.

The Company wholly owned the shares in another private company which was an Australian tax resident and which had been owned wholly by the Company since it was incorporated, which was before 20 September 1985.

The primary asset of the subsidiary company was a commercial property which it acquired prior to 20 September 1985. Prior to it being sold, the property was always rented out on an arm's length basis.

As the property was a pre-CGT asset, the gain on sale of $XXX was credited to Equity in the Financial Statements as a Pre-CGT Capital profit reserve.

The subsidiary company's Pre-CGT Capital profit reserve balance was maintained until it was placed into Members' Voluntary Liquidation. The subsidiary company's liquidator declared a first and final dividend which included the distribution of the Pre-CGT Capital profit reserve.

The distribution sourced from the Pre-CGT Capital profit reserve was debited against that account. The net distribution was recorded as a credit to the shareholder company's Pre-CGT Capital Profits Reserve account.

The subsidiary company was deregistered.

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It is proposed to have the Company placed into a Member's Voluntary Liquidation.

The liquidator will separately identify and pay the amount of the Company's Pre-CGT Capital Profits Reserve to the current shareholders.

The distribution sourced from the Pre-CGT Capital profit reserve will be debited against this account. The statement of distribution from the liquidator will make it clear as to the quantum that each shareholder has received that has been appropriated from the Pre-CGT Capital Profits Reserve account.

Questions

1. Was Division 149 of the ITAA 1997 triggered at any time in relation to the pre-CGT assets of the company?
2. Will a liquidator's distribution sourced from the company's Pre-CGT Capital Profits Reserve be considered a dividend under section 47 of the ITAA 1936 such that it is assessable to the Company's shareholders under section 44 of the ITAA 1936?
3. Will CGT event C2 in section 104-25 of the ITAA 1997 apply to the liquidator's distribution on cancellation of the Company's shares where the Company ceases to exist within 18 months of the payment?

Decision

Question 1

The ATO ruled that the majority underlying interests in the Company's pre-CGT assets have been maintained by the same persons who held majority underlying interests in those assets immediately before 20 September 1985 and accordingly Division 149 of the ITAA 1997 has not been triggered to impact the pre-CGT status of the Company's pre-CGT assets.

Division 149 of the ITAA 1997 provides that an asset acquired by the taxpayer on or before 19 September 1985 shall be deemed to have been acquired by the taxpayer after that date unless the Commissioner is satisfied, or considers it reasonable to assume, that, at all times after that date when the asset was held by the taxpayer, majority underlying interests in the asset were held by natural persons who, immediately before 20 September 1985, held majority underlying interests in the asset.

The majority underlying interests is defined to mean in relation to an asset, more than one-half of:

1. the beneficial interests that natural persons hold (whether directly or indirectly) in the asset, and
2. the beneficial interests held by natural persons (whether directly or indirectly) in any income that may be derived from the asset.

The ATO noted that the Company continuously held the direct legal and beneficial ownership of its pre-CGT assets, but as the Company is a company and not a natural person, a tracing exercise to the Company's shareholders is required.

The ATO considered that the transfer of shares from the advisor to Child A and Child B did not change the beneficial ownership in those shares that had existed since prior to 20 September 1985.

The shareholding changes that occurred because of the death of Individual A and Individual B did not result in a change in underlying ownership as a result of

When Individual B inherited Individual A's shares (equating to XXX%), they were treated as standing in the shoes of Individual A, as though they had owned the shares since immediately prior to 20 September 1985.

When Child A and Child B inherited Individual B's shares (equating to XXX%), they were treated as standing in the shoes of Individual B, as though they had owned the shares since immediately prior to 20 September 1985.

It also then follows that when Child A and Child B inherited the shares from Individual B, they were treated as standing in the shoes of Individual B, who was in turn standing in the shoes of Individual A. Accordingly, Child A and Child B should be treated as though they had owned the twice inherited shares since immediately prior to 20 September 1985.

Question 2

The ATO considered that a liquidator's distribution sourced from the Company's Pre-CGT Capital Profits Reserve will not be considered a dividend under section 47 of the ITAA 1936. As such, the liquidator's distribution will not be assessable to the Company's shareholders under section 44 of the ITAA 1936.

The ATO noted that distributions to shareholders of a company by a liquidator in the course of winding up the company are, at first instance, not considered to be distribution out of profits of the company. At common law, a distribution to a shareholder by a liquidator is capital in the hands of the shareholder since it is a realisation of the shareholder's interest in the company: *FC of T (NSW) v Stevenson* (1937) 4 ATD 415; (1937) 59 CLR 80; *FC of T v Blakely* (1951) 9 ATD 239 at 245, 247; (1951) 82 CLR 388 at 402, 407; *FC of T v Brewing Investments Ltd* [2000] FCA 920; 2000 ATC 4431 per Hill J at 18 - 19.

In the ATO view this is supported by the inclusion of Section 47 of the ITAA 1936, which governs liquidator's distributions that would otherwise fall out of the ambit of Section 44. Section 47 of the ITAA 1936 specifically deems certain amounts to be dividends paid to the shareholders out of the profits derived by the company but does not deem pre-CGT profits to be dividends.

Taxation Determination 95/10 Income tax: what is the significance of the Archer Brothers principle in the context of liquidation distributions? (TD 95/10) explains the Commissioner's view on that same ability in the context of liquidation distributions under the Archer Brothers principle.

The ATO explained that the Archer Brothers principle is if a liquidator appropriates a particular fund of profit or income in making a distribution, that appropriation ordinarily determines the character of the distributed amount for the purposes of section 47 and other provisions of the Act. TD 95/10 provides the Commissioner will accept that a liquidator may rely on the Archer Brothers principle if:

- a specific provision in the Act does not produce a different result;
- the company accounts have been kept so that a liquidator can clearly identify a specific profit or fund in making a distribution; and
- it is clear from either the accounts or statement of distribution that the liquidator has appropriated the specific profit or fund in making the distribution.

In this case, the ATO accepted that the capital distribution proposed to be made by the liquidator will be made in accordance with the Archer Bros Principle. Therefore, the distribution of the Pre-CGT Capital Profits Reserve will not be considered a dividend under subsection 47(1) of the ITAA 1936. The distribution will be the distribution of a capital profit associated with the disposal of assets acquired by the company prior to 20 September 1985.

Question 3

CGT event C2 in section 104-25 of the ITAA 1997 will apply to the liquidator's distribution on cancellation of the Company's shares where the Company ceases to exist within 18 months of the payment.

TD 2001/27 explains that the full amount of a distribution made by a liquidator on the winding-up of a company constitutes capital proceeds from the ending of the shareholder's shares in the company. Where the company is wound up within 18 months of the distribution, the relevant CGT event for the company's shareholders will be CGT event C2 in section 104-25 of the ITAA 1997.

Where the Company's shareholders hold pre-CGT shares in the company, any capital gain made under CGT event C2 will be disregarded under the exception of that event in subsection 104-25(5)(a) of the ITAA 1997.

The Company's post-CGT shareholders must calculate any capital gain or loss under CGT event C2 having regard to their respective cost bases of their shares.

ATO reference *Private Binding Ruling Authorisation Number 1052080831612*
w https://www.ato.gov.au/law/view/document?docid=EV/1052080831612

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6. ATO and other materials

6.1 Deductions and FBT for electric vehicle home charging

On 31 March 2023, the ATO published a draft practical compliance guideline PCG 2023/D1 regarding the calculation of electricity costs when charging a vehicle at an employee's or individual's home.

The guideline is available to certain employers and individuals who need to calculate the electricity cost of charging a vehicle for FBT or income tax purposes. Taxpayers may choose to use the methodology in the guideline, or may use the 'actual cost' method instead.

The guideline provides a shortcut methodology for calculating electric vehicle home charging costs, being the prescribed EV home charging rate multiplied by the number of kilometres travelled by the vehicle in the period. For the income year commencing on or after 1 April 2022, the rate is 4.2 cents per kilometre.

The guideline only applies to 'zero emissions vehicles'. Where the electric vehicle is a plug-in hybrid vehicle which has an internal combustion engine, the methodology in the guideline will not apply as the shortcut method applies the home charging rate to all kilometres driven in the FBT or income tax year.

Employers who can rely on the guideline

Employers can rely on the guideline to calculate electricity costs of charging an electric vehicle at the employee's home if they:

1. provide the electric vehicle to an employee or associate for private use resulting in the provision of a car fringe benefit, residual fringe benefit or pay for expenses associated with the car resulting in a car expense payment benefit;
2. provide the electric vehicle to an employee or associate who charges the electric vehicle using electricity at a residential premises, where the electricity cost directly attributable to charging the electric vehicle cannot be practically segregated from the cost of running other electrical appliances in the home; and
3. are required to calculate the taxable value for one or more of the following as part of your FBT obligations
   (a) car fringe benefit;
   (b) residual fringe benefit;
   (c) car expense payment benefit - where the electricity charging cost incurred by the employee is reimbursed by the employer;
   (d) the grossed-up taxable value for reporting of the reportable fringe benefit amount (RFBA) for your employee - which continues to be reportable, even if the car benefit arising from the provision of the electric vehicle is exempt.

Individuals who can rely on the guideline

An individual can rely on the guideline to calculate electricity costs of charging an electric vehicle at their home if they:

1. use a zero emissions electric vehicle while carrying out their income-earning activities;
2. incur electricity expenses when charging the electric vehicle at home; and
3. have kept the relevant records for the income year.

Record keeping

If a taxpayer wishes to rely on the EV home charging rate to calculate their electricity charging expenses, they will need to keep a record of the distance travelled by the car (odometer records) in either the applicable FBT year to 31 March or the income year to 30 June.

If an employer chooses to apply this guideline and the EV home charging rate for FBT purposes, a valid logbook must be maintained if the operating cost method is used.

If an individual chooses to apply this guideline and the EV home charging rate for income tax purposes, to satisfy the record-keeping requirements they must have:

1. a valid logbook to use the logbook method of calculating work-related car expenses. For other vehicles, it is recommended a logbook is maintained to demonstrate work-related use of the vehicle; and
2. one electricity bill for their residential premises in the applicable income year to show they have incurred electricity costs.

For FBT purposes, the guideline will apply from 1 April 2022.

For income tax purposes, the guideline will apply when calculating relevant vehicle expenses from 1 July 2022.

There is a transitional approach to record keeping for the 2023 fringe benefits tax year and 2023 income year. If odometer records have not been maintained as at 1 April or 1 July 2022, a reasonable estimate may be used based on service records, logbooks or other available information. This approach will only be available for the opening odometer reading at 1 April or 1 July 2022.

The last day for comments on draft PCG 2023/D1 is 26 May 2023.

ATO reference *PCG 2023/D1*
w https://www.ato.gov.au/law/view/document?docid=DPC/PCG2023D1/NAT/ATO/00001

6.2 Consultation on taxation of super balances over $3 million

On 31 March 2023, Treasury released a consultation paper seeking feedback on the proposal to increase the headline tax rate to 30%, up from 15%, for earnings corresponding to the proportion of an individual's superannuation balance that is greater than $3 million. The proposal still taxes unrealised gains on assets, but the paper provides further detail on how the mechanism is to operate.

The changes are proposed to apply from 1 July 2025. The proposal was originally announced by the government on 28 February 2023 (see our March 2023 tax training notes).

Submissions are due to Treasury by 17 April 2023.

w https://treasury.gov.au/consultation/c2023-373973

6.3 SMSF rectification directions

The ATO has published *Practice Statement Law Administration* PS LA 2023/1 regarding Self-managed superannuation funds - rectification directions for contraventions of the *Superannuation Industry (Supervision) Act 1993* (SIS Act).

Under section 159 of the SIS Act, the Commissioner is permitted to give a rectification direction to an individual trustee or director of a corporate trustee of a self-managed superannuation fund, where that person has contravened the SIS Act.

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A rectification direction is a written notice that the Commissioner gives to an individual trustee or director of a corporate trustee of a self-managed superannuation fund, requiring them to take action to rectify the SIS Act contravention and provide evidence that they have done so. An example may be repaying a loan or borrowing, disposing of an asset or lodging an outstanding return. The rectification direction will specify the timeframe for compliance (typically up to 6 months, or up to 12 months in extreme cases).

There is no administrative penalty for failing to comply with the notice, but the ATO may take further compliance action. A person may object to the decision to give a rectification direction or to not vary a direction under Part IVC of the TAA.

A rectification direction is one of a range of compliance tools the Commissioner may use to deal with self-managed superannuation fund trustees who have failed to comply with the SIS Act. The Practice Statement suggests that an education direction and charging administrative penalties may commonly be applied in conjunction with a rectification direction. However, the Practice Statement says that a rectification direction should not be given where one or more of the following compliance tools are being used:

1. disqualifying an individual and prohibiting them from acting as a trustee of an SMSF or as a responsible officer of a body corporate that is trustee of an SMSF;
2. issuing a notice of non-compliance to the fund; or
3. taking action to wind-up the fund.

Rectification directions must not be given in circumstances where the ATO has accepted an enforceable undertaking which covers the contravention and the undertaking remains in place in respect of the contravention.

The Practice Statement states that the Commissioner should consider following general principles and case specific factors when deciding whether to issue a rectification direction:

1. general principles such as the Taxpayers' Charter and ATO Compliance model;
2. any financial detriment that might reasonably be expected to be suffered by the fund as a result of the person complying with the direction;
3. the nature and seriousness of the contravention, including:
   (a) the type and nature of contravention and whether it is possible to be rectified;
   (b) the person's behaviour, circumstances and compliance history;
   (c) the value of assets involved in the contravention; and
   (d) the number of contraventions during the income year;
4. other relevant circumstances, including:
   (a) whether the person has taken proactive steps to rectify the contravention;
   (b) the capability of the trustees to carry out required actions;
   (c) whether the person has previously been given an education direction; and
   (d) whether ATO compliance action (such as an audit) confirms that the person has not attempted to rectify a reported contravention.

ATO reference *PS LA 2023/1* w https://www.ato.gov.au/law/view/document?docid=PSR/PS20231/NAT/ATO/00001

6.4 ATO approach – penalty for failure to keep or retain records

The ATO has updated Practice Statement Law Administration *PS LA 2005/2* to include guidance on when the ATO will consider issuing a 'direction to educate'. The updated Practice Statement provides a new step in the approach the Commissioner takes when administering the penalty for failing to keep or retain records under section 288-25 of Schedule 1 to the TAA. These steps are:

1. determine if the law imposes a penalty;
2. determine if a direction to educate should be issued;
3. determine the amount of the penalty;
4. determine if remission is appropriate; and
5. record the penalty and notify the entity.

The focus of the amendment of the Practice Statement is in relation to Step 2.

The Practice Statement explains that a direction to educate is given to entities that they consider have failed to comply with their record-keeping obligations.

A direction to educate will only be issued if the Commissioner believes that an entity has made a reasonable and genuine attempt to comply with, or had mistakenly believed they were complying with, their tax record-keeping obligations.

To be eligible for this direction, the entity must be carrying on a business.

The entities will need to complete the approved online record-keeping course. If the entity successfully completes the course by the due date, then they are no longer liable to the penalty.

The Commissioner cannot issue a direction to educate for record-keeping obligations under:

1. the *Superannuation Guarantee (Administration) Act 1992* (Cth);
2. Part X of the *Fringe Benefits Tax Assessment Act 1986* (Cth);
3. Division 900 of ITAA 1997.

When issuing the direction, the Commissioner must provide written notice to the business. The notice will specify a reasonable period for the business to comply with the direction.

The business can request the terms be varied. The request must:

1. be in writing;
2. set out the reasons for the variation; and
3. be provided to the Commissioner before the end of the period of the notice.

The purpose of this direction is to ensure that the entity is aware of their record keeping obligations, and a penalty should not be remitted unless in exceptional circumstances.

The entity can object to the Commissioner's decision if they are dissatisfied with:

1. a direction to educate; or
2. the Commissioner's refusal to vary a direction to educate.

All other aspects of the Practice Statement remain the same.

ATO reference *PS LA 2005/2*
w https://www.ato.gov.au/law/view/document?docid=PSR/PS20052/NAT/ATO/00001&PiT=20230313000001

6.5 Victorian taxes on foreign property Investors

On 15 March 2023, the Victorian State Revenue Office (**SRO**) acknowledged the announcement of Revenue NSW regarding the exemptions of the NSW foreign owner surcharge and surcharge purchaser duty for citizens of South Africa, New Zealand, Finland and Germany.

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The SRO has confirmed it will continue to apply the Victorian foreign owner surcharge and surcharge purchaser duty provisions to all foreign purchasers and absentee owners, despite the NSW position.

w https://www.sro.vic.gov.au/news/taxes-foreign-property-investors

6.6 Tax consequences on sales of small scale land subdivisions

The ATO has updated its website guidance on the tax consequences on sales of small scale land subdivisions. The guidance discusses the need to determine whether the property is on capital account or on revenue account when it is sold and whether the activity is considered to be carrying on an enterprise for ABN and GST purposes.

The guidance provides a summary of the following relevant factors:

1. type of entity undertaking the subdivision;
2. types of activities the person is involved in;
3. costs incurred prior to the sale;
4. complexity and steps undertaken;
5. parties and phases involved;
6. the relationship to other parties involved in the land subdivision;
7. the purpose in buying the land; and
8. timing and steps undertaken for the sale.

For each relevant factor, the guidance provides a table with examples of when a gain is more likely to be a capital gain, compared to when it is more likely to be ordinary income.

An interesting example of a two lot subdivision is included in the guidance:

Claude purchased his home on a single title from a private seller on 1 July 2001 for $300,000. The house was situated on the front portion of an 800m² block. Claude wished to remain in this home however maintaining the big backyard became a burden.

On 1 July 2020, Claude began detailed research and spoke with multiple local real estate agents to understand if he could subdivide his backyard to build a new house and sell it.

Claude's registered valuer valued the entire property at $600,000 split 60%:40%:

- *original house and land – $360,000*
- *newly created subdivided lot – $240,000.*

Claude decided to subdivide, build a house, and sell the newly created subdivided development. To do this, he:

- *lodged an application for subdivision and received council approval*
- *engaged a project developer to:*
- *prepare and submit a development application*
- *build the new house.*

Claude funded the development expenses of $440,000 (GST inclusive) through a bank loan and expected the sale of the new house to pay the loan out in full.

He engaged a local real estate agent to sell the new house. He sold it via a contract signed on 1 July 2021 for $1,210,000. There is no agreement to apply the margin scheme to the sale.

Income tax outcome

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Once the backyard got its own title, it became its own asset and was no longer part of Claude's home as a domestic asset. Because Claude's transaction is more complex than just selling the vacant lot, his activities amount to a development activity.

The sale of the backyard became a profit-making activity once Claude made the decision to embark on that activity. The net profit from that activity will be included in his assessable income:

Claude made an overall gain (net profit plus capital gain) of $580,000. This will be the assessable income he pays tax on.

The overall gain ($580,000) is based on the GST exclusive sale proceeds ($1,100,000) minus the GST exclusive development expenses ($400,000) and the original cost attributable to the newly subdivided lot of $120,000($300,000 x 40%).

The increase in the value of the newly created subdivided lot from when it was originally acquired (1 July 2001) up to when the profit-making activities began (1 July 2020) should be treated as a capital gain.

The original cost, attributable to the newly created subdivided lot was $120,000 (40% of $300,000) on 1 July 2001.

The value of the newly created subdivided lot at the time Claude began to undertake profit-making activities on 1 July 2020 was $240,000. As Claude has held the subdivided block for greater than 12 months he is entitled to a 50% CGT discount, hence there is a discounted capital gain of $60,000.

The increase in the value of the newly created subdivided lot from when the profit-making activities began up to the time of sale should be treated as ordinary income.

The net profit ($460,000) will be based on the GST exclusive sale proceeds ($1,100,000) minus the GST exclusive development expenses ($400,000) and the value of the subdivided lot ($240,000).

GST outcome

As Claude has entered a profit-making activity and the projected sale price of the developed land will exceed the GST registration turnover threshold, he is required to register for GST. He will:

- *have a GST liability of $110,000 on the sale price of the townhouse*
- *provide a notification to the purchaser of the amount at settlement to be withheld and paid to the ATO*
- *be able to claim $40,000 credits for the GST included in the price of his development purchases (subject to the normal GST rules)*
- *report these transactions by completing business activity statements.*

TRAP – if a property is held on revenue account, the general CGT discount, the CGT main residence exemption and the small business CGT concessions will not be available to reduce the tax on the ordinary income.

TIP – further information can be found *in Taxation Ruling TR 92/3 Income tax: whether profits on isolated transactions are income* and *Miscellaneous Taxation Ruling MT 2006/1 The New Tax System: the meaning of entity carrying on an enterprise for the purposes of entitlement to an Australian Business Number*.

w https://www.ato.gov.au/General/Property/Tax-consequences-on-sales-of-small-scale-land-subdivisions/

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6.7 New lodgment deferral function coming soon

The ATO has commenced beta testing of new lodgment deferral functions in Online Services for Agents. The new functions are expected to launch in late April.

The new functions are intended to:

1. populate and validate data for agents with on-screen prompts to help agents complete requests;
2. create a single-entry point for all lodgment deferral requests – eliminating the need for completing various spreadsheets and reducing the confusion in relation to forms;
3. allow up to 40 lodgment deferral applications at a time with the option for agents to submit a request for more;
4. allow agents to view lodgment deferral requests submitted in the previous 60 days; and
5. reduce processing times to 48 hours for requests that meet low-risk (agent-assessed) guidelines. Other requests will continue to be escalated for review and may take up to 28 days.

How to prepare

The ATO recommends the following steps be taken in preparation for the new functions:

1. all staff submitting lodgment deferral requests should have standard myGovID identity strength;
2. agents should have access to client registration add/update permission in online services;
3. staff should be updated on the upcoming changes.

w https://www.ato.gov.au/Tax-professionals/Newsroom/Lodgment-and-payment/One-month-to-go--New-lodgment-deferral-function-coming/

6.8 Queensland land tax concessions for build-to-rent developments

The Queensland Government released a Media Statement on 28 March 2023 announcing that it will cut land tax by 50% for Build-to-Rent developments that feature at least 10% of rental homes as affordable housing.

The range of investment-attracting tax concessions for Build-to-Rent developments will include:

1. a 50% discount on land tax payable for up to 20 years;
2. a full exemption for the 2% foreign investor land tax surcharge for up to 20 years; and
3. a full exemption from the Additional Foreign Acquirer Duty for the future transfer of a Build-to-Rent site.

Queensland Treasury will consult with the property industry on the land tax concessions ahead of the proposed 1 July 2023 commencement.

w https://statements.qld.gov.au/statements/97453

6.9 Revenue NSW Shared Equity Home Buyer Helper – Financial Assets & Excess Savings

On 1 March 2023, Revenue NSW released CPN 028: Shared Equity Home Buyer Helper – Financial Assets & Excess Savings. The practice note addresses certain aspects of how the Chief Commissioner will administer the NSW Shared Equity Scheme Policy Guidelines published on 2 December 2022 (**Guidelines**). In particular, the practice note provides guidance and examples in relation to:

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1. the types of financial assets the Chief Commissioner may include when determining whether an applicant satisfies the asset limit and whether the applicant has excess savings under the NSW Shared Equity Scheme (**Scheme**) as determined by the Guidelines; and
2. circumstances when the Chief Commissioner may or may not require an applicant to apply some or all excess savings towards the purchase of a property under the Scheme.

Financial Assets

As part of the eligibility criteria for the Scheme, the Guidelines require a person to satisfy the 'asset limit'. An applicant satisfies the asset limit if the applicant's financial assets on application, whether in Australia or overseas, are no more than:

1. 30% of the total property price if the joint applicants' aggregate gross annual income is more than $90,000 for a Scheme assessment in the 2022-2023 financial year;
2. 45% of the total property price if the applicant's aggregate gross annual income is up to $90,000 for a Scheme assessment in the 2023-2023 financial year; and
3. 65% of the total property price if the applicant is a single person 50 years of age or older.

The Guidelines set out broadly the types of assets that the Chief Commissioner must treat as financial assets. The Chief Commissioner has a discretion to include 'household assets' that are not ordinary household items and may be considered to be luxury items. The Chief Commissioner may also include other financial assets considered to be relevant for determining eligibility for the purpose of the Scheme and the Guidelines.

The practice note provides that a household item may be considered to be a luxury item where it is of a high cost or value but it is not essential for living or for which there is a modestly priced alternative that provides substantially the same core functionality or meets a similar purpose.

The practice note provides the following non-exhaustive list of household items that may be considered luxury items:

1. haute couture clothing;
2. designer or bespoke watches, jewellery, shoes and accessories;
3. cellared wine and champagne;
4. artwork including paintings, prints, and sculpture;
5. home entertainment systems and servers;
6. antique furniture, objects and other items,
7. luxury, performance and vintage motor vehicles and motor vehicles surplus to household transportation needs;
8. recreational vehicles (e.g. motorhomes, campervans and caravans);
9. recreational vessels (e.g. any watercraft capable of being used as transportation on water).

Other types of financial assets that the Chief Commissioner may consider include, but are not limited to:

1. crypto currencies
2. uncleared cheques (of which the applicant is payee);
3. funds of the applicant held in trust accounts;
4. gold, silver or platinum bullion or other interest in precious metals;
5. gemstones;
6. licences such as commercial fishing and taxi licences;
7. surrender value of life insurance policies;
8. surrender value of annuities;
9. collectables (whether for trading, investment or hobby purposes);
10. call options over securities.

As a matter of practice, the value of all financial assets must be disclosed in Australian dollars. The value of a financial asset is the unencumbered market value of the asset in Australian dollars. Any financial asset

denominated in a foreign currency must be converted to Australian dollars using the rate exchange reported by the Reserve Bank of Australia at the date of application. Where there is no active market for an asset or valuation of the asset is not available, a reasonable estimate may be provided to the Chief Commissioner.

Excess Savings

The Guidelines defines 'Scheme Amount' as the money to be provided by the State at the time of settlement in exchange for a 'Scheme interest' in the property. The maximum Scheme amount is 30% of the total property price for an established home or of 40% of the total property price for a new home.

The Scheme Amount is determined as:

1. the total property price;
2. less the maximum loan for which a panel financier has given final approval; and
3. less the financial contribution of the applicant which is required to be no less than 2% of the total property price; plus
4. any excess savings the Chief Commissioner has determined are required to be used as a financial contribution.

Excess savings is defined as the financial assets of an applicant greater than $100,000 in aggregate. The Chief Commissioner has the discretion to require an applicant to use some or all of any excess savings as a financial contribution towards the total property price of a property purchased under the Scheme. This has the effect of reducing the Scheme amount and increasing the financial contribution of the applicant.

The extent of excess savings (if any) required to be used as part of an applicant's financial contribution towards the total property price will depend on the reasonableness of such a requirement having regard to the intended use of the excess savings by the applicant. The Chief Commissioner will consider this on a case-by-case basis.

If excess savings are required to be applied towards the total property price, an applicant may need to sell financial assets in order to apply some or all of the proceeds of sale to acquire the property.

Factors that the Chief Commissioner will consider when weighing the applicant's intended use of the excess savings against their use to maximise the applicant's financial contribution to the purchase of the property may include the following:

1. necessity: the more essential the intended use of the excess savings by the applicant and their dependents the less likely the excess savings will be applied towards the acquisition of the property. Necessity may include an intended use that applies to basic living expenses, essential medical treatment or education;
2. time critical: the sooner the funds are required by an applicant (or the more difficult it is for the applicant to defer the use of the funds to a later date) the less likely the funds will be required towards the property acquisition;
3. reasonable alternatives: the lack of lower cost alternatives that provide a reasonable substitute to the applicant's intended use of the excess funds the less likely the excess funds will be required to be applied towards the property acquisition.

The practice note includes a number of examples of when excess savings may or may not be applied. For example:

When excess saving may be applied

Example 5 – Prospective (Not Time Critical) expenses

38. *F is a single parent of a dependent child one year of age. F has excess savings of $70,000 and intends to build upon these savings as a tertiary education fund for the dependent child (and any additional children).*

    The Chief Commissioner may require F to contribute all or part of the excess savings if the funding of the dependent child's education is not an imminent expense and which will be incurred at a later date, when other options could be available to F (such as re-financing with the Panel Financier to any extent permissible under clauses 8.6 and 8.9).

When excess savings may not be applied

Example 7 – Medical expenses (Necessity)

42. *G is an eligible person and has excess savings of $40,000. G is planning to undergo a medical procedure for a health condition that is impacting his quality of life. G intends to use the $30,000 to fund the medical procedure.*
43. *Under such circumstances, the Chief Commissioner may waive the requirement for G's excess savings to be applied as a financial contribution towards the purchase of a property. G will be required to substantiate his intentions to apply the excess savings towards the performance of the medical procedure. This can be in the form of a medical report describing the nature of the health condition, the timing and proposed cost of the medical procedure, and any anticipated post-procedure expenses.*

Revenue NSW reference *CPN 028: Shared Equity Home Buyer Helper – Financial Assets & Excess Savings*
w https://www.revenue.nsw.gov.au/help-centre/resources-library/cpn/cpn-028

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