

Taxation

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Trust asset reevaluation strategies ... revisiting the practice

*Peter Slegers, CTA, and
Joshua Pascale*

Death and income tax –
some discrete issues: part 1

*Ian Raspin, CTA, Lyn Freshwater,
and Mark Morris, FTI*

Foreign residents and the
main residence exemption
no more

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Invitation to write



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

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

Tax News – at a glance

by TaxCounsel Pty Ltd

February – what happened in tax?

The following points highlight important federal tax developments that occurred during February 2020. A selection of the developments is considered in more detail in the “Tax News – the details” column on page 416 (at the item number indicated).

Community sheds

The government has released exposure draft legislation and explanatory material for the introduction of a new general category of deductible gift recipient (DGR) for community sheds. The new DGR category will apply to public institutions that are registered charities and satisfy the definition of a community shed. **See item 1.**

Goods taken from stock for private use

The Commissioner has issued a determination that provides an update of amounts that he will accept as estimates of the value of goods taken from trading stock for private use by taxpayers in named industries for the 2019-20 income year (TD 2020/1). **See item 2.**

GST: extent of creditable purpose

The Commissioner has released an addendum to GSTR 2006/4 to include methodologies for determining the extent of creditable purpose for car expenses. **See item 3.**

Taxpayer alert: schemes relating to intangible assets

The Commissioner has released a taxpayer alert in relation to non-arm's length arrangements and schemes connected with the development, enhancement, maintenance, protection and exploitation of intangible assets (TA 2020/1). **See item 4.**

Crowdfunding

On 31 January 2020, the Commissioner released a document that sets out his current view on the tax implications of crowdfunding arrangements. **See item 5.**

Deceased estates: protected information

A legislative instrument has been made that modifies the operation of s 355-25 of Sch 1 of the *Taxation Administration Act 1953* (Cth) to ensure that a taxation officer can disclose protected information to the registered tax agent or BAS agent, or legal practitioner of an executor or administrator

of an estate of an individual who has died (CRP 2020/1).

See item 6.

Trust income

In a recent decision, the AAT has considered several practical issues, including the effect of purported disclaimers by beneficiaries of a discretionary trust, the non-compliance with the provisions of the constitution of the trustee company in the making of purported distribution resolutions, and the operation of a guardian consent provision in the trust deed (*Trustee for the Whitby Trust and FCT* [2019] AATA 5637).

See item 7.



President's Report

by Peter Godber, CTA

Influential leaders to address The Tax Summit 2020

New president Peter Godber highlights the relevance of bringing together our diverse membership at The Tax Summit.

It is always helpful for us to keep in mind some of the key elements of our vision at The Tax Institute.

We are the leading forum for the tax community in Australia. We are committed to supporting our diverse membership and being relevant and valuable to them. We continue to help shape the future of the tax profession. We advocate for improvements to the tax system for the benefit of all. We achieve this through the advancement of knowledge, member support and advocacy.

The Tax Summit 2020, to be held in Sydney in March this year, will showcase the important role of the Institute in our tax community, with a technical program that heralds depth and unprecedented quality in its sessions. Again, we have attracted leading tax professionals and experts to deliver our sessions across five break-outs and eight technical streams.

We will have an amazing line-up of experts, and industry and regulatory leaders, to engage with us in plenary sessions that will cater for the interests of all members within the expanse of the International Convention Centre in Sydney.

A welcome address will be provided on behalf of the NSW Government by the Treasurer, the Hon. Dominic Perrottet. In addition to the annual Commissioner of Taxation's address, we are also pleased to announce that an additional keynote address will be given by Mr Peter Costello, chair of Australia's Future Fund, and the longest serving Federal Treasurer in our nation's history.

To finish the event, and to ensure that we are future focused, our Friday lunch will be addressed by Mr Stephen Scheeler, former Facebook CEO for Australia and New Zealand. That will provide an inspiring insight into our modern work environment.

Most importantly, The Tax Summit 2020 will be a premier member event — The Tax Advisor of the Year Awards,

fantastic opportunities to meet and mingle and catch up with old and new friends, and the chance to absorb the environment at this very unique event – this is all about our members, present and future.

We now have hundreds of organisations that have committed to the attendance of their people. Again, if you have not already registered, it is not too late! We welcome the return of our national annual premier event to Sydney and we look forward to all that is on offer at the International Convention Centre and its surrounds.

Looking again at our national CPD program, I have already had the benefit of attending and enjoying our annual Financial Services Conference, which was held at the Grand Hyatt in Melbourne from 5 to 7 February. This is Australia's leading conference on financial services industry taxation, and this year's program had wide coverage of many areas relevant to the sector. It had a comprehensive technical program, was well attended, and the social gatherings were first-rate and most enjoyable.

The event is one of the dedicated industry events that we are able to provide, with high-profile and quality speakers, and attendees, at an industry specific learning event. Later in the year, we will conduct similarly attractive events that are specifically focused on infrastructure and resources.

Our advocacy activities are winding up for the year ahead, and in future issues of this journal, we will be able to report on the progress of our stakeholder engagement in this regard.

As is usual, we have an oversupply of topics on which there will be external consultation and submissions over the course of 2020, and we will be active in our engagement with the issues affecting the profession and our tax community as a whole.

During March, we will respond to the Tax Practitioners Board discussion paper, released on 19 February, in which it is proposed that the continuing professional education (CPE) requirement for tax agents increase to 40 hours per year. The proposal is for an increase in the annual CPE hours, without reference to an averaging over more than a year. The discussion paper raises some broader questions and we will be conscious to represent members' views on this important potential increase in the CPE threshold.

See you all at The Tax Summit 2020!



CEO's Report

by Giles Hurst

Reaching the summit through considered investments

CEO Giles Hurst explains how The Tax Institute is investing in members, technology and big, bold events.

Leaving the ladders down

The recent launch of our Speakers Academy gave us an opportunity to mix with the best and brightest in tax at our North Sydney offices. The initiative reminded me of the importance of increasing the Institute's investment in the up-and-coming talent in our profession.

Any time that we are afforded the opportunity to speak in front of our peers, it can conjure up some interesting reactions, some of which we cannot always control. The innate fear of rejection is probably the most common of these feelings and the struggle to process our emotional response is one which is carried with us throughout our entire careers.

In the months ahead, we will begin extending the Speakers Academy to other states. The invitation will go out to our more experienced volunteers and members to nominate up-and-coming tax professionals looking to actively develop techniques to complement their undoubted tax technical capabilities. This is the opportunity to truly act as a mentor and guide to the future leaders in tax and I urge us all to think about how we can play our part in future-proofing the tax profession.

Investing in our future

The Tax Institute has certainly been through a lot of modernisation and change in 2018 and 2019, and in 2020, we intend to invest the surplus we have generated in the long-overdue refresh of our website.

Making it easier for members to search for resources, content, tools and learning opportunities will be an important step forward as we seek to become the go-to place for all of our member's needs. We will be asking many of you in

the weeks ahead, through numerous channels, for input and feedback about what matters to you in the interactions you enjoy with *your* Institute.

We are the voice of tax

The Tax Summit 2020 has been nine months in the making. As I write, it is already the single largest event that The Tax Institute has ever hosted, and the sheer scale of the content and value sets a new standard in tax for Australia.

Registrations continue to roll in and I am very excited to welcome all of our members to the ICC Sydney next month as we share stories, rub shoulders with players at every level of the profession, and celebrate the winners of the various Tax Adviser of the Year awards.

The gala dinner also promises to be an unforgettable evening, with last year's winner of *The Voice*, Diana Rouvas, making a special guest appearance with the outstanding band we have assembled. There will be something for everyone and we hope to see you at the Summit to celebrate all that is tax in Australia.

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As a member you get exclusive access!

Being a member of The Tax Institute gives you exclusive access to tax experts and what they have to say.

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We are launching a **Monthly Special Topic** where a different tax specialist will share key insights. We are also enhancing our **Monthly Tax Update**. This popular webinar is now presented by The Tax Institute's very own Senior Tax Counsel, Professor Bob Deutsch.

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Tax Counsel's Report

by Stephanie Caredes,
CTA

Success breeds success

In this month's column, tax counsel Stephanie Caredes comments on the success of the Institute's work in improving guidance in the tax and superannuation system.

Nearly two years ago, Tax Institute members identified a rising concern with the quality of the guidance that Treasury and the ATO were producing and placing into the tax and superannuation system. We first made comments on this issue in our [submission to the Australian Public Service Review](#). This opened the pathway for the other professional bodies to join in the discussion with the production of a [joint paper submitted to the ATO National Tax Liaison Group](#), followed up by a [letter to the Assistant Treasurer](#), the Hon. Michael Sukkar, MP, in June 2019 to improve consultation in the tax and superannuation system.

The Tax Institute rounded out the year by lodging formal [submissions with Treasury](#) and [the ATO](#), capturing members concerns.

Key concern

The key concern is that, where there is a lack of pertinent guidance in an explanatory memorandum (EM), this creates a chasm in the available interpretive guidance on how a new tax law was intended to be interpreted by parliament. Consequently, members have seen examples where the ATO has moved to fill the chasm with its own guidance.

In the Institute's view, an EM should have the following characteristics:

- an EM should contain an overall objective statement of the policy behind the measure;
- an EM should provide readers with an understanding of the government of the day's intended meaning of the new legislation/legislative amendments, providing context and helpful, practical examples of the intended application and not just simply restate or reproduce the new provisions;
- an EM should provide an explanation for all technical legislative corrections contained in the Bill;
- an EM should contain clear statements regarding whether the amendments (including minor technical amendments) are intended to change the operation/application of the

law or whether they are intended to clarify the operation/application of the law;

- an EM should be consistent with the drafting instructions/briefing provided to the Office of Parliamentary Counsel; and
- an EM should align with the content of the parliamentary second reading speech of a Bill and the Bill itself.

This isn't too much to ask, is it?

Members had noticed trends arising in relation to EMs, including:

- misalignments between statements of parliament's intent captured in EMs and the actual drafting of the legislation; and
- leaving pertinent examples, explanations and interpretative guidance out of EMs, consequently leaving space for the ATO to instead include this material in law companion rulings.

Once members' minds turned to this issue, further trends emerged in relation to ATO guidance, including:

- a perceived trend where members felt that the ATO was not acknowledging competing interpretations of the law;
- a perceived trend where the ATO foreshadows its position before it has analysed issues in detail;
- a decrease in binding guidance which has enabled the ATO to include more administrative guidance in non-binding products — the Institute encourages a balance being struck between binding and non-binding guidance;
- as noted above, there is a growing trend for ATO guidance to include analysis that should actually be included in the relevant EM; and
- the delay between issuing in draft and finalisation of a ruling which creates uncertainty for taxpayers, particularly if the ATO's view changes between the draft and finalised ruling.

Response

Prior to finalising our submissions, the Institute held preliminary discussions with senior representatives at Treasury and the ATO to bring this issue to their attention. In response to the work that the Institute has done, supported by the National Technical Committee volunteer network, Treasury has indicated that it will coordinate with the ATO and consult on this matter. Further, the Law Design Office within Treasury has indicated that it will conduct an internal review of all EMs issued in the Treasury portfolio. This goes well beyond the issues highlighted by the Institute, which are confined to tax and superannuation laws. In our view, this is a successful outcome, albeit only just the beginning of what needs to be done to address this issue.

Successful outcomes

They say that success breeds success. The Institute could not be happier with how responsive Treasury and the ATO have been to this issue, and with the groundswell among other bodies that represent taxpayers and tax professionals which has contributed to carrying this issue along.

To the Tax Policy and Advocacy Team, this work has been highly successful. We anticipate that this will flow on to improve the quality of EMs and ATO guidance being produced. Certainly, that is our intention and that will be the ultimate mark of success.

Tax News – the details

by TaxCounsel Pty Ltd

February – what happened in tax?

The following points highlight important federal tax developments that occurred during February 2020.

Government initiatives

1. Community sheds

The government has released exposure draft legislation and explanatory material for the introduction of a new general category of deductible gift recipient (DGR) for community sheds. The new DGR category will apply to public institutions that are registered charities and satisfy the definition of a community shed.

To be a community shed, a public institution must:

- have the dominant purposes of advancing mental health and preventing or relieving social isolation;
- primarily advance these purposes through providing a physical location at which individuals are supported to work on projects and undertake other activities in the company of others; and
- have open membership to members of the public.

The amendments, once enacted, are to apply to gifts and contributions made on or after 1 July 2020.

The Commissioner's perspective

2. Goods taken from stock for private use

The Commissioner has issued a determination that provides an update of amounts that he will accept as estimates of the value of goods taken from trading stock for private use by taxpayers in named industries for the 2019-20 income year (TD 2020/1).

The updated amounts are as follows:

Type of business	Amount (excluding GST) for adult/child over 16 years old	Amount (excluding GST) for child 4 to 16 years old
Bakery	\$1,350	\$675
Butcher	\$850	\$425
Restaurant/café (licensed)	\$4,640	\$1,750
Restaurant/café (unlicensed)	\$3,500	\$1,750
Caterer	\$3,790	\$1,895
Delicatessen	\$3,500	\$1,750

Type of business	Amount (excluding GST) for adult/child over 16 years old	Amount (excluding GST) for child 4 to 16 years old
Fruiterer/greengrocer	\$880	\$440
Takeaway food shop	\$3,440	\$1,720
Mixed business (includes milk bar, general store and convenience store)	\$4,260	\$2,130

3. GST: extent of creditable purpose

The Commissioner has released an addendum to GSTR 2006/4 to include methodologies for determining the extent of creditable purpose for car expenses.

The ruling points out that there may be a number of approaches for determining the extent of use for a creditable purpose. The ruling has given a number of approaches for several situations (including home office expenses and now motor vehicle expenses) and, while the use of the approaches is not compulsory, if a taxpayer chooses to use an approach, the Commissioner will accept that the taxpayer has correctly determined the extent of their creditable purpose where the representative periods reflect actual usage.

Now the addendum gives the following methods in the case of motor vehicle expenses:

- cents-per-kilometre method; or
- logbook method.

A taxpayer who uses the cents-per-kilometre method for income tax is not required to calculate an extent of business use. Therefore, the taxpayer would need a method to work out their extent of creditable purpose. This can be done using the following formula:

$$\frac{\text{reasonable estimate of business kilometres per tax period}}{\text{reasonable estimate of total kilometres per tax period}}$$

where the estimate of business kilometres is the same as that used for income tax purposes, excluding any travel in respect of employment or making input-taxed supplies. Business and total kilometres can be estimated from odometer readings, service records or any other reasonable basis. It is not necessary that the taxpayer is using the cents-per-kilometre method for income tax to use this formula for GST.

For income tax purposes, the cents-per-kilometre method is limited to the first 5,000 business kilometres in a tax year. This limitation does not apply for GST purposes, provided the taxpayer's records are sufficient to show that the extent of creditable purpose that is used is a fair and reasonable approximation of the actual use of the car.

If a logbook is maintained and all of the taxpayer's business use of the car is for a creditable purpose, the Commissioner will accept that the percentage of business use obtained for income tax can also be used as the extent of creditable purpose. If the taxpayer's business use is not entirely for a creditable purpose, for instance, the taxpayer's business use includes travel for their employment or travel in respect of input-taxed supplies, the extent of creditable purpose must be reduced accordingly.

The addendum applies on and from 22 January 2020. GSTR 2006/1 (how to claim input-tax credits for car expenses) was withdrawn as from that date.

4. Taxpayer alert: schemes relating to intangible assets

The Commissioner has released a taxpayer alert in relation to non-arm's length arrangements and schemes connected with the development, enhancement, maintenance, protection and exploitation (DEMPE) of intangible assets (TA 2020/1).

In particular, the ATO is currently reviewing international arrangements that mischaracterise Australian activities connected with the DEMPE of intangible assets. The ATO is concerned that these arrangements may be non-arm's length or structured to avoid tax obligations, resulting in inappropriate outcomes for Australian tax purposes.

The ATO's concerns include whether functions performed, assets used and risks assumed by Australian entities in connection with the DEMPE of intangible assets are properly recognised and remunerated in accordance with the arm's length requirements of the transfer pricing provisions in the taxation law.

The ATO is also concerned that parties to these arrangements may fail to properly comply with Australian income tax obligations, such as those imposed by the CGT and capital allowances provisions. There is a particular concern where intangible assets and/or associated rights are migrated to international related parties as part of non-arm's length arrangements and/or in a manner intended to avoid Australian tax.

In circumstances where these arrangements lack evidence of commercial rationale and/or substance, the ATO's concerns extend to the application of the exceptions in the transfer pricing provisions and anti-avoidance rules. The general anti-avoidance rule (Pt IVA of the *Income Tax Assessment Act 1936* (Cth)) or diverted profits tax (DPT) provisions may apply where a tax benefit or DPT benefit is obtained in connection with these arrangements.

The taxpayer alert gives two examples of arrangements of particular concern but states that the taxpayer alert is not limited to these arrangements.

5. Crowdfunding

On 31 January 2020, the Commissioner released a document that sets out his current view on the tax implications of crowdfunding arrangements.

Crowdfunding is the practice of using internet platforms, mail-order subscriptions, benefit events and other methods to find supporters and raise funds for a project or venture. Crowdfunding is a rapidly evolving industry. As the industry expands and new developments arise, the ATO will review and update the information.

Anyone involved in crowdfunding, regardless of their role, needs to be aware of the tax consequences. These vary depending on the nature of the arrangement, a person's particular role in it and their circumstances.

It is important to determine whether the money received through crowdfunding is income and whether there are any

GST issues. The following topics are covered in the ATO document:

- crowdfunding roles;
- types of crowdfunding;
- crowdfunding and income tax; and
- crowdfunding and GST.

6. Deceased estates: protected information

A legislative instrument has been made that modifies the operation of s 355-25 of Sch 1 of the *Taxation Administration Act 1953* (Cth) to ensure that a taxation officer can disclose protected information to the registered tax agent or BAS agent, or legal practitioner of an executor or administrator of an estate of an individual who has died (CRP 2020/1).

The explanatory statement for the instrument states that the instrument recognises that an executor or administrator of a deceased estate effectively "stands in the shoes" of the deceased person, in the sense that they assume the rights, burdens and obligations of the deceased person after death. By allowing taxation officers to disclose the deceased person's protected information to a representative, the executor or administrator is able to be represented, when performing their duties, in the same way that the deceased person could have if they were alive.

The effect of the instrument is to provide for representatives of an executor or administrator of a deceased estate to be considered a covered entity for the purposes of s 355-25(2).

The modification does create a change to the taxpayer confidentiality provisions. The key principle to be considered is the protection of taxpayer information. Any disclosure of information exceptions are only provided in instances where privacy concerns are outweighed by the public benefit of these disclosures.

Recent case decisions

7. Trust income

In a recent decision, the AAT has considered several practical issues, including the effect of purported disclaimers by beneficiaries of a discretionary trust (the Whitby Trust), the non-compliance with the provisions of the constitution of the trustee company in the making of purported distribution resolutions, and the operation of a guardian consent provision in the trust deed (*Trustee for the Whitby Trust and FCT*¹).

One fundamental question that is of practical importance was whether the documents purporting to distribute the income of the Whitby Trust had that effect. The AAT said that, for two reasons, the answer was no. These reasons were:

1. on the evidence led, the tribunal could not find that the terms of the trustee's constitution had been followed so as to produce a decision or resolution of either its shareholders or the directors. Against a backdrop of the Commissioner not being satisfied that meetings had occurred as alleged, this absence of evidence was telling. The objection decision plainly put the applicant on notice that the Commissioner did not accept that the documents bearing the date of 30 June in each year had the effect they purported to have, and one of the reasons the

Commissioner had formed the view that he had was that the documents did not detail who was in attendance at the meetings; and

2. the terms of the trust deed were not observed. Even if the documents bearing the date 30 June in each of the income years could be accepted as records of properly constituted meetings or properly passed resolutions, each of the distributions purporting to have been made was to an eligible entity under the trust deed. The first of any such distributions required consent of all of the guardians and there was no evidence that both of the named guardians had consented as required.

It will be appreciated that, when the making of a distribution by the corporate trustee of a discretionary trust is being contemplated, close attention to the terms of the trust deed and of the constitution of the trustee will be essential. The terms of the constitution of the trustee may be affected by the trust deed.

TaxCounsel Pty Ltd
ACN 117 651 420

Reference

- 1 [2019] AATA 5637.



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Tax Tips

by TaxCounsel Pty Ltd

CGT choices: timing issues

A number of choices are provided for by the CGT provisions of the ITAA97 and there is a general CGT choice-making rule that raises some issues.

Background

Since their enactment, the CGT provisions of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) have provided for various choices to be made and the circumstances in which they may be made. There is, as explained below, a general provision which governs the making of CGT choices.

For instance, the CGT main residence exemption provisions provide for the making of choices in particular circumstances the effect of which, if validly made, will be that a dwelling will be treated, contrary to fact, as being the taxpayer's main residence at a particular time or during a particular period, usually to the exclusion of any other residence.¹

There are also now significant CGT choices provided for by the CGT small business relief provisions in Div 152 ITAA97. It is issues relating to the making of these choices that are considered in this article.

The general choice-making rule

As indicated, the CGT provisions contain a general provision which governs the making of CGT choices. That provision is s 103-25 ITAA97 which reads as follows:

"103-25 Choices

- (1) A choice you can make under this Part or Part 3-3 must be made:
 - (a) by the day you lodge your income tax return for the income year in which the relevant CGT event happened; or
 - (b) within a further time allowed by the Commissioner.
- (2) The way you (and any other entity making the choice) prepare your income tax returns is sufficient evidence of the making of the choice.
- (3) However, there are some exceptions:
 - (aa) subsection 115-230(3) (relating to assessment of capital gains of resident testamentary trusts) requires a trustee to make a choice by the time specified in subsection 115-230(5); and
 - (b) subsections 152-315(4) and (5) (relating to the small business retirement exemption) require a choice to be made in writing.

Note: This section is modified in calculating the attributable income of a CFC: see section 421 of the *Income Tax Assessment Act 1936*."

This provision raises a number of potential problems which are not within the scope of this article. However, what is of particular present relevance is the operation of para (1)(a) in the context of a capital gain that arises from the happening of CGT event A1 and which potentially qualifies for the CGT small business reliefs. More particularly, the assumed underlying scenario for the purposes of this article is that a contract is entered into for the disposal of a CGT asset and the relevant CGT event will be CGT event A1.

CGT event A1

CGT event A1 happens if a taxpayer disposes of a CGT asset (s 104-10(1) ITAA97). For this purpose, a taxpayer will dispose of a CGT asset if a change of ownership occurs from the taxpayer to another entity, whether because of some act or event or by operation of law.

Where there is a contract for the disposal of a CGT asset, the change in ownership of the asset would usually only occur when the contract is completed. But the time of the happening of CGT event A1 would be taken to be when the contract for the disposal was entered into (s 104-10(3) ITAA97). The important point for present purposes is that CGT event A1 cannot be taken to have happened unless the contract is completed.

The problem

In many situations, no difficulty will arise in the making of a relevant CGT small business relief choice that involves the happening of CGT event A1 because the settlement of the contract would have occurred before the lodgment of the taxpayer's tax return for the income year in which the contract was entered into.

However, there will inevitably be situations where the contract for the sale of a CGT asset is not completed by the time the income tax return of the taxpayer for the income year in which the contract was entered into is lodged. It is such a situation that is considered in this article.

It will be appreciated that, in a case where the contract is not completed before the income tax return for the income year in which the contract was entered into is lodged, a valid choice could only be made if the Commissioner were to allow a further period within which to make the choice.

Recognition of capital gain or loss

Whether or not a CGT choice is involved, an even more fundamental CGT issue arises where CGT event A1 is involved and the disposal contract is not completed by the time of lodgment of the return for the income year in which the disposal contract is entered into.

This issue is that, because CGT event A1 would not have happened when the return of income is lodged (because the contract has not been completed), a capital gain or capital loss would not have arisen by the time the return is lodged. However, once the contract is completed, the happening of a CGT event would be deemed to have retrospectively happened at the date of the contract. The Commissioner has addressed this issue in TD 94/89 which deals with the way the corresponding CGT provisions of the *Income Tax Assessment Act 1936* (Cth) operated. Relevantly, TD 94/89 states:

“3. However, a taxpayer is not required to include any capital gain or loss in the appropriate year until an actual change of ownership occurs. Settlement effects a change of ownership and a disposal (subsection 160M(1)) which then triggers the operation of subsection 160U(3). When settlement occurs, the taxpayer is then required to include any capital gain or loss in the year of income in which the contract was made (subsection 160U(3)). If an assessment has already been made for that year of income, the taxpayer may need to have that assessment amended.”

However, the Commissioner has not addressed the situation where a choice is required to be made by the time an income tax return is lodged.

The CGT small business relief choices

The CGT small business reliefs are only available if the “basic conditions” for the reliefs to apply are met.²

One of these basic conditions is that “... a CGT event happens in relation to a CGT asset of yours in an income year” (s 152-10(1)(a) ITAA97).¹

This means, it is suggested, that if, in the present context, CGT event A1 has not happened (and is not taken to have happened) at the time the taxpayer lodges the relevant return of income (because the contract has not completed by that time), the CGT small business reliefs could not be claimed in that return of income as lodged (so any choices that could be available under the CGT small business reliefs would not be available at that time).

Also, if a choice has purportedly been made, it is further suggested that the fact that, at a later time (completion of the contract), CGT event A1 will be taken to have happened retrospectively could not validate the choice purportedly made. This is because whether a valid choice is made depends on the basic conditions (including the happening of a CGT event) being met at the time when the choice is made.

The CGT choices that are provided for by the CGT small business relief provisions are significant and often require further steps to be undertaken. Briefly, the CGT small business relief choices are:

1. a taxpayer who or which is eligible to claim the reliefs in respect of a capital gain may choose that the general 50% CGT small business relief not apply (s 152-220 ITAA97); and
2. to the extent that a capital gain then remains, the taxpayer may choose whether to apply CGT small business retirement relief or CGT small business roll-over relief, or partly one and partly the other relief (ss 152-305 and 152-410 ITAA97).

The difficulties that arise in the case of the making of a choice for CGT small business retirement relief to apply are compounded by the fact that the operation of the reliefs depends not only on the making of a choice for it to apply, but also on the taxpayer specifying a CGT-exempt amount or amounts, and (broadly):

- in the case of an individual taxpayer who is under 55 years of age, the making of a relevant contribution to a superannuation fund by a particular time which depends on the time the choice is made;³ and

- in the case of a company or trust that makes the choice, the making of a payment or payments to a CGT concession stakeholder or stakeholders (or to a superannuation fund in the case of a CGT concession stakeholder who is under 55 years of age).

The timing of the making of such payments depends, in the usual case, on when the choice is made.⁴

It is submitted that, technically:

- a choice for CGT small business retirement relief can only be made once the CGT event has happened by virtue of the CGT event provisions;
- a purported choice made at any earlier time will not be effective; and
- any payments made on the basis that a choice purportedly made before the particular CGT event has happened by virtue of the CGT event provisions, would not be effective.

Comment

It is submitted that the issues raised are potentially significant and can lead to considerable uncertainty for taxpayers. There needs to be certainty and this, ideally, could only be achieved by legislative amendment.

In the absence of legislative clarification, the Commissioner could, for example, issue a binding ruling which clarified the position. One possible way that this could be done is for the Commissioner to bind himself in such a case to granting a further minimum period within which a choice could be made. That, it is suggested, would be a valid exercise of the power to grant a further period within which to make a choice because, in the circumstances, a decision by the Commissioner to refuse to allow a further period on an application by a taxpayer would be marred by legal error. The Commissioner could, at the least, issue a practice statement.

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References

- 1 See, for example, s 118-145 ITAA97 (absences).
- 2 See ss 152-105 and 152-110(1)(a) ITAA97 (small business 15-year exemption), s 152-205 ITAA97 (small business 50% reduction), s 152-305(1)(a) and (2)(a) ITAA97 (small business retirement relief), and s 152-410 ITAA97 (small business roll-over relief).
- 3 There are special considerations in the case of CGT events J2, J5 and J6, but these events are ignored for the purposes of this article. As explained, it is assumed that it is CGT event A1 that is relevant.
- 4 The time when capital proceeds are received may in some circumstances be relevant.

Mid Market Focus

by Andrew Burns, CTA, HLB Mann Judd

Tax and natural disasters

In this month's column, we look at some of the tax issues which need to be considered when dealing with natural disasters or other similar events.

Introduction

It would be an understatement to say that the end of 2019 and the start of 2020 have been traumatic for many people affected by the bushfires which have burnt large areas across multiple states.

At times like this, most people's only tax-related thoughts are whether they can claim a tax deduction for the donations that they have made to the various charities working to help in the recovery. However, as people start to get their lives back together, and get their affairs in order, there are a number of tax concessions which may be relevant.

ATO response

While there is no specific requirement in legislation requiring the Commissioner of Taxation to provide assistance to those affected by natural disasters, he is able to exercise his discretion to grant extensions for lodgments and payments to taxpayers in extraordinary circumstances.

As at the time of writing, those taxpayers in bushfire-affected areas have been granted automatic extensions for the lodgment and payment of their income tax returns for the year ended 30 June 2019 until 28 May 2020. In addition, those taxpayers expecting refunds will have their refunds "fast-tracked".

In order to be eligible, the taxpayer merely needs to have an address within one of the postcodes contained in a list published on the ATO website. If a taxpayer's address is not within one of these postcodes, they will not be eligible for the automatic deferral. However, they can still contact the ATO to discuss their particular circumstances and what relief can be offered.

This discretion does not only apply in times of widescale natural disaster, but can also be applied whenever a taxpayer is faced with extraordinary circumstances and where the strict application of the lodgment and payment deadlines will cause them hardship. In any situation, the first step is to call the ATO and discuss the taxpayer's particular situation.

Main residence exemption

The number of homes that have been lost in the recent fires has been well-documented by the media. The people who have lost their homes are now faced with the decision of whether to rebuild or not, and if they do rebuild, whether to live in the new house.

The basic principles of the main residence exemption contained in Subdiv 118-B of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) are well known by most people in that they are not subject to tax on any capital gain realised on the sale of their main residence. However, several of the specific details of the exemption will need to be considered in these circumstances.

The first issue to address is the fact that, in order for the main residence exemption to apply, s 118-110 ITAA97 requires that the gain be a result of a CGT event occurring in relation to a "dwelling". A dwelling for this purpose is defined in s 118-115 ITAA97, which requires there to be a structure which is capable of being used for the owner's accommodation. Land which no longer contains a dwelling will not be eligible for the main residence exemption.

However, s 118-160 ITAA97 extends the main residence exemption to include land which was sold following the destruction of the dwelling which was the taxpayer's main residence. By applying this extension, an individual can elect to treat the land as their main residence for the period between the destruction of the dwelling and the sale of the land.

Unlike the "temporary absence" rule, there is no time limit for the election made under s 118-160. However, the restriction on applying the main residence exemption to multiple dwellings will still apply.

This election is not limited to natural disasters, but can apply whenever the dwelling is accidentally destroyed.

If the taxpayer chooses to rebuild their home, they can elect to treat the property as their main residence for capital gains tax purposes under s 118-150 ITAA97, provided they move into the house as soon as practicable after construction has been completed and they live there for at least three months.

If the taxpayer rebuilds the home but then sells the completed building, they will not be eligible for a full main residence exemption. However, they may be eligible for a partial exemption for the period that they lived in the original house.

Other buildings

Clearly, not all of the buildings destroyed in the recent bushfires were people's homes, with large numbers of farm sheds, commercial buildings, and most likely rental properties also destroyed. While these buildings will not be eligible for the main residence exemption, other tax provisions may apply.

The first thing that must be considered is that a building is generally not a separate asset to the land on which it is built. Therefore, the destruction of the building will not result in a CGT event occurring.

Section 108-55 ITAA97 contains two exceptions to this general rule, stating that a building can be a separate asset from the land in the following circumstances:

- where the building is subject to the balancing adjustments under either:
 - the capital allowance provisions in Div 40 ITAA97; or
 - the R&D rules in ss 355-315 or 355-525 ITAA97; and
- where the building was constructed after 20 September 1985 on land acquired prior to 20 September 1985.

Section 45-40(1)(c) ITAA97 includes structural improvements on land used for agricultural or pastoral operations within the meaning of “plant” (unless they are used for domestic or residential purposes). Therefore, as plant, any farm sheds which were destroyed by fire will be subject to the balancing adjustment provisions of Div 40.

This balancing adjustment will be equal to the difference between the written down value of the shed and any insurance proceeds received.

A replacement asset roll-over may be available where a new shed is built in its place.

Ignoring the R&D provisions, which will only apply in relatively limited circumstances, the only other buildings which will be subject to separate taxation will be any post-CGT buildings constructed on pre-CGT land. The destruction of these buildings will result in CGT event C1 occurring, with the resulting capital gain or loss being the difference between the cost base of the building and any insurance proceeds received.

CGT event C1 may be ignored if the taxpayer chooses to apply the roll-over relief contained in Subdiv 124-B ITAA97. Under this Subdivision, where a CGT event occurs due to the compulsory acquisition, loss or destruction of an asset, that CGT event will be ignored where the taxpayer acquires a replacement asset. Therefore, if the taxpayer replaces the destroyed building, the new building will be treated as a continuation of the original building for tax purposes.

While any other buildings will not be considered separate assets, their destruction may still have a tax impact if the construction costs had been claimed under the capital allowance provisions in Div 43 ITAA97. In that situation, Subdiv 43-H ITAA97 provides for a balancing adjustment that is equal to the difference between the written down value of the capital works and any insurance proceeds received.

Conclusion

While the above discussion focuses mainly on the buildings which were destroyed in the recent bushfires, it highlights the importance of considering all of the available concessions which may apply to taxpayers who are faced with losses due to circumstances outside of their control.

The tax law is not designed to penalise people who are already experiencing hardship. Rather, there are a range of provisions which can apply to either remove or defer any tax consequences of unforeseen events.

Andrew Burns, CTA
Manager
HLB Mann Judd



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Clare Pendlebury, Supervisor, CIB Accountants & Advisers, NSW

Can you provide a brief background of your career in tax?

After graduating from high school, my 19 years of experience commenced with a cadetship program with Young Barnsdall Sydney, which is now Pitcher Partners. I worked in business services under the partner Yvette Pietsch who gave me excellent training and offered great guidance for a young person in a professional world. During my time at Pitcher Partners, I also did one audit season and a secondment to New York which helped me to know that my interests lay in tax rather than audit.

A few years after completing my degree and the Chartered Accountants Program, I moved to CIB Accountants & Advisers in Parramatta, where I have been working solely in business advisory. I have taken a few breaks over the years, due to having three children, and currently enjoy the challenges of working and raising small children. I have the privilege of working for a partner, Ronelle Wilson, who understands my life situation and encourages me to have a fulfilling and rewarding career.

What is the most valuable aspect of studying with the Institute?

The most valuable aspect of CTA1 Foundations has been cementing existing tax knowledge and being forced to go back to first principles in the legislation.

What are your areas of new confidence?

I now have greater confidence in all of the basic areas of tax as covered in the CTA1 Foundations subject, mainly due to reading the legislation and cases to help gain greater understanding. The course is very practical and makes sure that you understand how to do calculations that so often we rely on computer software to do.

What was the reason for undertaking study with the Institute?

I have always wanted to do further study after completing the CA Program many years ago. However, taking numerous breaks for child-raising had delayed those plans. As our

youngest child has now turned five, I thought it was time to pick up the books again.

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

I have enrolled in the Graduate Diploma of Applied Tax, so I am working towards its completion, along with qualifying as a Certified Tax Adviser.

What are the challenges of juggling study and work?

Life is a constant juggle between family commitments, work and study. My family responsibilities take priority, which is why I still work part-time, especially since my husband has very unpredictable work hours. The part-time work schedule allows me the flexibility to manage my workload without taking breaks. However, I must admit that most of my study is done in the evenings after the children have gone to bed. My husband is very supportive of my study and has picked up some of the domestic load in order to enable me to squeeze in study between work and family. An important tip is to make sure you still maintain a recreational activity that allows you to clear your head and simply enjoy being in the moment. For me, it's going for a run or swim a few times a week, even if 5:30 am is the only time it fits into the day.

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

There is no substitute for giving yourself the time and structured learning environment to help with both the fundamentals and the more difficult scenarios of the work you complete every day in the office. After many years of working in a tax environment, there were still new things to learn in the Foundations subject, and I have personally gained more knowledge from the course. If you are considering taking CTA1 Foundations, just give it a go — CTA1 Foundations is a nice way to ease into the world of tax and study. This course would also be highly beneficial to new graduates working in the tax environment in order to get a good, solid and practical understanding of the basics of tax.

Widyawati Utomo, Accountant, CIA Tax, Victoria

Can you provide a brief background of your career in tax?

After I graduated with a Bachelor of Commerce from the University of Melbourne, I worked in the strata industry for a couple of years before starting my career in public practice, where I predominantly worked with medical professionals and small businesses. After a few years working in tax, I gained my CPA qualification and decided to run my own hospitality business for five years. Having worked in different industries and performed various roles, I realised that the aspects of my work that I find the most rewarding are all in tax-related functions. I find that taxation is a thoroughly intellectually stimulating career. With the guidance from my mentor, I decided to continue pursuing my career in tax and now I am working in a public practice at CIA Tax. I have

over eight years of experience working as an accountant, including three years' experience in tax and business services.

What is the most valuable aspect of studying with the Institute?

The Commercial Law 3 subject has helped me to have a better understanding of Australian commercial law in relation to tangible and intellectual property, as well as the laws in regulating insurance, financing transactions and electronic commerce.

What are your areas of new confidence?

My favourite modules of Commercial Law 3 were "Introduction to the Fundamental Law of Real and Personal Property Transactions", and "Intellectual Property". I had little knowledge of the laws regulating these areas prior to undertaking this course. The modules provided an excellent summary and have allowed me to gain confidence in these two areas of law.

What was the reason for undertaking study with the Institute?

I chose the Commercial Law 3 subject as I wanted to gain knowledge in Australian property law. Commercial Law 3 is also one of the electives of the Graduate Diploma of Applied Tax Law.

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

I have one more subject of the Graduate Diploma of Applied Tax Law, which I hope to complete by mid-2020. After that, I will continue to pursue the Chartered Tax Adviser qualification.

What are some challenges of juggling study and work?

Juggling study, work and a social life and still getting everything done without stress is quite challenging. For me, planning and self-discipline are key.

I try to get ahead on reading and study throughout the period, rather than leaving everything to the last couple of weeks before the exam. I find that, once all the work has piled up, it is even harder to motivate myself to get started. I have always had a schedule to keep me on track and I set aside at least one hour every day to read. I do my reading mostly early in the morning before work so that I can have evenings for myself. And I always make sure that I get a good night's sleep.

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

Returning to the tax industry was very challenging for me because the tax laws are continuously changing. The subjects I undertook, and the regular tax updates provided by The Tax Institute, have helped me to refresh and bring my technical knowledge up to speed quickly. The course materials have an emphasis on legislation, while at the same time providing you with many practical examples that are applicable to real-life situations and which give you confidence when dealing with clients and tax authorities.



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Trust asset revaluation strategies ... revisiting the practice

by Peter Slegers, CTA, Director, and Joshua Pascale, Associate, Cowell Clarke

The seminal case of *Fischer v Nemeske* has accepted the effectiveness of asset revaluation reserves under trust law, reinvigorating the use of such reserves for the purposes of facilitating succession planning, asset protection and family exit objectives. This article explores the utility and mechanics of asset revaluation reserve strategies, including the common pitfalls that may arise when not properly implemented. The article also speaks to the pertinent taxation and commercial issues associated with those strategies that advisers must consider. This includes managing Div 7A obligations, being aware of the trust streaming implications, and maintaining the deductibility of interest on any borrowings associated with paying a beneficiary's entitlement from an asset revaluation reserve. The article concludes by envisaging a resurgence of activity in this area, particularly given the commercial outcomes that such strategies may achieve.

Historical perspective

The practice of trustees of discretionary trusts distributing amounts from "asset revaluation reserves" is not new. Typically, these arrangements involve a number of steps. First, the trustee revalues an existing trust asset, debiting the asset's increase in value and crediting the revaluation increment to a reserve in the financial records of the trust. Next, the trustee, relying on a specific power under the trust deed, distributes the unrealised gain in favour of a particular beneficiary. The beneficiary's entitlement (normally a capital rather than an income entitlement) might then be paid by the trustee and lent back as a loan from the beneficiary. Finally, the financial statements of the trust are updated to recognise the above transactions, including the resulting credit loan in favour of the beneficiary.

Such practices were particularly prevalent in the late 1990s and early 2000s as a way of overcoming Div 7A

of the *Income Tax Assessment Act 1936* (Cth) (ITAA36) exposures. In some cases, these practices also offered a planning benefit where credit balances could be created and drawn on by individual beneficiaries, even where the trust in question had made unpaid distributions to a corporate beneficiary.¹

The Div 7A advantages of adopting trust revaluation reserve arrangements were all but stamped out with the introduction of Subdiv EA of Div 7A from 12 December 2002.² Notwithstanding the Div 7A anti-avoidance measures, there remain a variety of commercial reasons for trustees to adopt asset revaluation reserve arrangements which, in the authors' view, can be regarded as entirely legitimate.

It is also important to note that, traditionally, there has been very little authority on the effectiveness of such arrangements from a trust law perspective. That was, at least, until the more recent High Court decision of *Fischer v Nemeske*³ (*Nemeske*). While *Nemeske* addresses a variety of issues, in the authors' view, the decision is definitive authority that asset revaluation reserve arrangements are effective under trust law (see further below).

It is not the purpose of this article to explore the issues arising in the *Nemeske* decision in any detail. Instead, the article seeks to briefly consider the commercial outcomes that might be achieved by implementing these arrangements and the mechanics of such arrangements. It also comments on the some of the tax pitfalls that need to be taken into account in this area.

Utility and mechanics

There are a variety of commercial outcomes that a trust asset revaluation reserve strategy may provide to a family group. For instance:

- it may be desirable for one of the potential beneficiaries of a discretionary trust to have a fixed entitlement or a specific claim against the trust. This entitlement, normally funded from capital, might be used to bring greater certainty over that beneficiary's inheritance in accordance with the trust controller's succession plans;
- a trust asset revaluation arrangement may facilitate the exit of family members who have previously had joint control of a discretionary trust. This might, for instance, involve the existing member receiving an entitlement to capital that is converted into a credit loan and then repaid by the trustee on the beneficiary's exit; and
- the creation of the resulting credit loan in favour of an individual beneficiary as a result of these arrangements may, in certain circumstances, also assist in protecting trust assets against third party claims. This may be particularly advantageous where a trustee with a valuable asset is also conducting a business and is therefore exposing that asset to a high level of risk. Where the asset is an unencumbered trust asset, the creation of a credit loan in favour of an individual (or other related party) may allow that related party to become a secured creditor.

On the basis that there are clear commercial benefits in implementing these arrangements, the next issue to consider is: what are the specific steps that need to be taken?

Some tax practitioners will informally speak of distributing

an amount “from an asset revaluation reserve”, but that is imprecise language.

Typically, the precise mechanics may involve:

- identifying a particular asset in a discretionary trust where the market value of that asset significantly exceeds its book value;
- amending the trust deed to ensure that the trustee has a specific power to appoint unrealised gains (ordinarily as a capital distribution) to its potential beneficiaries;
- the trustee revaluing the trust asset pursuant to a valid power in the trust deed (often after receiving a professional valuation to support the increase in value);⁴
- booking the revaluation increment as an increase in trust capital, typically by debiting the asset and crediting trust capital — the latter often by reference to an “asset revaluation reserve” line item;
- the trustee relying on the power under the trust deed, then appointing (but not paying) the unrealised gain to the desired beneficiary; and
- the beneficiary calling for payment of its unpaid present entitlement (UPE)⁵ to trust capital and the trustee paying the amount on the basis that the amount is immediately lent back to the trustee as a loan.⁶

In taking these steps, the trustee will have created a credit loan in the financial records of the trust in favour of the desired beneficiary. Where commercially desirable and feasible to do so, the loan in question may be secured by a trust asset and consequentially offer certain asset protection benefits to the group.

The arrangement implemented in *Nemeske* (which we will now consider) largely conformed to the above process.⁷

Fischer v Nemeske: a seminal trust law case

The High Court decision in *Nemeske* considered the enforceability of a distribution arising from a trust asset revaluation reserve. In that case:

- Mr and Mrs Nemes and Mr and Mrs Fischer were potential beneficiaries of the Nemes Family Trust, being a discretionary trust established by deed dated 24 June 1974;
- in September 1994, the trustee of the Nemes Family Trust, being Nemeske Pty Ltd, undertook a revaluation of the shares that it held in a private company to their market value;
- Mr Nemes was the sole shareholder of Nemeske Pty Ltd;
- the above revaluation created a \$3.9m asset revaluation reserve in the trust accounts which was credited against the capital of the trust;
- following its creation, the trustee resolved to create an entitlement in the entire asset revaluation reserve in favour of Mr and Mrs Nemes;
- Nemeske Pty Ltd then executed a charge, securing a debt owed by the trustee to Mr and Mrs Nemes of \$3.9m;
- Mrs Nemes died 2010 and Mr Nemes in 2011. The Nemes’ were not survived by any children;
- under the terms of Mr Nemes’ will, Mr Nemes gifted Mr and Mrs Fischer his shares in Nemeske Pty Ltd. By this

action, the Fischer’s stood to inherit control of the Nemes Family Trust; and

- other beneficiaries, however, stood to inherit the residue of Mr Nemes will. Significantly, to Mr and Mrs Fischer’s dismay, this included a \$3.9m credit loan owed by the trustee of the Nemes Family Trust to Mr Nemes’ estate.

The principal issue before the High Court was whether the trustee’s distribution of the unrealised gain was a valid and effective exercise of its “power of advancement” under the trust deed of the Nemes Family Trust. If this were the case, the Fischers would have inherited control of a trust with little or no value due to the \$3.9m liability owed to the residual beneficiaries of Mr Nemes’ estate.

Unsurprisingly, the Fischers contended that the purported distribution of the asset revaluation reserve and the associated creation of a loan account in favour of Mr Nemes estate were invalid. As such, the Fischers contended that the trustee of the Nemes Family Trust was not indebted to the estate of the late Mr Nemes.

By a three to two majority, the High Court upheld the decision of the New South Wales Court of Appeal in finding that the creation of an entitlement of this kind from the property of a trust was a valid exercise of the power of advancement, as specified in the particular trust deed.⁸ It was said that the cogency of the arrangement was not affected by the lack of a change in the beneficial ownership of the assets, nor the trust assets being held in a non-monetary form.⁹

Perhaps the most instructive part of the judgment as to the arrangement’s validity can be found in the following passage from Gageler J:¹⁰

“Once it is accepted ... that a trustee can ‘apply’ trust property to the advancement of a specified beneficiary by resolving to allocate trust property unconditionally and irrevocably to the benefit of that beneficiary, it is difficult to see any reason in principle why such an unconditional and irrevocable allocation of trust property must take the form of an alteration of the beneficial ownership of one or more specific trust assets.”

In accepting the arrangement implemented in *Nemeske*, the High Court has held that a trustee can apply trust capital in favour of beneficiaries without giving rise to a change in the beneficial ownership of the revalued asset. In the authors’ view, this reasoning implicitly accepts that trust asset revaluation reserve arrangements are effective as a matter of trust law.

Of course, the judgment did not address the taxation implications of trust asset revaluation arrangements. Therefore, even though it might be said that the arrangements are valid under the general law, extreme care still needs to be taken in identifying and addressing any potential tax pitfalls.

Some challenging tax issues

As stated, the High Court considered the use of asset revaluation reserves in the context of trust law and equitable principles. Understandably, the Commissioner of Taxation has not directly addressed the impact of *Nemeske* under the income tax laws.

Since the decision, however, the Commissioner has released TA 2016/12 which targets the use of revaluation arrangements in specific tax avoidance schemes. In the authors' view, the targeted arrangements identified by the Commissioner appear to be artificial and contrived, with little or no commercial basis. These arrangements need to be distinguished from situations where asset revaluation reserves are used to achieve commercial outcomes.

There remain a number of other tax issues to consider when advising on, or implementing, these arrangements. These issues fall into three broad categories:

1. Div 7A and, in particular, Subdiv EA;
2. the trust streaming measures; and
3. in circumstances where funds are borrowed by the trustee to pay the amount owed to the desired beneficiary, interest deductibility.

We have considered each of these areas below.

Division 7A¹¹

The creation and distribution of an amount representing an unrealised capital gain should not give rise to the ordinary application of Div 7A.

That said, Subdiv EA of Div 7A can present a real issue here. In particular, care should be taken to ensure that an asset revaluation reserve arrangement is not implemented where a private company has an existing UPE to trust income.¹² In these circumstances, s 109XA(1) ITAA36 will be triggered where any amount of the individual beneficiary's is drawn up, creating a deemed dividend under Div 7A pursuant to s 109XB ITAA36.

Before implementing these arrangements, advisers should therefore review the financial statements of the trust to ensure that the trustee does not have any pre-existing UPEs in favour of a private company. Where such an entitlement is identified, a decision will need to be made as to whether the private company's entitlement should be converted into a complying Div 7A loan or (where the circumstances allow) paid out entirely. In the absence of making such a decision, Subdiv EA may capture the revaluation arrangement.

Significantly, the application of Subdiv EA must be considered on an ongoing basis. That is, all future distributions from the relevant trust must be monitored because, in the event that an unpaid trust distribution is created in favour of a private company, Subdiv EA may potentially apply.¹³

Trust streaming measures

The trust streaming provisions¹⁴ operate to ensure that a beneficiary who receives the financial benefit of a capital gain is also assessed on that capital gain. A beneficiary will be assessed on a "share" of the capital gain which is determined, among other things, on the basis of the beneficiary's specific entitlement.¹⁵

A beneficiary is specifically entitled to the extent that the beneficiary has received, or can be reasonably expected to receive, a net financial benefit referable to the capital gain.¹⁶

The explanatory memorandum of the Tax Laws Amendment (2011 Measures No. 5) Bill 2011 (EM) contemplates how the

trust streaming provisions would apply in the context of an asset revaluation reserve proposal. In particular, example 2.3 in the EM indicates that amounts of the asset revaluation reserve distributed prior to a sale are considered net financial benefits of the asset. The EM specifies that the financial benefit is determined over the "life of the asset", rather than in the year of the CGT event.¹⁷

Accordingly, in the authors' view, where an asset revaluation reserve arrangement creates an entitlement in an unrealised capital gain, the ultimate realisation of that gain may give rise to assessable income for the entitled beneficiary.

In this respect, when an asset that is subject to a revaluation arrangement is ultimately disposed of, the unrealised capital gain will be crystallised, and the beneficiaries entitled to such an unrealised gain should be assessed in proportion to their entitlement.

For this reason, the parties implementing such arrangements may wish to provide an indemnity in favour of an entitled beneficiary for any tax liability which may arise in connection with the ultimate disposal of the relevant asset.

"... the High Court has held that a trustee can apply trust capital ... without giving rise to a change in the beneficial ownership of the revalued asset."

Interest deductibility

In certain circumstances, the trustee may borrow externally to pay the amount owing to the beneficiary (rather than funding the payment from trust assets). This gives rise to an issue of whether the interest on the borrowed funds and borrowing costs are deductible. Naturally, this turns on the purpose of the borrowing.¹⁸

As a general rule, interest on money borrowed to secure working capital is ordinarily considered a deductible expense.¹⁹ In the case of *FCT v Roberts and Smith*,²⁰ it was found that, where a partnership borrows from a bank to repay an amount owed to one of the partners, "the character of the refinancing takes on the same character as the original borrowing and gives the interest incurred the character of a working expense".²¹

A similar approach has been taken by the Commissioner in TR 2005/12, where the Commissioner provides that the relevant interest expense must be incurred to refinance a "returnable amount". Moreover, the Commissioner indicates that interest on borrowings which are incurred to repay a loan by a beneficiary will be deductible if the objective purpose of the borrowing is to replace the amount of money repaid in order to produce assessable income.²² In the same ruling, the Commissioner makes it clear that the

“refinancing principle” is not applicable to borrowings used to distribute amounts attributable to unrealised revaluations of trust assets.²³ The Commissioner reasons that unrealised revaluations, unlike loans or unpaid distributions (that remain unpaid so that the funds can be used for the trust’s working capital), are not provided by the beneficiary to the trustee for such a purpose.

Significantly, the general law continues to distinguish between a UPE and a credit loan.²⁴ Therefore, for the purposes of interest deductibility, if the UPE is paid but the amount lent to the trust is for income-producing purposes, there may then be a case for the interest to be deductible.

Trust law and commercial issues

When advising on, and implementing, asset revaluation reserve arrangements, there are a variety of non-tax issues to consider. The documentation needs to be carefully prepared. It was recognised by counsel for both parties in *Nemeske* that the trustee resolutions were poorly drafted, notwithstanding that the arrangement was ultimately found to be effective.²⁵

Given the potentially adverse outcomes arising from poorly drafted resolutions, it is critical to ensure that the arrangement is properly documented so as to clearly evidence the creation of an entitlement due by the trustee to the intended beneficiary. Ideally, the documentation should be prepared and executed contemporaneously with the arrangement.

Trustees must also take care when revaluing trust assets. In particular, if an asset is overvalued, there is the potential for the distribution of the unrealised gain to render the trust insolvent. Although this may be a valid exercise of trust power, it may nonetheless create the circumstances where the arrangement can be challenged. Therefore, in order to substantiate a market value adopted by the trustee, it is recommended that the trustee obtains an independent professional valuation from a licensed valuer.

Asset revaluation reserve strategies – a future planning tool?

It should be clear from this article that asset revaluation reserve arrangements need to be implemented with a high degree of care. In light of the *Nemeske* case, it should be equally clear that trust law currently supports the effectiveness of these arrangements.

In these circumstances, a resurgence of activity in this area might be expected, particularly where the arrangement becomes a useful tool to achieve a variety of desired commercial, asset protection and succession planning outcomes. It is hoped that this article is of use in identifying some of the pertinent tax and trust law issues involved in asset revaluation reserve arrangements.

Peter Slegers, CTA

Director
Cowell Clarke

Joshua Pascale

Associate
Cowell Clarke

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References

- 1 Thus circumventing the now repealed s 109UB ITAA36 which was effectively replaced by s 109XB(2) ITAA36.
- 2 Through the Tax Laws Amendment (2004 Measures No. 1) Bill 2004 (Cth).
- 3 *Fischer v Nemeske* [2016] HCA 11.
- 4 The trust deed might be amended if it does not expressly contain the power to revalue trust assets.
- 5 “Unpaid present entitlement” is a term often referred to when dealing with a beneficiary’s unpaid entitlement as to trust income (see TR 2010/3, for instance). However, the term may be applied equally in the context of a beneficiary’s entitlement to trust capital.
- 6 The amount would normally be segregated from other credit balances in favour of the beneficiary, such as UPEs to income and other credit loans.
- 7 Although, in the authors’ view, the arrangements implemented in *Nemeske* may have been less than precise.
- 8 [2016] HCA 11 at [30] and [99].
- 9 [2016] HCA 11 at [32] and [100].
- 10 [2016] HCA 11 at [96].
- 11 Of course, any Div 7A issue is subject to the outcomes of the federal government’s review of the provisions.
- 12 S 109XA(1)(c)(i) ITAA36.
- 13 S 109XA(1)(c)(ii) ITAA36.
- 14 S 115-228 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97).
- 15 S 115-227(a) ITAA97.
- 16 S 115-228(1) ITAA97.
- 17 Para 2.55 of the EM.
- 18 *Fletcher v FCT* [1991] HCA 42.
- 19 *Texas Co (Australasia) Ltd v FCT* [1940] HCA 9.
- 20 [1992] FCA 363.
- 21 [1992] FCA 363 at [45].
- 22 Example 9 in TR 2005/12.
- 23 Para 25 and example 1 in paras 30 to 33 of TR 2005/12.
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Death and income tax – some discrete issues: part 1

by Ian Raspin, CTA, Managing Director, Lyn Freshwater, Senior Tax Consultant, and Mark Morris, FTI, Senior Tax Counsel, BNR Partners

This is part 1 of a two-part series dealing with some standalone issues about tax and deceased estates. This article discusses some of the factors that a legal personal representative should consider when deciding whether to hold or sell shares that the deceased owned. Relevant factors might include, for example, the tax residency of the estate and the beneficiaries. Part 1 also considers some of the advantages that testamentary discretionary trusts offer over those created *inter vivos*. For example, trustees of testamentary trusts are generally assessed at lower tax rates than trustees of *inter vivos* trusts and importantly have access to the CGT discount. Further, the higher tax rates that apply to a minor's unearned income do not apply to income from a testamentary trust, although, as noted, new rules are proposed which restrict this benefit to income from assets that the deceased person who created the trust owned.

Introduction

Deceased estate taxation is becoming increasingly complex for many reasons, including the likelihood of international elements and changes occurring (or proposed) in this area from both legislators and the ATO. The size of many estates is also much larger than in past generations, with a vast transfer of intergenerational wealth expected in the next decade.¹

This two-part series examines some discrete factual scenarios and issues that commonly arise in a succession planning context or in the administration of the estate of a deceased person or testamentary trust. The facts and issues below have been identified by practitioners. From the perspective of a legal personal representative (LPR) or trustee, it is important to understand where tax liabilities lie in order to ensure that those liabilities do not have to be met from the LPR's own funds.

The material in this article is current as at 20 January 2020, and deals only with income tax (including CGT) issues.

Distributing or selling the deceased's share portfolio: tax implications

There is no simple answer to the question: should the deceased's share portfolio be distributed or sold? Non-tax factors will usually be relevant, such as whether residuary beneficiaries want the shares or the cash. Tax implications will depend on a range of factors, including the tax residence of the LPR, the tax residence of the beneficiaries and the types of shares involved.

If the deceased was, and everyone involved in the estate is, a resident/s of Australia and the LPR distributes shares that the deceased owned to a beneficiary, the main implication is that tax is deferred until the beneficiary sells the shares. That is, under CGT "death" roll-over,² the beneficiary inherits the deceased's cost base,³ and any capital gain from the sale of the shares is included as part of the beneficiary's net capital gain in the year that a contract is entered into to sell them.⁴

Alternatively, if the LPR sells the shares, the capital gain would be included in the net income of the estate. Whether tax is paid by the LPR or a beneficiary of the estate will depend on whether there is any trust income and whether beneficiaries are presently entitled to it (or specifically entitled to capital gains or franked distributions).

Usually, until administration is complete, beneficiaries are not presently entitled to income of the estate, in which case the LPR will be taxed on trust net income under s 99 of the *Income Tax Assessment Act 1936* (Cth) (ITAA36).⁵ Section 99 rates are basically individual marginal tax rates, with a tax-free threshold for the first three years, and may be more tax favourable than if beneficiaries were assessed. However, an LPR can, during the administration of an estate, determine to make beneficiaries presently entitled to particular amounts of income (or specifically entitled to franked dividends⁶). There may be advantages in doing this, for example, if the beneficiary is a charity that is a gift-deductible recipient.

It is assumed above that the share portfolio is in listed companies or at least those that the deceased did not control.

Sometimes, the deceased will have held shares in a resident private family company, and perhaps a 100% or controlling interest. In this case, the LPR may have to consider selling the shares or winding-up (liquidating) the company by having the company sell its assets and distributing the proceeds or making an *in specie* distribution of the assets.

A sale and distribution approach may yield taxable gains for the company in respect of revenue assets such as trading stock and post-CGT acquired assets. Franked dividends can be paid and offset by the LPR (and any excess franking credits refunded if the LPR is taxed under s 99), whether distributions are made before or after liquidation commences.

Where the deceased's shares were pre-CGT, and taken to be acquired for market value at the date of death, pre-liquidation dividends paid to non-corporate LPRs will not affect the reduced cost base of the shares,⁷ allowing for potential

capital losses to be obtained for offset against estate gains (if any).

Distributing in liquidation has the advantage that gains on pre-CGT assets of the company are not taxable dividends,⁸ although the amounts will still constitute capital proceeds for the purposes of CGT event G1⁹ or CGT event C2 on the ending of the shares. Often, however, the benefits of tax deferral from simply allowing shares in the portfolio of the deceased to pass to the resident beneficiaries will outweigh other considerations.

Assets passing to foreign resident beneficiary

If shares that are non-taxable Australian property (non-TAP) assets owned by a resident deceased person pass¹⁰ to a foreign resident beneficiary (rather than being sold by the LPR), the usual CGT roll-over for death does not apply. (Shares will generally be non-TAP,¹¹ but if they are in “land rich” companies, they may be taxable Australian property (TAP).¹²)

Instead, CGT event K3¹³ happens so that the gain inherent in the non-TAP asset on death does not fall out of the Australian tax net.¹⁴

CGT event K3 happens immediately prior to the death of the deceased, with the result that any gain or loss is included in the deceased’s date of death income tax return (see the Appendix at the end of this article). A capital gain from CGT event K3 will arise if the market value of the relevant asset when the deceased died is more than its cost base at that time. A capital loss is made if that market value is less than the asset’s reduced cost base.

In a recent matter that the authors came across, a legal practice had overlooked the application of CGT event K3 that resulted in a \$60,000 tax liability. As all of the assets had been transferred to beneficiaries overseas, there were no funds left in Australia to pay the tax. As LPRs, the practitioners were liable to pay the tax.

Asset sold and proceeds paid to foreign resident beneficiaries

TD 2019/D7 indicates that, following the streaming amendments which apply for the 2011 and later income years, foreign resident beneficiaries cannot disregard their share of a resident trust capital gain (from the sale of TAP or non-TAP assets) on the basis that the capital gain was sourced outside Australia.

Section 115-220 ITAA97 now assesses the trustee on a foreign resident beneficiary’s share of a trust capital gain (without regard to the rules in Div 6 of Pt III ITAA36 whereby foreign residents are assessed only on amounts attributable to sources in Australia).

Prior to the streaming rules, only those gains that were made assessable under Div 6 were treated as relevant gains for the purposes of the rules in Subdiv 115-C ITAA97. Section 115-215(6) then ensured that the amount was not assessed twice (by excluding the “Division 6” capital gains). The ATO’s view in relation to the operation of the provisions prior to the streaming amendments is set out in ID 2010/54 and ID 2010/55.

Example

Andy is a resident of Australia. He owns his own home (subject to mortgage) and shares in numerous listed companies in Australia and overseas.

Andy passed away on 1 April 2017. Under his will, Andy left his estate to his three children in equal shares. One of his children (Janelle) resides in Switzerland.

His executors (the children in Australia) sell some of the foreign company shares on 28 June 2017 in order to pay out the mortgage. The estate has a net capital gain of \$99,000 for the 2017 income year. Although the administration is not completed, the executors make each of the beneficiaries specifically entitled to \$33,000 of trust capital gains for that year.

Janelle’s share of the gains from the sale of shares on foreign stock exchanges cannot be disregarded on the basis that those gains were sourced outside Australia. (The LPR will be assessed under s 115-220 ITAA97 on her behalf.)

Previously, the gains from the shares bought and sold on foreign stock exchanges would not have formed part of Janelle’s share of net income on the basis that those gains were sourced outside of Australia and so there was no amount in respect of which Subdiv 115-C could operate.

Further, in TD 2019/D6, the ATO takes the view that a foreign resident beneficiary of a non-fixed trust cannot disregard their share of a trust gain from non-TAP assets under s 855-10 ITAA97.¹⁵ On this view, gains from non-TAP trust assets can only be disregarded by beneficiaries of fixed trusts under s 855-40.

If this is correct, the ATO suggests, at para 21 of TD 2019/D7, that the only possible way around this for foreign-sourced non-TAP gains may be for the trustee to accumulate rather than distribute, have the trustee assessed under s 99 (or 99A) ITAA36, distribute to the non-resident beneficiary, and claim a refund under s 99D ITAA36. This is very messy and cumbersome, especially for deceased estates.

The following example shows how there may be a better way in the context of a deceased estate, and it would also deal with non-TAP gains that were not foreign-sourced.

Example

Continuing from the previous example, Janelle cannot disregard her share of the capital gains under s 855-10 ITAA97 on the basis that the gains are from non-TAP assets. The ATO’s view is that the exception only applies to gains that Janelle makes in her own right, not through a trust.

If, however, the gain was made in the year that the administration was completed, Janelle may be able to disregard her share of the trust capital gain under s 855-40 ITAA97. At the time she is taken to have made

Example (cont)

that gain (the end of the relevant income year), the trust is a fixed trust rather than a non-fixed trust.

Janelle would be well-advised to ask for a private ruling to confirm that the trust was a fixed trust.¹⁶

(Note that the situation would be the same for ASX-listed shares as they are also usually non-TAP assets.)

When the LPR is a foreign resident

For tax purposes, an LPR is treated as a trustee, and a deceased estate is treated as a trust estate. There are different tax rules that apply depending on whether or not the trust estate is a resident trust estate.

Where the LPR of an estate is a foreign resident, the estate will generally not be a resident trust estate for taxation purposes even though the deceased may have been an Australian tax resident.

This has several tax consequences; this article only considers those relating to capital gains.

Capital gains and losses made by the LPR of a foreign trust from assets that are non-TAP will not be included in the net income of the estate. This would include, for example, shares in most ASX-listed entities, foreign shares and foreign land. The ATO takes the view in TD 2017/23 that s 855-10 ITAA97 overrides the requirement in s 95(1) ITAA36 that the net income of a trust be calculated on the basis that the trustee was a resident taxpayer.

Example

Bob Builder resided in Australia throughout his life. When he died, he had an extensive portfolio of ASX-listed company shares.

Bob's will appointed his son Boris as his LPR. Boris has resided in London for many years. Boris, as LPR, sold the shares and made capital gains totalling \$5m.

As the estate is not a resident trust estate and the shares are not TAP, the gains from the shares are not included in the net income of the estate and so no liability arises.

Alternatively, if Boris had been a resident of Australia, the estate would be a resident trust estate and the gains would have been included in the estate net income. If there were no beneficiaries presently entitled to trust income, Boris, as LPR, would be assessed under s 99 ITAA36 on those capital gains (reduced by the 50% CGT discount where applicable).

Subsequent distribution to resident beneficiary

The ATO takes the view in TD 2017/24 that an amount attributable to a non-TAP gain of a foreign trust will be assessable under s 99B ITAA36 if it is later distributed to a resident beneficiary.¹⁷

Section 99B(1) includes in a beneficiary's assessable income an amount (being property of a trust) that is paid to, or applied for the benefit of, the beneficiary¹⁸ if they were a resident at any time during the income year. (Section 99B

does not apply if the beneficiary is a foreign resident for the entire income year in which the distribution is paid.)

There are exceptions to the application of s 99B.¹⁹ Perhaps the most important exception is for a distribution of trust corpus.²⁰ However, that exception does not apply to so much of a corpus distribution that would have been assessable had it been derived by a resident taxpayer.

Accordingly, TD 2017/24 takes the view that a distribution from corpus that is attributable to a capital gain does not fall within the corpus exception.

Further, TD 2017/24 takes the view that the amount made assessable by s 99B(1) ITAA36 does not have the character of a capital gain for Australian tax purposes, nor is there any linkage between s 99B(1) and Subdiv 115-C. This means that an amount which is included in assessable income under s 99B cannot be reduced by a capital loss or the CGT discount.

Example

Continuing from the previous example, assume that Boris, as LPR, distributes an amount attributable to the \$5m gain to his sister Doris who is a tax resident of Australia.

Doris must include the entire distribution of \$5m in her assessable income under s 99B. She cannot reduce the amount by her net capital loss or by the CGT discount.

(Note that the situation would be different if Doris was a foreign resident because s 99B only applies to distributions to Australian resident beneficiaries.)

The recent case of *Campbell and FCT*²¹ highlights the importance of maintaining records at the level of detail necessary to establish that the corpus exception applies.

Finally, if an amount is assessable under s 99B ITAA36, an interest charge may also be imposed under s 102AAM ITAA36 (there is an interest charge exception for amounts distributed from a deceased estate within three years of the date of death²²).

Should a testamentary trust for the grandchildren be set up for tax purposes?

The answer to the question of whether a testamentary trust for grandchildren should be set up for tax purposes, as with most things in tax, is that it may or it may not be, depending on all the circumstances. (It is assumed that, in this context, tax means income tax, including tax on capital gains.)

It is important at the outset to appreciate that there is no single type of testamentary trust. A testamentary trust, like one created inter vivos, may be purely discretionary, may confer contingent interests on the grandchildren which vest on their attaining their majority, may be a trust with successive interests (for example, to the testator's children for life with the remainder to the grandchildren), or may be some other type of trust.

Different tax outcomes may attach to these different arrangements or, even if the same tax is payable, the analysis or mechanism may be different.

Another significant point to note is that, while tax minimisation is almost always an important consideration in the choice of a structure to handle the assets of the deceased, there are almost always non-tax considerations which are equally (if not more) important. For example:

- a testamentary trust may be put in place so that the testator can effect some degree of control over the assets after death (for example, by using a discretionary testamentary trust with appointers etc);
- there may be strong asset protection aims involved so that the assets are not regarded as those of the grandchildren (or other beneficiaries) for bankruptcy or family law reasons, for example, if the grandchildren are of age and subject to risks in their business or professional undertakings; and
- one testamentary trust (as opposed to several) may not be the best structure to deal with situations other than where it is intended that the residue should simply be shared between the grandchildren on their attaining majority, that is, differences of opinion may arise about the management of the trust when the grandchildren are older and have families of their own. In circumstances where the grandchildren seek to split the trust into separate trusts, other tax issues may arise.

Having said that, it is true that testamentary trusts can offer some significant tax benefits (both in terms of annual income and capital gains) over other arrangements (for example, leaving assets directly to children who could then provide as they wished for the grandchildren).

The following analysis assumes that the trust and the grandchildren are Australian residents. More complex considerations may arise if this is not the case. For example, if the beneficiaries are foreign residents and it is proposed that the trust will hold non-TAP assets other than those owned by the deceased, there may be advantages in using a fixed trust (rather than a discretionary trust) to access the relief in s 855-40 ITAA97 when such assets are distributed to the beneficiaries.

The main tax advantages to using a testamentary trust include:

- the ability to secure favourable tax rates under s 99 ITAA36, including access to the CGT discount (where there are not presently entitled beneficiaries to all of the income);
- the ability to access exceptions to Div 6AA of Pt III ITAA36 (sometimes called “children’s tax”), in particular, where income is used for the maintenance and education of infant beneficiaries; and
- the CGT concessions that may be availed of when assets actually pass to the beneficiaries (for example, on their coming of age or at some later point).

These tax advantages are considered in more detail below.

Access to s 99 progressive individual rates

Testamentary trusts are, broadly speaking, subject to many of the same tax rules as other trusts (such as present entitlement to trust income, and the determination of trust net income) in Div 6 of Pt III ITAA36. However, there are some special considerations that may provide testamentary trusts

with tax rate advantages over inter vivos trusts (especially when accumulating income) or compared with top marginal tax rates applying to individuals (as direct beneficiaries).

In the case of a testamentary trust where the interests of minor grandchildren have not yet become vested (that is, the income is accumulated absent an amount being applied for their benefit, such as for their education), much of the net income will fall to be assessed to the trustee.

Many people do not appreciate that, strictly, the penal rates (top marginal tax rate plus Medicare) that apply to assessments under s 99A ITAA36 apply to all trusts, including testamentary trusts, unless the Commissioner determines that it would be unreasonable to apply them having regard to some narrow exceptions. One exception is a trust resulting from a will, codicil etc.²³ This is not limited to the deceased estate (a trust for tax purposes, although not at general law), but also includes a testamentary trust.

If the exception applies, s 99 ITAA36 applies rather than s 99A. Broadly, the trustee is taxed on the income as if an individual (at progressive rates). However, the trustee is not entitled to the tax-free threshold.

It is sometimes thought that the special rates that apply within three years of death (which include a tax-free threshold of \$18,200) can apply to a testamentary trust. They cannot, even if the testamentary trust arises within the three years. The special rates can only be applied to the estate of a deceased person (that is, while it is under administration).²⁴

“... testamentary trusts offer some significant benefits ... over other arrangements ...”

Avoiding Div 6AA ITAA36 consequences

Prima facie, a minor’s assessable income over \$416²⁵ from trusts is taxed at the top marginal rate (even to the extent of effectively taxing the \$416 if it is exceeded), and this has been the case since 1979. But there are important exceptions for “excepted income”, including income of a trust estate that resulted from a will.²⁶ This exception is itself subject to some specific anti-avoidance rules.

Excepted trust income is taxed at adult marginal rates with a tax-free threshold so, effectively, \$18,200 is tax-free in most cases for minor grandchildren.²⁷ For example, if there are five such grandchildren, \$91,000 can be freed from tax. As the tax-free threshold is not available under s 99 ITAA36 for a trustee of a testamentary trust, there may well be tax advantages associated with making sure that the grandchildren derive assessable income from the trust, as opposed to it being accumulated. This sort of arrangement can be very tax effective — parents can spend “untaxed” money on children (maintenance/education), whereas normally they would be paying this out of after-tax income.

For completeness, it should be noted that, even if a testamentary trust has not been set up in favour of grandchildren (for example, where the testator has left the

property to a child directly, leaving it up to that child to make some provision for the grandchildren), it may still be possible to obtain the relief under Div 6AA of Pt III ITAA36 that would have been available for a testamentary trust in favour of the grandchildren.

This requires gifting or transferring the estate assets into an inter vivos trust. However, the requirements are very specific, including requirements as to timing which must be within three years of the date of death.²⁸ Where an inter vivos trust is involved, the CGT and stamp duty implications may not be the same.

Adding assets and related income to the testamentary trust

So far, it has been assumed that the concessions have been sought for assets of, and income from assets of, the deceased person. Significant opportunities may be available (subject to some announced proposed amendments) if the concessions can be obtained in relation to other assets and income — often referred to as “after-acquired” property and the income derived from such property.

The first question is, can it be done? If the terms of the trust do not permit such contributions to be received by the trustee (and there is no power of amendment to change this), it probably cannot be done as there would be a new and different trust created even if it were on the same terms.

If it can be done, case law²⁹ makes it clear that the exemption from the Div 6AA rates is not limited to income from assets that the deceased had. This is a significant loophole in the existing law which effectively allows income from non-estate assets to be favourably treated. It is not a loophole that the authors recommend exploiting, nor in their experience one that is used by the general legal/accounting community or listed trustee companies. In any event, the ability to take advantage of it has now been curtailed by a proposed change to the law (see below).

Budget announcement to address loophole

The 2018-19 federal Budget included a proposed integrity measure to deny excepted trust income status from 1 July 2019 to income derived from introduced estate property, such as gifts or borrowings. These changes have not yet been enacted, but legislation has been introduced.³⁰ The amendments will apply to assets acquired by or transferred to a testamentary trust on or after 1 July 2019. However, income derived from assets acquired or transferred before that date and distributed to minors will not be affected. There are also rules to prevent the addition of new entities to the class of beneficiaries for the deceased estate.

Existing anti-avoidance measures

There are already anti-avoidance measures which apply Div 6AA tax to income derived by a minor beneficiary from a testamentary trust where effectively value is injected. This is where:

- the income is derived from an arrangement or a transaction that is not arm’s length, eg where estate property is exchanged at overvalue;³¹ or
- the income is derived from an arrangement entered into or carried out for a purpose of securing the tax concession.

It need not be a dominant purpose — just not incidental. This is a low bar to trip over.³²

CGT reliefs

Assets of deceased at death

On a literal reading of the tax law, the so-called “death” roll-over in Div 128 ITAA97 may not apply when testamentary trust assets pass to beneficiaries. This is because the relief applies to an LPR, which technically does not include a trustee of a testamentary trust arising from a will. However, the ATO has long administered the law on the basis that it does include a person acting in that capacity, but only in respect of trust assets that were owned by the deceased at the time of death.³³

Government announcement to address

In the 2011-12 federal Budget, the then government announced that it would legislate the Commissioner’s practice of allowing Div 128 ITAA97 to apply to assets coming out of testamentary trusts to beneficiaries. It also said that it would rewrite the deceased estate provisions with a principled approach, and make some minor technical amendments.

Again, in the 2012-13 federal Budget, the then government announced that this legislation would proceed, and that a series of minor amendments would be made to the measure (for example, to reduce compliance costs from the change, modifying application dates, and extending the integrity provisions to assets subject to survivorship).

However, on 14 December 2013, the then government announced that these changes would no longer be proceeded with, resulting in some continuing uncertainty. There is a small degree of risk that, absent legislative change, the Commissioner may change his view or a case may come before the courts where the law is interpreted strictly.

Assets acquired by the trustee after the death of the deceased

The Commissioner’s view is that Div 128 ITAA97 does not happen in relation to “after-acquired” property of a testamentary trust. It is therefore possible that relevant CGT events (for example, CGT event E5 to CGT event E7, which are excluded for Div 128 cases) may throw up taxable capital gains when beneficiaries become absolutely entitled to those assets (CGT event E5)³⁴ or they are transferred to beneficiaries who are not absolutely entitled to them (CGT event E7).³⁵ Although these CGT events can operate at both the trustee level and the beneficiary level, usually the beneficiary has not paid for their interest or acquired it by assignment, so any gain or loss at the beneficiary level is disregarded.

The detailed operation of these provisions is beyond the scope of this discussion, but suffice to say that, in the Commissioner’s view outlined in TR 2004/D25, absolute entitlement (CGT event E5) does not arise for indivisible property such as land where there are multiple beneficiaries. Moreover, notwithstanding what the Commissioner says in TR 2004/D25, it probably does not strictly arise for divisible “fungible” property like shares either — for several reasons, including that beneficiaries cannot point to particular shares that they are absolutely entitled to, or the shares may rarely

be truly fungible (eg if they have different cost bases or dates of acquisition). This means that, provided there are multiple beneficiaries (“grandchildren”), trust capital gains can be deferred at least until actual distribution or transfer of almost all assets, unless an earlier taxing point is sought consistent with the ruling for “fungible” assets.

Life estates

Where testamentary trusts are established using life estates (so that a surviving spouse or child derives a constant income during their life, with the residue being held for the grandchildren), more complex CGT outcomes can arise, and these are discussed in detail in TR 2006/14.

In general terms, while the creation of the testamentary trust may trigger CGT event E1,³⁶ Div 128 ITAA97 avoids any adverse consequences in respect of assets of the deceased. Further, on death of the life tenant, CGT event C2³⁷ happens to the life tenant but any gain or loss is disregarded under Div 128.

The positions of the remainder beneficiaries and trustee have to be considered. The death of the life tenant may result in remainder beneficiaries becoming absolutely entitled (normally triggering CGT event E5); if not, the actual transfer of the asset by the trustee would normally trigger CGT event E7. However, in relation to assets of the deceased, CGT events E5 and E7 do not happen.

It is not entirely clear whether, strictly, other CGT events (such as CGT event A1³⁸) could happen in relation to the deceased’s assets. On one view, the specific exclusion to the normal trust CGT events having been met suggests that no other CGT event should be regarded as happening. Even if that is not correct, the trustee would seem to be protected by the Commissioner’s administrative approach whereby the trustee is treated as if it were an LPR for Div 128 purposes. The position of the remainder beneficiaries is even less clear, but it has never been suggested by the ATO that a beneficiary receiving assets of the deceased for Div 128 purposes has any capital gain or capital loss on the ending of their interest, for example, pursuant to CGT event C2.

Different outcomes may arise in relation to “after-acquired” property, if there is any.

Mere right of occupancy

Sometimes the use of a mere right of occupancy of a marital home (without a full life estate) will be enough to confer the intended benefit for a surviving spouse or another person without the above more complex implications. Stamp duty liability may also be averted, which may not be the case for life estates. Also, the main residence exception can be preserved where the spouse or a person with a right to reside under the will occupies the dwelling.

Conclusion

This concludes part 1 of the two-part series on discrete facts and tax issues related to deceased estate administration. Part 2 will look at main residence issues and whether a challenge to the will can result in upfront CGT for a deceased estate.

Ian Raspin, CTA

Managing Director
BNR Partners

Lyn Freshwater

Senior Tax Consultant
BNR Partners

Mark Morris, FTI

Senior Tax Counsel
BNR Partners

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Appendix

An issue arises when the estate administration process exceeds the period available to amend the deceased person’s assessment for their final return. The amendment periods permitted under s 170 ITAA36 are generally capped at either two or four years after an assessment notice has been issued, depending particularly on whether the deceased was involved in a business that was not a small business. Accordingly, it is not possible to generally amend an assessment to include any omitted capital gain arising under CGT event K3 in the deceased’s date of death return after these time periods have elapsed.

This problem is known to regulators and was proposed to be addressed by amendment. The proposed amendment was designed to capture any gain or loss from CGT event K3 in either the estate or testamentary trust tax return at the date of transfer, albeit at market value at the date of death of the testator. Subsequently, the government announced, on 15 December 2013 as part of its “announced but unenacted measures” review, that it was not proceeding with the measure. As it currently stands, if CGT event K3 happens after the amendment period of two or four years has expired, it is essentially a tax-free gain because an amendment of a prior year assessment is statute barred. However, the general anti-avoidance provisions in Pt IVA ITAA36 may need to be considered if this eventuality is planned.

References

- 1 A recent study in the United States indicates that millennials in that country are expected to inherit \$68t from their baby-boomer parents by 2030. See www.cnbc.com/2020/01/16/receiving-an-inheritance-four-things-experts-say-you-should-know.html.
- 2 Div 128 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97).
- 3 If the shares were pre-CGT shares of the deceased, they are acquired at the date of death and have an acquisition cost equal to their market value at that death. See item 4 of the table in s 128-15(4) ITAA97.
- 4 S 104-10(3) ITAA97.
- 5 Sch 10 to the *Income Tax Rates Act 1986* (Cth).
- 6 IT 2622.
- 7 S 110-55(7) ITAA97.
- 8 S 47(1) and (1A) ITAA36.

- 9 S 104-135 ITAA97.
- 10 Note that the ATO takes the view in TD 2004/3 that an asset will “pass” to the beneficiary of a deceased estate when the beneficiary becomes absolutely entitled to the asset as against the estate’s trustee (whether or not the asset is later transmitted or transferred to the beneficiary). In the authors’ opinion, this view is contestable as it can reasonably be argued that “pass” in this context means “given to” — had the legislature intended the test to be absolute entitlement, it could easily have done so.
- 11 “Taxable Australian property” is defined in s 855-15 ITAA97. It includes mostly land in Australia, and certain indirect interests in land.
- 12 Section 855-25 ITAA97 sets out when an indirect real property interest will be TAP.
- 13 S 104-215 ITAA97.
- 14 That is, foreign residents are only subject to tax on TAP assets.
- 15 In the ATO’s view, s 855-10 only applies to a foreign resident entity that makes a capital gain from a CGT event happening to them. A capital gain that a beneficiary of a trust is taken to make under Subdiv 115-C is not from a CGT event happening to them; rather, it happened to the trustee. See TD 2019/D6.
- 16 It may be difficult for many trusts to satisfy the definition of “fixed trust” unless the Commissioner exercises his discretion to treat the beneficiaries’ interests as fixed entitlements. PCG 2016/16 outlines the factors that the Commissioner will take into account when exercising that discretion. It also provides a safe-harbour compliance approach for trustees of certain trusts that allows them to manage the trust’s tax affairs as if the Commissioner had exercised the discretion to treat beneficiaries as having fixed entitlements to income and capital of the trust.
- 17 In the Boris example, where the trust was resident, the application of s 99 would mean that there would be no subsequent application of s 99B on distribution to a resident beneficiary, and it is evident that some trusts proposing to make such distributions would be much better off if they had been resident trusts for tax purposes. The appointment of a resident LPR would usually be enough to achieve this outcome.
- 18 Section 99C ITAA36 sets out when an amount will be taken to have been applied for the benefit of a beneficiary.
- 19 S 99B(2) ITAA36.
- 20 S 99B(2)(a) ITAA36.
- 21 [2019] AATA 2043.
- 22 S 102AAM(1B) ITAA36.
- 23 S 99A(2) ITAA36.
- 24 Div 6AA of Pt III ITAA36; and para (1)(b) in Pt I of Sch 10 to the *Income Tax Rates Act 1986*.
- 25 Subdiv C of Pt II of the *Income Tax Rates Act 1986*.
- 26 S 102AG(2) ITAA36.
- 27 The assessments are made to the trustee under s 98 ITAA36 to facilitate collection of tax. The beneficiaries may also be assessable under s 100 ITAA36 but will be entitled to a credit for the tax paid by the trustee.
- 28 S 102AG(2)(d)(ii) ITAA36.
- 29 *The Trustee for the Estate of the late AW Furse No. 5 Will Trust v FCT* (1990) 21 ATR 1123.
- 30 Treasury Laws Amendment (2019 Measures No. 3) Bill 2019, introduced on 5 December 2019.
- 31 S 102AG(3) ITAA36.
- 32 S 102AG(4) ITAA36.
- 33 PS LA 2003/12; and TR 2006/14.
- 34 S 104-75 ITAA97.
- 35 S 104-85 ITAA97.
- 36 S 104-55 ITAA97.
- 37 S 104-25 ITAA97.
- 38 S 104-10 ITAA97.



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Foreign residents and the main residence exemption no more

by David Montani, CTA, National Tax Director, Nexia Australia

It can be quite an adventure to live and work overseas for a time, should the opportunity arise. Many who have done so choose to keep their home in Australia because they can maintain the main residence exemption from capital gains tax. However, not anymore. In fact, not ever. Following the 2017-18 Budget announcement, the CGT provisions were amended with effect from 9 May 2017 to abolish the main residence exemption for foreign residents. While there is no grandfathering for existing properties, there is a limited transitional period during which the exemption may still be available. This article examines the technical features of the amendments, the practical consequences, and the tough decision many expats will need to make very soon. In addition, the article sets out how practitioners can help their affected clients make that decision.

Background

In the 2017-18 Budget, a number of measures were announced to reduce pressure on housing affordability, including the abolition of the main residence exemption for foreign residents. The original Bill was released before last year's election to almost universal condemnation from the tax profession. It was thought that consultation with the profession was successful, as the then Assistant Treasurer Stuart Robert hinted at The Tax Institute's National Convention in March 2019 that the Bill might not be progressed any further. However, after the election, Treasurer Josh Frydenberg reaffirmed that it remained government policy.

In December last year, parliament passed the Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures) Bill 2019, and it received royal assent on 12 December 2019 (the Act). While the amendments apply from 7.30 pm (AEST) on 9 May 2017, the truly draconian part is that there is no recognition of the time that a dwelling actually was a person's residence. At its core, the law now

simply asks whether a person is an Australian resident at the time of sale. If the answer is yes, these amendments do not apply. If the answer is no, the person's former home will be subject to capital gains tax (CGT) — it does not matter that it was once their main residence, nor for how long.

The Tax Institute's senior tax counsel, Bob Deutsch, CTA, described the Bill as an "outrageous piece of legislation".¹ As the effect of these amendments is laid out below, it will become clear that Bob was not exaggerating. Further, how these amendments actually improve housing affordability is not clear, and the subject barely rates a mention in the explanatory memorandum.

The fact is that the Act is the law, and so all we can do is provide affected clients with the information they need to understand their position and make informed decisions.

Main residence exemption

Under s 102-5 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97), your assessable income includes a net capital gain for an income year. Calculating your net capital gain first requires compiling all of the capital gains and losses you have made during the income year. However, any capital gain that is disregarded under another provision is excluded. Subdivision 118-B of Pt 3-1 ITAA97 sets out the rules for a capital gain or loss to be disregarded in relation to a dwelling that is your main residence.

How the amendments disrupt the availability of the main residence exemption for foreign residents is set out below.

Abolition of main residence exemption for foreign residents

Section 118-110 ITAA97 sets out the basic rules for a dwelling to qualify for the main residence exemption when a CGT event happens. The core amendment that the Act makes is the addition of s 118-110(3), (4) and (5), which disallow the exemption for foreign residents. This is followed by a series of follow-on amendments, much of which is simply altering examples and notes to reflect this change.

Under s 118-110(3), the main residence exemption is no longer available if, at the time the CGT event happens, you are:

- an "excluded foreign resident"; or
- a foreign resident who does not satisfy the "life events test".

This is the simple "yes or no" part. If you fall into either category of foreign resident, the main residence exemption is not available, full stop. There is no recognition whatsoever of the dwelling's history as your main residence.

We now turn to the components requiring examination: CGT event, foreign resident, excluded foreign resident, and the life events test.

CGT event

CGT event A1 would typically be the applicable CGT event, and it would usually happen by way of entering into a sale contract. Accordingly, the point in time at which to answer whether or not a person falls into either of the above categories of foreign resident is the date the contract is executed.

Foreign resident

A person is a foreign resident if they are not a resident of Australia under s 6(1) of the *Income Tax Assessment Act 1936* (Cth). That means a foreign resident includes a temporary resident. The amendments are relevant for anyone who owns a dwelling in Australia that is subject to a potential full or partial main residence exemption. Thus, the overwhelming majority of situations for which practitioners will be called on to advise is where a person:

- was an Australian resident, but now is not; or
- is currently an Australian resident, contemplating moving overseas with a resulting cessation in Australian residency, but would like to keep their residence.

Determining a person's residency status is a stand-alone matter, and is beyond the scope of this article.

Foreign residents are then divided into the previously mentioned two categories. The reason for the division is to give the latter category a chance to retain the main residence exemption — but you will understand why I say that those foreign residents in this latter category should not get their hopes up.

Excluded foreign resident: > six years

Section 118-110(4) provides that you are an “excluded foreign resident” at a time if:

- you are a foreign resident at that time; and
- you have been a foreign resident continuously for more than six years.

In short, foreign residents of more than six years' continuous duration are denied the main residence exemption, no exceptions. The fact that a dwelling may have been their main residence for many years beforehand is irrelevant. There is no recognition for this whatsoever, and thus any capital gain or loss is no longer disregarded — to any extent — under the main residence exemption. Accordingly, where the dwelling is taxable Australian property (eg real property situated in Australia), the capital gain or loss is included when determining their net capital gain for the income year, to be disclosed in their Australian income tax return. (Non-real property dwellings are considered further below.)

Note that, if a capital loss arises, that is similarly not disregarded. Accordingly, it will reduce other capital gains, or contribute to a net capital loss carried forward.

Life events test: foreign resident ≤ six years

A person who has been a foreign resident for six years or less at the time of the CGT event is similarly denied the main residence exemption, but only if they do *not* satisfy the life events test. In other words, satisfying the life events test is the chance afforded to this category of foreign resident to maintain access to a full or partial main residence exemption.

Under s 118-110(5), a foreign resident will satisfy the life events test, at the time a CGT event happens, if:

- the person has been a foreign resident for six years or less; and
- any one of the following happened:
 - they or their spouse had a “terminal medical condition” at any time during the above period of foreign residency;

- their child had a terminal medical condition at any time during that period, and they were under 18 years of age;
- their spouse or under-18 child died during that period; or
- the CGT event involves the person and their spouse under the marriage or relationship breakdown provisions in s 126-5(1) ITAA97.

Having a “terminal medical condition”² at a time means:

1. two registered medical practitioners have jointly or separately certified that, due to illness or injury, a person will likely die within two years;
2. at least one of the practitioners is a specialist practising in an area related to the illness or injury; and
3. the time is within that two-year period from the date of certification.

Item 3 above means that, if a person obtains the above certification but is still alive two years later and subsequently disposes of their dwelling, they did *not* have a terminal medical condition at the time of disposal.

In summary, where a person has been a foreign resident for six years or less, the main residence exemption remains available only if they, their spouse or minor child are expected to die within two years, their spouse or minor child did die, or they suffer a relationship breakdown. Obviously, there is no joy in retaining the main residence exemption from satisfying the life events test.

“Our value contribution is providing clarity so that our client can make a decision with confidence.”

Transitional rule: big decision, little time

A transitional rule in s 118-110 of the *Income Tax (Transitional Provisions) Act 1997* (Cth) provides a limited opportunity for foreign residents to dispose of their former residence, unaffected by the Act's amendments. The main residence exemption will still be available, as if none of these amendments had been enacted, if a person satisfies all of the following:

- the CGT event happens on or before 30 June 2020;
- they held an ownership interest in the dwelling before 7.30 pm (AEST) on 9 May 2017; and
- they continuously held the ownership interest up to the CGT event.

The transitional rule essentially applies where a person acquired their home before 9 May 2017, they subsequently became a foreign resident, but sold the property by 30 June 2020. Note the different timing mechanisms used. The acquisition must have *settled* before 7.30 pm on 9 May 2017 (irrespective of when the purchase contract was executed)

in order to have an “ownership interest” before that time.³ Conversely, the CGT event happening by 30 June 2020 means that the sale contract must be executed by that date (irrespective of when settlement occurs).⁴

For anyone who has become a foreign resident, and still owns their former residence, this leaves little time to make a decision.

The transitional rule is not available where settlement for the acquisition of a dwelling occurred on or after 7.30 pm on 9 May 2017. All such properties are subject to the amendments, irrespective of when they are sold.

Example 1

Josh purchased his home on 1 October 1985 for \$70,000. He moved overseas on 1 October 2019, and became a foreign resident. He intends to choose to apply the absence rule in s 118-145 ITAA97 such that his house will continue to be treated as his main residence.

Josh executes a contract to sell his house on 1 October 2020 for \$970,000, with a capital gain of \$900,000 arising. Having been a foreign resident for only a year, Josh is not an “excluded foreign resident”, but let’s say he does not satisfy the life events test. Accordingly, s 118-110(3)(b) ITAA97 applies, as Josh is a foreign resident of six years or less, and does not satisfy the life events test as at 1 October 2020. Therefore, the main residence exemption is not available (to any extent) in respect on his \$900,000 capital gain.

The property having been Josh’s home for 34 of the 35 years he owned it is irrelevant. Further, the fact that Josh intended to apply the absence rule is also irrelevant.

Assuming the capital gain is the only relevant matter for Josh’s 2020-21 Australian income tax return, his tax liability is calculated as follows:

	\$
Capital gain	900,000
Less 48.57% discount	(437,130) ⁵
Net capital gain	<u>462,870</u>
Tax at non-resident rates	<u>189,842</u> ⁶

If Josh had executed the sale contract a few months earlier, by 30 June 2020, the transitional rule would operate, meaning none of these amendments would apply. The main residence exemption, including his choice to apply the absence rule, would have been available, resulting in his \$900,000 capital gain being fully disregarded. The short delay has cost him almost \$190,000.

Any client in this situation needs to make a decision – very soon

Anyone who settled the purchase of their home before 7.30 pm (AEST) on 9 May 2017, and has since become a foreign resident, has a significant decision to make — and they need to make it very soon.

Here are their options:

1. sell their home by 30 June 2020: under the transitional rule, none of these amendments apply, and a full or partial main residence exemption will be available in the ordinary course as if the amendments were never enacted;

2. keep their home: the main residence exemption will no longer be available from 1 July 2020. If they are still a foreign resident when the home is sold, any capital gain or loss will not be disregarded (the exception is a foreign resident of six years or less who satisfies the life events test); or
3. return to Australia (whenever in the future) and become an Australian resident again. Then sell their home (whether or not resumed as their main residence) while they are an Australian resident. As they are an Australian resident at the time of sale, the amendments do not apply, and thus a full or partial main residence exemption will be available in the ordinary course.

For anyone who is entrenched in their life overseas, option 3 might be unrealistic. So, if it is between options 1 and 2, making an informed decision — sell or keep — requires estimating by how much the future sale proceeds under option 2 will be diminished by CGT. At the stroke of midnight on Tuesday, 30 June 2020, this will be an instant — and for many, substantial — diminution embedded in their personal wealth.

Assisting clients to make an informed decision

Having set out how the amended law operates, and the resulting sell/keep decision now confronting many people, what comes next is how we, as practitioners, can help clients to make an informed decision. To do that, a client will need to provide us with two things:

1. an estimate of the property’s current sale value; and
2. a prediction of the future growth in value of the property.

Of course, the above requires your client to make an estimate and a prediction. However, that is unavoidable in order to provide specific numbers back to your client. Your risk as the adviser is managed by stating that your advice is based on the estimates provided by your client.

Here’s the key point: option 1 may well mean keeping 100 cents in the dollar of present-day sale proceeds under a full main residence exemption. Option 2, on the other hand, means keeping something less than 100 cents in the dollar of future sale proceeds. Substantial *after-CGT* capital growth beyond 1 July 2020 would likely be required to make up for the CGT cost that will become embedded in the property’s value from that date.

It ultimately comes down to comparing two numbers:

Compare	
Today’s sale proceeds (Full amount if full main residence exemption, or net of CGT, if only partial)	Future sale proceeds , less CGT, discounted back to today’s dollars

Example 2

Following on from example 1, let’s say Josh is your client, and instead of just doing what he did above, he wisely seeks your advice so that he can make an informed decision — sell his house by 30 June 2020, or keep it. He provides you with the following in relation to the house:

1. estimated current sale value: \$990,000; and
2. predicted value in five years: \$1,300,000.

If Josh sells his house by 30 June (ie option 1), his capital gain will be fully exempt under the main residence exemption (with choosing the absence rule), and his after-tax sale proceeds will be the full \$990,000 expected.

Alternatively, if Josh were to keep the house (ie option 2), we need to estimate his tax liability on selling it in five years (say, 1 October 2025) for \$1,300,000, with a capital gain of \$1,230,000 arising. The after-tax sale proceeds will then need to be discounted back five years to today's dollars. For this example, we will use a discount rate of 5%.

The estimated outcome for Josh is calculated as follows:

	\$
Capital gain	1,230,000
Less 42.5% discount	<u>(522,750)⁷</u>
Net capital gain	<u>707,250</u>
Tax at non-resident rates	<u>299,813⁶</u>
Sale proceeds	1,300,000
Less above tax liability	<u>(299,813)</u>
After-tax sale proceeds	<u>1,000,188</u>
Discounted back to today's dollars	<u>783,673⁸</u>

In today's dollars, option 1 will leave Josh with \$990,000 in his pocket, whereas option 2 will leave him well short, with only about \$783,000. But that's not the end of the matter. The other factor to consider is, if the property were sold now, where Josh would invest the \$990,000. What return would he earn, compared to, say, the rental return that he might continue receiving on the property? Even if the rental return from keeping the property were higher than what \$990,000 deployed elsewhere would earn, it is unlikely that the additional return, after tax, would make up for the estimated \$207,000 (\$990,000 – \$783,000) shortfall in current-dollars after-tax sale proceeds. Having this information, Josh is now in a position to make an informed decision. If he chooses option 1, it's time to call the real estate agent.

Of course, the decision may not necessarily be that simple. What if the house still has tenants? Residential tenancy laws vary between states/territories, but landlords generally can terminate a residential lease only in limited circumstances. If the current lease term extends past 30 June 2020, the pool of potential buyers may well be limited to investors (to whom the lease would be assigned).

There may also be personal non-financial factors in play. For example, the house might hold such sentimental value to your client that they accept the diminution in their wealth — now that they have an estimate of how much their wealth will decline — in return for keeping the house.

Again, it must be made clear to your client that, as the adviser, your calculations are based on *their* estimated values, a reasonable discount factor, and the assumption that the capital gain is the only matter for the future year's tax return.

General anti-avoidance

A person who is currently a foreign resident might consider transferring their property to a related party before

30 June 2020, to take advantage of the transitional rule. Or, an Australian resident might consider doing the same before becoming a foreign resident. This results in availing oneself of the main residence exemption, but keeps the property in the family group. However, it has been made clear that the Commissioner of Taxation may seek to apply the general anti-avoidance provisions.⁹ One can imagine the ATO conducting a data-matching exercise between non-resident taxpayers and land title transfers up to 30 June 2020 for scrutiny.

Tangible decision-making framework

The above provides a tangible framework for a client to make a decision. As practitioners, our value contribution is providing clarity so that our client can make a decision with confidence.

The client will also need to seek tax advice within their country of residence to determine whether any tax liability will arise in that country, and whether any double-taxation relief is available.

Of course, for anyone who does choose option 2, option 3 will still be open, if things end up working out that way. Also, under option 2, the purchaser would be obligated to withhold 12.5% of the sale price where it is \$750,000 or more.

Decreased labour mobility

Anyone who owns a dwelling that is sitting on a full or partial main residence exemption now has this whole additional factor to consider before accepting an overseas opportunity that will involve ceasing Australian tax residency. Losing the main residence exemption or reluctantly selling your house are both unappealing options. And spare a thought for anyone who decides to avail themselves of the main residence exemption while they can, seeks to sell before leaving (reluctantly or not), but is unable to secure a buyer before departure.

Sustainable economic development is aided by capital and labour being able to move freely within and between countries. These amendments run counter to that by creating a disincentive for people to work overseas, thus inhibiting labour mobility.

Calculating the capital gain – practical problem with cost base

A practical difficulty arises for homes purchased after 20 August 1991. The third element of cost base¹⁰ includes non-capital costs of ownership, such as interest, insurance, rates, and repairs and maintenance (for periods when the home was not used to produce income). The higher the cost base, the lower any capital gain, and thus the lower any resulting tax liability.

Over time, these costs could add substantially to a property's cost base — but who has kept records of these for their home? Virtually no one, because there was never any need. But now there is. If the costs cannot be substantiated, they cannot be included in the cost base. Perhaps the Commissioner will provide guidelines for making acceptable estimates of these costs that any homeowner would have incurred.

Non-real property dwellings

CGT event I1 will happen for an individual on ceasing to be an Australian resident.¹¹ A market value-based capital gain or loss arises for all CGT assets, except for certain exclusions, such as taxable Australian real property (TARP). Dwellings attached to land (houses, units etc) are generally TARP, and so CGT event I1 does not happen for them. Instead, when sold, CGT event A1 happens, and the preceding discussion all unfolds.

However, some dwellings are not attached to land, such as caravans, houseboats and other types of mobile homes. These are not TARP assets, meaning the abovementioned exclusion does not apply and CGT event I1 happens to them, with the resulting capital gain or loss arising. Section 118-110(2) contains a list of the CGT events in respect of which the main residence exemption is available. CGT event I1 (and CGT event I2 for companies) has now been removed from that list. Accordingly, for the abovementioned types of non-TARP dwellings that were the individual's main residence, any capital gain or loss arising under CGT event I1 can no longer be disregarded under the main residence exemption.

Individuals can still choose to disregard the CGT event I1 capital gain in return for the non-TARP dwelling being treated as taxable Australian property and continuing to be subject to Australia's CGT system.¹²

Deceased estates

Subdivision 118-B contains provisions dealing with the application of the main residence exemption to dwellings sold from a deceased estate or sold by a beneficiary of a deceased estate.¹³ These have been amended to incorporate the abolition of the main residence exemption for foreign residents.

Where a deceased person was a resident at the time of death, or was a foreign resident for six years or less, the main residence exemption accrued by the deceased for a dwelling continues to be available to the estate or beneficiary. However, if a beneficiary to whom the dwelling is bequeathed is a foreign resident at the time it is sold, only a partial exemption is available. Any additional component of the main residence exemption that they otherwise accrued in their own right is excluded.

If the deceased was an excluded foreign resident at the time of death, the portion of the main residence exemption accrued by the deceased in respect of the dwelling is not available to the beneficiary.

If the deceased was an excluded foreign resident at the time of death, and the beneficiary that inherits the ownership interest is a foreign resident at the time the CGT event occurs, no main residence exemption is available.

Not retrospective?

The government has continued to argue that these amendments are not retrospective, on the basis that they apply only to properties sold after they were announced on 9 May 2017. While their *application* is not retrospective, their *effect* certainly is. For years, or decades even, former homes

of foreign residents carried within them the main residence exemption, but now they "never" did.

Other measures

Measures are included to accommodate a dwelling compulsorily acquired, and those held in a special disability trust.

Conclusion

Despite the legitimate charge that these amendments contravene the spirit of the CGT main residence exemption, they are a reality and cannot be ignored. Anyone who has kept their former residence since becoming a foreign resident has a significant decision to make, and soon. For anyone thinking of going to live overseas, the entire main residence exemption for their home is at risk.

The key is having the necessary information to make an informed decision, albeit an unenviable one, and that is the value we, as practitioners, can provide to our clients.

David Montani, CTA

National Tax Director
Nexia Australia

References

- 1 The Tax Institute, *TaxVine*, 13 December 2019.
- 2 Reg 303-10.01 of the *Income Tax Assessment Regulations 1997* (Cth).
- 3 S 118-130 ITAA97.
- 4 S 104-10(3)(a) ITAA97.
- 5 Pro-rated discount, being the period 1 October 1985 to 1 October 2019 divided by the period 1 October 1985 to 1 October 2020 (ie $12,418/12,784 \times 50\% = 48.57\%$).
- 6 \$62,550 plus 45% of the excess over \$180,000. The general CGT discount provides for a lower tax liability compared to indexation.
- 7 Pro-rated discount, being the period 1 October 1985 to 1 October 2019 divided by the period 1 October 1985 to 1 October 2025 (ie $12,418/14,610 \times 50\% = 42.5\%$).
- 8 Excel formula: $=1,000,188/(1+5\%)^5$.
- 9 Para 1.24 of the explanatory memorandum.
- 10 S 110-25(4) ITAA97.
- 11 S 104-160 ITAA97.
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- 13 Ss 118-195 to 118-210 ITAA97.

A Matter of Trusts

by Edward Hennebry, FTI, Sladen Legal

Interpreting and varying trust deeds

When varying a trust deed, careful regard must be directed to the provisions of the deed as a whole, and the potential tax implications that can arise.

What are the principles of interpreting a trust deed?

Trust deeds generally define the powers, duties and responsibilities of trustees over trust property, and prescribe a framework for how and when trust property can be distributed to beneficiaries.

At some stage during the trust's lifetime, it might be desirable to amend the trust deed to add flexibility or in response to legislative changes. While the variation power is naturally a good place to start, deciphering what can and cannot be amended requires having regard to some fundamental maxims of interpretation which have been emphasised by the courts, including:

1. the rules that apply to the construction and interpretation of deeds and contracts equally apply to trusts;¹
2. the trust deed as a whole must be considered when interpreting a clause in the trust deed, as the surrounding provisions assist with deciphering context and purpose, as well as harmonising meaning;²
3. the intentions of the parties to the trust deed must be assessed objectively;³
4. unless specifically defined, words and phrases within the trust deed will carry their natural and ordinary meaning;⁴
5. provisions within a trust deed should generally not be construed narrowly;⁵ and
6. when assessing intention, the recitals do not form part of the operative part of the trust deed and should only be utilised if the operative part is unclear.⁶

A trustee has no implicit power to amend a trust deed.⁷ Accordingly, in the absence of an express power, any purported variations to the deed are likely to be invalid.⁸ As the power of amendment is construed strictly in respect of any conditions on the exercise of the power,⁷ it is important to understand what powers are conferred to the trustee under the variation clause. Notably, even broadly drafted variation clauses can be challenged.

For instance, "unconfined discretions" afforded to trustees must be approached with caution as equitable doctrines of

fraud cannot be overridden.⁹ Additionally, a power that seeks to alter the "substratum" of the trust may be considered void. Deciphering the underlying "substratum" of the trust is a difficult task and will often require a reading of the trust deed as a whole and in context.

Furthermore, the significance of a trust's "substratum" might be questionable in light of the "modern" trust deed, where flexibility to mitigate against the impact of legislative change or family breakdowns are often central to the drafter's objectives. Accordingly, some trusts may arguably have no "substratum", as was suggested by Meagher J in *Kearns v Hill*:¹⁰

"In *Re Dyer* it was held that the power of variation contained in a particular trust deed did not extend to varying the trust in a way which would destroy its 'substratum'. That, again, is not really helpful in the present context, where either it is impossible to locate any substratum at all, or alternatively, the relevant substratum is the benefit of the descendants of a named person ...

I also put to one side the equally obvious consideration that the conditions which existed in England in 1850 are not necessarily the same as those which existed in New South Wales in 1970."

Nevertheless, in some instances, changing the appointor of a trust can constitute an alteration to a trust's substratum, as highlighted in the next section of this article.

Changing the appointor

Generally, the amendment power under a trust deed will permit trustees to alter key terms, such as to extend the vesting date (provided it does not infringe on state/territory perpetuity periods) or to enable streaming of capital gains and franked dividends. However, problems may arise where trustees use the amendment power to alter the schedule of a trust deed to, for example, change the identity of an appointor or a guardian.

This issue was considered by Le Miere J of the Western Australian Supreme Court in *Mercanti v Mercanti*.¹¹ Here, the trustee sought to exercise its general amendment power to change the appointor of the FW Trust. The amendment clause read:¹²

"The Trustee may at any time and from time to time ... by deeds revoke add to or vary all or any of the trusts hereinbefore provided or the trusts provided by any variation alteration or addition made thereto from time to time and may by the same or any other deed declare any new or other trusts or powers concerning the Trust Fund or any part thereof of the trusts whereof shall have been so revoked added to or varied."

Having regard to the trust deed as a whole and the ordinary and natural meaning of the words used in the amendment clause, Le Miere J held that the trust had distinguished between "trusts" and the "trusts powers and provisions", and that the identity of the office of appointor was not "any of the trusts hereinbefore provided". Accordingly, the trustee's actions were invalid.

A similar outcome was reached by Douglas J of the Queensland Supreme Court in *Jenkins v Ellet*.¹³ Here, the trustee sought to exercise its amendment power to remove and replace a principal (appointor) of the George Jenkins Family Trust. The amendment clause provided:¹⁴

“The Trustee may by Deed revoke add to release or vary all or any of the Trusts declared or any Trusts declared by any variation, alteration or addition made from time to time and may by the same or any other Deed declare any new or other trusts or powers concerning the Trust Fund but so that the Trustee shall not have any power to revoke add to or vary any of the Trusts so that the Settlor may acquire a beneficial interest in the Trust Fund ...”

Having regard to the trust deed as a whole and the fact that the principal’s power to remove and replace a trustee was fundamental to the trust, Douglas J considered the actions of the trustee to be invalid because such a change would be akin to “destroying the substratum of the trust”.

The argument has often been raised that it is nonsensical for the trustee to have the ability to remove and replace the appointor. That is, in light of the fact that the primary purpose of the appointor is to oversee and remove the trustee, it would be contrary to the fundamental purpose for which the power to amend was created if the trustee could replace the appointor.¹⁵ Such arguments, however, will be given little weight and it is ultimately the terms of the trust deed that dictate what is and is not permitted.

Furthermore, contentions that a deed implicitly prevents a trustee from removing an appointor are often tenuous and untenable. In addition, the notion that an appointor who resigns from their position has the implicit ability to decide their replacement may also trigger scrutiny. Generally, the power of appointing a replacement appointor must be expressly provided for.¹⁶

Overall, the above cases highlight some limitations of amendment powers under a trust deed.

Amending the variation power

The variation power may be amended, provided the deed expressly allows for it. However, in most modern trust deeds, the amendment clause is specifically prohibited from amendment (and particularly so if the trustee has already resolved to pay or set aside income/capital for a specific beneficiary).

An interesting point is raised in *Thomas on Powers*, a reference that is often cited by the courts:¹⁷

“Indeed, it is probably the case that there is an implied (albeit rebuttable) presumption, in the absence of an express direction to that effect, that a power of amendment (like any other kind of power) cannot be used to extend its own scope or amend its own terms. Moreover, a power of amendment is not likely to be held to extend to varying the trust in a way which would destroy its ‘substratum’. The underlying purpose for the furtherance of which the power was initially created or conferred will obviously be paramount.”

Caution should therefore be taken when attempting to amend the variation power, particularly if it is not expressly permitted under the deed.

Will the variation trigger a resettlement for income tax purposes?

Whether variations to a trust deed will trigger resettlement (and consequently CGT event E1) has been the subject of extensive consideration from the courts and revenue authorities.

Following *FCT v Clark*¹⁸ and TD 2012/21, no income tax consequences should arise when trustees amend a trust deed, provided:

- the amendments are made in accordance with the terms of the trust deed;
- there is continuity of trust property (ie the trust property remains legally held by the trustee for the benefit of beneficiaries); and
- there is continuity of membership (ie the beneficiaries/ persons who are entitled to benefit under the trust remain largely unchanged).

The above principles appear sensible. A trust is a relationship whereby trust property is held on trust by a trustee for the benefit of beneficiaries. Substantial alterations to the trust property or beneficiaries would invariably enliven an argument that the trust property is held on different terms and to benefit different persons. However, deciphering whether amendments constitute a resettlement are not always clear.

In Australia, it is not uncommon for many businesses to operate in a discretionary trust through which a family trust election has been made to facilitate the utilisation of tax losses and the passing through of franking credits.

When attempting to sell a business in a family trust, we were recently asked if, rather than selling the business to a third party, it would be possible for the third party to effectively “take over” the discretionary trust by virtue of:

- modifying the directors and shareholders of the trustee company;
- changing the primary beneficiaries of the discretionary trust; and
- changing the appointor of the discretionary trust.

For the reasons identified above, and even if the trust deed permitted the proposed variations, any such proposals should be carefully reviewed as they are likely to constitute a resettlement. The commerciality of such changes would also be questionable, as well as the fact that any future distributions are likely to trigger family trust distributions tax.

It is often forgotten that beneficiaries under discretionary trusts do not have defined predetermined interests in trust property — they are mere objects and have an expectancy, and nothing else, to become entitled to the income or capital of the trust. In such circumstances, contemplation may be directed towards pre-sale structuring through a Subdiv 122-A roll-over or using the small business CGT concessions.

Concluding comments

There is no one-size-fits-all approach to varying a trust deed. Regard must be given to the ordinary and natural meaning of the provisions of the trust deed as a whole, and the wording of the relevant amendment power must allow for the specific variation.

Where the trustee acts within their power such that the variation is valid, cases such as *FCT v Commercial Nominees of Australia Ltd*,¹⁹ *Clark* and the ATO’s examples under TD 2012/21 demonstrate that even substantial changes to a trust deed may not trigger a resettlement (and enliven

CGT event E1). This might implicitly reflect (as noted above) a recognition that “modern” trust deeds are typically drafted to afford maximum flexibility and that the traditional notion of a trust having a particular “substratum” may be unduly restrictive and out of fashion.

Where the risks of a resettlement are significant (particularly if land of substantial value is involved), certainty can be sought through the private ruling application process with the ATO and the relevant state revenue office.

Edward Hennebry, FTI

Associate
Sladen Legal

Acknowledgment

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Superannuation

by Daniel Butler, CTA, and Bryce Figot, CTA,
DBA Lawyers

What is a reversionary pension?

If a trustee has a discretionary power and the trustee decides how it will exercise that power in the future, such a decision will be unenforceable.

There is a little-known rule that can have huge implications for self-managed superannuation funds (SMSFs), particularly when it comes to reversionary pensions. This article provides the crucial “must know” details.

What is a “reversionary pension”?

The ATO describes a reversionary pension, without actually using the term “reversionary”, as follows:¹

“A superannuation income stream ceases as soon as a member in receipt of the superannuation income stream dies, unless a dependant beneficiary of the deceased member is automatically entitled, under the governing rules of the superannuation fund or the rules of the superannuation income stream, to receive an income stream on the death of the member. If a dependant beneficiary of the deceased member is automatically entitled to receive the income stream upon the member’s death, the superannuation income stream continues.”

The ATO also describes a reversionary pension as follows:²

“A reversionary death benefit income stream is a superannuation income stream that reverts to the reversionary beneficiary automatically upon the member’s death. That is, the superannuation income stream continues with the entitlement to it passing from one person (the member) to another (the dependant beneficiary).”

The income tax legislation uses the term “reversionary beneficiary”.³ Although the income tax legislation does not define the term, the explanatory memorandum that introduced this legislation does state that a “reversionary income stream” means:⁴

“A superannuation income stream that automatically reverts to a nominated beneficiary on the death of its current recipient.”

The common theme in all of the above definitions is the idea that the pension continues to be paid on death *automatically* (ie that the SMSF trustee is instantly bound and compelled to continue paying the pension).

Case study

Imagine an SMSF trustee that signs a pension agreement with a member stating that the trustee will start paying a pension to the member now, and then when the member dies, the pension will automatically continue to be paid (ie revert) to the member’s spouse. The trustee makes resolutions confirming this.

Most would think that this agreement is binding, and that once the member dies, the trustee is compelled to pay the pension to their spouse. However, there is more to the picture!

The rule against “fettering”

There is a general rule against trustees of trusts (which includes SMSF trustees) fettering their discretion. The specifics of this rule were conveniently summarised by Chesterman J in *Dagenmont Pty Ltd v Lugton*:⁵

“According to the *Law of Trusts* by Underhill and Hayton 16th edition (p 690):

‘... it is trite law that trustees cannot fetter the future exercise of powers vested in trustees *ex officio* Any fetter is of no effect. Trustees need to be properly informed of all relevant matters at the time they come to exercise their relevant power.’

Meagher and Gummow in *Jacobs Law of Trusts in Australia* 6th edition para 1616 say:

‘Trustees must exercise powers according to circumstances as they exist at the time. They must not anticipate the arrival of the proper period by ... undertaking beforehand as to the mode in which the power will be exercised *in futuro*.’

Professor Finn (as his Honour then was) in his work *Fiduciary Obligations* wrote (at para 51):

‘Equity’s rule is that a fiduciary cannot effectively bind himself as to the manner in which he will exercise a discretion in the future. He cannot by some antecedent resolution, or by contract with ... a third party — or a beneficiary — impose a “fetter” on his discretions.’

Finkelstein J summarised the position succinctly in *Fitzwood Pty Ltd v Unique Goal Pty Ltd (in liquidation)* [2001] FCA 1628 (para 121). His Honour said:

‘Speaking generally, a trustee is not entitled to fetter the exercise of discretionary power (for example a power of sale) in advance ... If the trustee makes a resolution to that effect, it will be unenforceable, and if the trustee enters into an agreement to that effect, the agreement will not be enforced ...’

In short, if a trustee has a discretionary power and the trustee decides how it will exercise that power in the future, such a decision will be unenforceable. This is extremely relevant in the context of reversionary pensions.

Tax issues

The ATO applies a strict test regarding pensions in that, unless a pension is made automatically reversionary on the death of a member, the pension will cease. As noted in TR 2013/5 above, a pension ceases “unless a dependant beneficiary of the deceased member is automatically entitled”. Paragraph 126 of TR 2013/5 is key to understanding what the ATO considers to be an automatically reversionary pension:

“A superannuation income stream automatically transfers to a dependant beneficiary on the death of a member if the governing rules of the superannuation fund, or other rules governing the superannuation income stream, specify that this will occur. The rules must specify both the person to whom the benefit will become payable and that it will be paid in the form of a superannuation income stream. The rules may also specify a class of person (for example, spouse) to whom the benefit will become payable. It is not sufficient that a superannuation income stream becomes payable to a beneficiary of a deceased member only because of a discretion (or power) granted to the trustee by the governing rules of the superannuation fund. The discretion (or power) may relate to determining either who will receive the deceased member’s benefits, or the form in which the benefits will be payable.”

How this applies to pensions

The vast majority of SMSF deeds provide that, if, on death, there is no binding death benefit nomination (BDBN), the trustee has a discretion regarding to whom (eg to a spouse) and how (eg as a pension) any death benefit is paid. Accordingly, if the trustee has previously:

- resolved; and/or
- agreed,

how this discretionary power will be exercised in the future (eg that the pension reverts to a spouse), this constitutes a fetter and will not be enforceable!

When is this practically a problem?

In a practical sense, if, on death, the trustee wants to pay a pension to the person named “reversionary beneficiary” in the pension documents, it is generally no issue. However, in that circumstance, it is unlikely that a reversionary pension is running the SMSF, there’s no great need to restrict their actions — unless there is some particular social security law or tax reason resulting in an automatically reversionary pension being desirable.

On the other hand, consider the situation where the SMSF trustee does not want to pay the death benefit to the surviving spouse. It could be that the spouse is the member’s second spouse and the member has children from a prior relationship who are on adverse terms. Depending on how the member’s will, SMSF deed and related documents are drafted, it is possible that the children from the prior relationship will end up as SMSF trustees after the member’s death.

Assume that the children from the prior relationship no longer get on with their (now former) step-parent. The children might point to the rule against fettering discretion and say that any pension documents are invalid and that it would be wrong of them to blindly follow the reversion in those pension documents. Accordingly, they might choose to remake the decision as to whom the death benefits should be paid. Somewhat unsurprisingly, in these circumstances, children tend to pay the benefits to themselves; self-interest generally wins out.

Although there are some grounds on which the children’s action could be challenged by the spouse, the spouse would be facing an uphill legal battle.

Can a fetter ever be valid?

It is possible for a fetter to be valid. After all, a BDBN is really just a type of fetter. However, in order for such a fetter to be valid, the deed must allow for it. As Harman LJ stated in *Muir v Inland Revenue Commissioners*:⁶

“... if a power is conferred on trustees *virtute officii*, that is to say, if it is a trust power which the trustees have a duty to exercise, they cannot release [eg enter into a fetter] it *in the absence of words in the trust deed authorising them so to do.*”

Unfortunately, few SMSF deeds are written with clear enough provisions to successfully oust the prohibition on fettering.

Different types of reversionary pensions

There are two main types of reversionary pensions, namely:

1. a discretionary reversionary pension where there is no valid fetter in the SMSF deed that “locks in” the nomination of the reversionary beneficiary; and
2. an enforceable automatically reversionary pension supported by an SMSF that includes a valid fetter that satisfies the ATO’s criteria in TR 2013/5.

There are numerous SMSF deeds that provide a priority to a reversionary pension nomination over a BDBN in the event of conflict, for example, if the member’s pension nominates the surviving spouse but the BDBN nominates their estate (legal personal representative), the pension nomination wins out.

One of the risks of relying on this type of SMSF deed is that, as explained in this article, the pension documents themselves may not provide a binding pension nomination. Thus, the priority given to the pension nomination could itself be subject to challenge, resulting in the BDBN taking priority.

We therefore recommend that members seeking to rely on a reversionary pension nomination priority obtain confirmation that their pension nominations are valid and effective if they also have made a BDBN. Moreover, such members should also obtain confirmation that their BDBNs are valid and effective, as the reversionary nomination may undermine what is in their BDBN.

Advisers should also request their client to have a lawyer review and settle these documents so that they are consistent with the client’s wills and estate plans. In particular, advisers need to be aware when assisting clients in relation to estate planning, including reversionary pension nominations and BDBNs, not to overstep the line if they start providing legal services.

After many years of practical experience and assisting numerous clients in SMSF succession planning and legal disputes, DBA Lawyers generally recommends that an SMSF deed should provide clear priority to the BDBN. There should also be a conflict clause that provides certainty on what wins out in the event that there is a conflict between a reversionary pension nomination and a BDBN. Unfortunately, many SMSF deeds allow these matters to remain “ripe” for disputes.

Practical implications

There are several practicable take-aways that advisers should note.

First, pension documents alone are unlikely to implement an enforceable reversionary pension.

Second, if someone wants to implement an enforceable automatically reversionary pension, regard must be had to the wording of the SMSF deed, any BDBN and other related documentation.

Third, make sure that the SMSF documentation is provided by a quality supplier who has the relevant experience and qualifications to ensure that the documents are valid and effective (eg will the SMSF deed and pension documents facilitate an enforceable automatically reversionary pension that satisfies the criteria in TR 2013/5?).

Finally, and most importantly, it is critical to determine who will be controlling the SMSF on death. If someone who wishes to frustrate the wishes of the deceased is controlling the SMSF, regardless of whether there is binding and effective documentation in place, the rightfully entitled recipients might face a very difficult legal battle in obtaining their entitlements.

Daniel Butler, CTA

Director
DBA Lawyers

Bryce Figot, CTA

Special Counsel
DBA Lawyers

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Tax Cases

by Michael Norbury, CTA, Norbury Lawyers

Eichmann and storing on vacant land

How much use of an asset is needed before it becomes an active asset for the CGT small business concessions?

This article discusses how much “use” must be made of an asset before the small business concessions can apply to that asset.

Facts

The Eichmann family trust had, for many years, run a business of building, bricklaying and paving. Mr Eichmann and his wife were directors and shareholders of the trustee company and beneficiaries of the trust.

Mr Eichmann owned two adjoining parcels of land located at Mooloolaba in Queensland. Both parcels were purchased in 1997. Mr Eichmann’s family home was on one of the parcels. The other parcel had two 4 metre x 3 metre sheds, as well as a 2 metre high block wall and a gate to secure the property.¹

The usage of that parcel involved:²

- the two sheds were used for the storage of work tools, equipment and materials;
- the open space on the parcel was used to store materials that did not need to be stored under cover, including bricks, blocks, pavers, mixers, wheelbarrows, drums, scaffolding and iron;
- work vehicles and trailers were parked on the parcel;
- tools and items were collected on a daily basis; and
- in some cases, the parcel would be visited a number of times a day in between jobs, depending on what each job required.

The parcel was used mainly for storage, as work would be done on work sites³ but, on occasion, some preparatory work was done at the parcel in a limited capacity. There was no business signage on the parcel.

In October 2016, the parcel was sold for \$935,000. The business had an aggregated turnover of less than \$2m a year.⁴

Mr Eichmann and his wife sought a public ruling to the effect that the parcel of land which was sold was an “active asset” within the meaning of that expression in s 152-40(1)(a) of

the *Income Tax Assessment Act 1997* (Cth) (ITAA97). The Commissioner ruled that the parcel was not an active asset.

Mr Eichmann sought review by the AAT. The AAT substituted a decision, allowing Mr Eichmann’s objection in relation to the private ruling, and determined that the parcel of land which Mr Eichmann and his wife had owned was an “active asset”.⁵ The effect of that decision was that Mr Eichmann and his wife would be entitled to a concession in relation to the amount of capital gains tax payable on gains made by them on the sale of the parcel.

The Commissioner appealed pursuant to s 44 of the *Administrative Appeals Tribunal Act 1975* (Cth) from the tribunal’s decision to the Federal Court.

The issue

The case dealt with the small business relief found in Div 152 ITAA97. The court explained that, in the ordinary course, where a gain had been made as a result of a CGT event which occurred in respect of a non-depreciating asset of a business, such as land or buildings, shares or investments or intangible assets, the asset’s owner will generally be liable for CGT. Division 152 was intended to assist small businesses by creating an exception to the general rule.

Section 152-1 ITAA97 provided:³

“To help small business, if the basic conditions for relief are satisfied, capital gains can be reduced by the various concessions in this Division. Those basic conditions are in Subdivision 152-A. Some of the concessions have additional, specific conditions that must also be satisfied.”

Subdivision 152-C ITAA97 provided for a 50% reduction in CGT.⁴ However, Subdiv 152-A ITAA97 imposed some essential conditions for relief under Div 152. Section 152-5 identified the three basic conditions, two of which were relevant in this case. They were:⁶

- the entity must be a CGT small business entity or a partner in a partnership that is a CGT small business entity, or the net value of assets that the entity and related entities own must not exceed \$6,000,000; and
- the CGT asset must be an active asset.

Here, the question in issue was whether the parcel of land satisfied the “active asset” test. That test follows:⁷

“Section 152–35 Active asset test

- (1) A CGT asset satisfies the active asset test if:
 - (a) you have owned the asset for 15 years or less and the asset was an active asset of yours for a total of at least half of the period specified in subsection (2); or
 - (b) you have owned the asset for more than 15 years and the asset was an active asset of yours for a total of at least 7½ years during the period specified in subsection (2).
- (2) The period:
 - (a) begins when you acquired the asset; and
 - (b) ends at the earlier of:
 - (i) the CGT event; and
 - (ii) if the relevant business ceased to be carried on in the 12 months before that time or any longer period that the Commissioner allows—the cessation of the business.

Section 152-40(1) ITAA97 defined “active asset” as follows:⁸

“A CGT asset is an **active asset** at a time if, at that time:

- (a) you own the asset (whether the asset is tangible or intangible) and it is used, or held ready for use, in the course of carrying on a *business that is carried on (whether alone or in partnership) by:

...

- (iii) another entity that is *connected with you ...”

Consideration

The Commissioner identified what were said to be two questions of law arising from the AAT’s decision. They were:⁹

- whether, for the purposes of the “active asset test” in Subdiv 152-A, and on a proper construction of s 152-40(1) ITAA97:
 - it is sufficient for the characterisation of the land as an “active asset” to show that the land, owned by the taxpayer, was used for the purposes of a business carried on by an entity connected with the taxpayer in a manner that was no more than non-trivial and not insignificant; and
 - the words “is used, or held ready for use, in the course of carrying on a business” in s 152-40(1)(a) ITAA97 refer to a use that is integral to the process or processes by which the business is carried on; and
- whether the AAT exceeded its jurisdiction when it made findings of fact that were neither found in, nor inferences necessarily drawn from, the facts before it.

The parties agreed before the court that the central issue concerned the application of the active asset test, it being agreed that Mr Eichmann and his spouse otherwise satisfied the requirements of s 152-35 ITAA97.¹⁰

Parties’ arguments

The Commissioner submitted that, in order for an asset to satisfy the “active asset” test, its use must be an integral part of the relevant business. It was submitted that the concession for small business had been a feature of the CGT provisions since inception and the concept of an “active asset” has been a feature of the scheme since 1997. The Commissioner relied on the explanatory memorandum at the time the provisions were introduced. However, notwithstanding that speech and other arguments put on behalf of the Commissioner, the court held that the requirement that the asset was an “active asset” used, or held ready for use, in the course of carrying on a business remained an essential feature of the entitlement to a concession.¹¹

Despite the expansion of the concession and the introduction of the aggregation rules, the Commissioner submitted that the “active asset” test had not been diluted since its introduction in 1997.¹²

Mr Eichmann argued that the Commissioner’s submissions effectively sought to read into the definition of “active asset” in s 152-40(1) the additional requirement that the use of the asset was integral to the carrying on of the business, and such an exegesis was unwarranted. He referred to the oft-cited principles of statutory construction to the

effect that the task begins and ends with the words of the statute.¹³

Court’s analysis

While noting these principles, the court observed that it is often the case that the words used in statutory provisions are entirely free of either patent or latent ambiguity. This was particularly so with phrases which have a chameleon-like quality and which take their meaning from the context in which they are used. The court concluded that, to overcome that ambiguity and to give meaning to the words used, reference may be made to the context in which the provision was enacted. The court relied on *FCT v Consolidated Media Holdings Ltd*,¹⁴ where the plurality of the High Court emphasised this when their Honours said:¹⁵

“This Court has stated on many occasions that the task of statutory construction must begin with a consideration of the [statutory] text’ [*Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue*]¹⁶. So must the task of statutory construction end. The statutory text must be considered in its context. That context includes legislative history and extrinsic materials. Understanding context has utility if, and in so far as, it assists in fixing the meaning of the statutory text. Legislative history and extrinsic materials cannot displace the meaning of the statutory text. Nor is their examination an end in itself.”

The court held that the curial task was to construe the words employed by the legislature in the context in which they had been used. In this case, the history and context included the long-established concessions on CGT which were granted to small businesses in relation to active assets, being those which were utilised in the course of carrying on a business.¹⁷

The court noted that the asset under consideration was the whole 16.16 hectares of the parcel of land owned by the taxpayer. The taxpayer sought to reduce the gain arising on the disposal of the whole of the land for the purposes of CGT, even though only 10% of it was used for purposes related to the business. The court relied on *Council of the City of Newcastle v Royal Newcastle Hospital*¹⁸ and noted that the vacant land did not contribute to the business activities of the company, but part of it was used merely for storage and office facilities.¹⁹

In *Royal Newcastle Hospital*, the Judicial Committee favoured the view expressed by Taylor J in the High Court as to the concept of “use”, where his Honour had said (at 515):²⁰

“The word ‘used’ is, of course, a word of wide import and its meaning in any particular case will depend to a great extent upon the context in which it is employed. The uses to which property of any description may be put are manifold and what will constitute ‘use’ will depend to a great extent upon the purpose for which it has been acquired or created. Land, it may be said, is no exception and [the relevant statutory provision] itself shows plainly enough that the ‘use’ of land will vary with the purpose for which it has been acquired and to which it has been devoted. ... But where an exemption is prescribed by reference to use for a purpose or purposes it is sufficient, in my opinion, if it be shown that the land in question has been wholly devoted to that purpose even though, the fulfilment of the purpose does not require the immediate physical use of every part of the land.”

The court held that the observations of Taylor J were applicable to the definition of “active asset”. The purpose of the definition was to identify those assets which were used

in the carrying on of a business and, in respect of which, gains made on their disposal would not be subject to the full liability for CGT. There was nothing in the terms of the legislation which suggested that a taxpayer ought to be entitled to claim a CGT concession in respect of the gains made on the disposal of an asset where only part of it had been utilised in the carrying on of a business for the requisite time. The intent of Subdiv 152-A was to afford relief to small business operators by recognising that they frequently utilise their own assets or those of associated entities for the operation of their businesses and, where they have done so, the CGT burden arising on the subsequent disposal of such assets ought to be reduced.²¹

Where it was claimed that an asset had been used in the course of carrying on a business, such that the owner is entitled to a CGT concession in relation to the gains made on its disposal, it needs to be established that the whole, or predominantly the whole, of the asset had been so used. The characteristic of the asset which qualifies the gains made on its disposal for a concession is its use in the course of carrying on of a business. It would be an unusual construction were the legislature to have intended that a CGT concession would apply to all of the gains on the sale of an asset where only a small portion of it had been so used.²²

The court found that there was insufficient material before it to in fact expressly identify the extent to which the property was used for purposes associated with Eichmann & Sons' business. The size of the property was not identified, nor was there any indication of the proportionate areas covered by the sheds, used for storage areas, or used for car parking.²³

The court found that, while it could legitimately be said that the words employed in the scheme facts to describe the uses to which the land was put involved some ambiguity, at face value, they could be taken as indicating that all of the land was used for the identified purposes and no others. There was nothing which raised an inference to the contrary.²⁴

The court found, however, that it was not sufficient that the asset in question be used "in relation to" the course of carrying on a business or for purposes associated with the business. The requirement of the definition of "active asset" was that it be used "in the course of carrying on a business".²⁵

The court rejected the Commissioner's submission that, for the purposes of the "active asset" test, the asset's use must have some centrality to the business processes of the relevant entity.

However, the court accepted that the expression "used in the course of carrying on a business" required no more than that the asset was used by an entity which was carrying on a business. It was necessary that there was the existence of a direct relationship between the use to which the asset is put and the carrying on of the business. The requirement that the asset be used "in" the carrying on of the business, rather than merely "in the business" or of having some relationship to the business, indicated that the use must be in the activities of the business which are directed to the

gaining or production of assessable income. The asset must be used in the ordinary and common flow of the business transactions. The mere fact that there was a temporal connection between the carrying on of the business and the asset's use is insufficient,²⁶ and that is so even if there is some other connection between the use and the business which falls short of using the asset in the conducting of the business activities.²⁷

In essence, in order for an asset to be used "in" the course of carrying on a business, it is necessary for the use to have a direct functional relevance to the carrying on of the normal day-to-day activities of the business which are directed to the gaining or production of assessable income.²⁸

Here, there were no facts which disclosed that the identified uses of the land were part of the business activities of Eichmann & Sons directed to the gaining or production of assessable income. The business of the company was the provision of services in the nature of construction, bricklaying and paving, and the activities engaged in the course of that business would be those directed to the securing and performing of those services. To a large extent, that occurred on the work sites where the services were provided.²⁹

Conversely, the uses to which the land was put were preparatory to the undertaking of activities in the ordinary course of business. The property was used for the storage of materials for use by the company when it engaged in its business activities if those materials were required, but the storage itself was not an activity in the ordinary course of Eichmann & Sons' business. While it may have been a use of the land "in relation to" the carrying on of the business, it was not, of itself, an activity in the course of carrying on the business. There was no direct connection between the uses and the business activities, and the uses had no functional relevance to those activities. It followed that the land was not "used, or held ready for use, in the course of carrying on a business", and the Commissioner was correct to conclude that the land was not an active asset.³⁰

Conclusion and comment

The court has drawn a very fine line between assets used in a way which is preparatory to the conduct of activities in the ordinary course of business and those used in the ordinary course of business. In the context of a business described by the court as the business of the provision of services in the nature of construction, bricklaying and paving, and the activities engaged in the course of that business would be those directed to the securing and performing of those services, it is difficult to see how the use of land for the storage of materials and plant and equipment for use in that business can be described as "preparatory". Perhaps the issue lies in the intermittent nature of the use of the site. If the land had been used every day, could its use have been said to be preparatory to the conduct of the business, and would it not be used in the ordinary course?

Michael Norbury, CTA
Principal
Norbury Lawyers

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- 2 *Eichmann* at [12].
- 3 *Eichmann* at [13].
- 4 *Eichmann* at [14].
- 5 *Eichmann* at [2].
- 6 *Eichmann* at [15].
- 7 *Eichmann* at [16].
- 8 *Eichmann* at [17].
- 9 *Eichmann* at [26].
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- 11 *Eichmann* at [35].
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Alternative Assets Insights

by Luke Bugden and Nick Rogaris, PwC

Foreign superannuation funds and sovereign immunity

LCR 2019/D4 provides welcome guidance from the ATO on the new rules limiting concessions available to foreign superannuation funds and the newly codified rules for sovereign immunity.

On 4 December 2019, the ATO released LCR 2019/D4, providing guidance on the new rules limiting concessions available to foreign superannuation funds, and the newly codified rules for sovereign immunity that were enacted early last year.

The draft law companion ruling (LCR) provides guidance on some of the new concepts and definitions. In particular, the draft LCR contains guidance on the “influence test” (which has relevance to both the exemption for foreign superannuation funds and sovereign immunity) and guidance on the following new terms and definitions relevant to the sovereign immunity rules:

- sovereign entity group;
- return on public moneys;
- public financial entity and public non-financial entity; and
- “central banking activities” and “consular functions”.

While LCR 2019/D4 explains the Commissioner’s view on a limited number of new concepts, there are still a number of uncertainties and questions about the practical application of these rules by the ATO. This may mean that some entities will be required to seek private rulings from the ATO to confirm their eligibility to apply the exemptions.

Comments on the draft LCR are due by 21 February 2020.

In detail

New rules were enacted in April 2019 by the *Treasury Laws Amendment (Making Sure Foreign Investors Pay Their Fair Share of Tax in Australia and Other Measures) Act 2019* (the Act), which introduced additional eligibility conditions to access the dividend and interest withholding tax exemption applying to superannuation funds for foreign residents and a newly codified regime for sovereign immunity. Subject to the transitional rules, both of these measures apply to income derived on or after 1 July 2019.

The eligibility conditions in the foreign superannuation fund rules impose two additional requirements which must be met by superannuation funds for foreign residents seeking to be eligible for an exemption from withholding tax — the portfolio interest test and the influence test. The new codified sovereign immunity rules also introduce a portfolio interest test and an influence test. However, the new sovereign immunity rules impose these conditions on the “sovereign entity group”, rather than just the investor. The sovereign immunity rules also introduced additional restrictions on the type of investment that could be held, the type of activities that could be conducted by the investing entity, and the sources and uses of the moneys for the investment.

LCR 2019/D4 explains the Commissioner’s view on a number of these new concepts, which we discuss in further detail below.

The influence test (applying to the foreign superannuation fund and sovereign immunity rules)

LCR 2019/D4 provides that the influence tests introduced in the foreign superannuation fund and sovereign immunity rules are “almost identical”, identifying two sub-tests that need to be considered by taxpayers. These are discussed below.

Identity of decision-makers

LCR 2019/D4 indicates that the investor’s ability to determine the identity of the decision-makers of the test entity is a question of fact, and includes the mere right to make the decision, without having to have exercised that right at any time in the past or an intent to do so in the future.

The draft LCR provides that an indirect and direct right to influence the identity of a decision-maker would be relevant to this sub-test. The examples that follow highlight that it is important to understand the rights that are available to the investor in their own right, in addition to the rights that they may have based on aggregate investment thresholds with other investors under the constituent documents of the investment entity.

In LCR 2019/D4, the Commissioner acknowledges that the directors of a company usually make decisions on the control and direction of a company’s operations. However, the guidance provides that the class of persons who are decision-makers needs to be considered more widely, and is not restricted to directors. The class of persons should include any person who has a role in the high-level decision-making process or governance of a company and could include a member of an advisory committee or investment committee, where such a committee is required to approve the director decisions. Where this is the case, this may amount to influence.

The comments in the draft LCR make clear that the satisfaction of this requirement requires a broad analysis of the rights of the investors, potential rights of the investors under the constituent documents of the investment entity, and any direct or indirect ability to influence the control and direction of the entity. The introduction of such an important concept to underpin “influence” more generally was given very little additional guidance, so we expect that this will be a matter for which the ATO will need to provide further guidance.

Helpfully, the ATO provides that irrevocably and unconditionally waiving your rights to determine the identity of those who make decisions by way of a legally enforceable agreement indicates that you should not be “able” to determine those who make the decisions for the purposes of the influence test.

Influence through decision-makers

Relevant influence exists where a decision-maker of the investment entity would be accustomed or obliged to act, or might reasonably be expected to act, in accordance with the directions, instructions or wishes of the investor. LCR 2019/D4 provides that “the test for these purposes, requires something more than mere coincidence, but does not require control”.

The examples used by the Commissioner demonstrate that the influence test may not be satisfied even where the investor holds less than 10% of the interests in the investment entity. A specific example is provided where an investor has a representative on the advisory committee and the board of the investment entity habitually complies with the recommendations of the advisory committee, which indicates that the investor does have the requisite level of influence to fail the influence test.

As most of these advisory committees are in place for investor protection, it will be important to understand how the ATO will practically consider the role of the advisory committee (or similar).

A similar concept of “sufficient influence” has recently been considered by the Full Federal Court in *FCT v BHP Billiton Ltd.*¹ As this case is currently the subject of a High Court appeal, we can expect that the Commissioner’s guidance will continue to evolve (depending on the outcome of this appeal).

Sovereign entity group

LCR 2019/D4 provides guidance on determining a sovereign entity group. It is made clear that, given the various structures and levels of government that exist in different countries, a uniform approach cannot be provided for determining the relevant different parts of a foreign country. The example in the draft LCR provides that, in a scenario where a foreign country has three levels of government — federal, state and provincial — any sovereign entity of a specific state will be a member of the sovereign entity group. However, sovereign entities of other states or provinces within the same country will not be grouped with such a sovereign entity group.

The draft LCR notes that the various structures and levels of government globally mean that it is not possible to provide a uniform approach to this definition, which has the result that affected entities will need to engage further with the ATO.

Return on ...

Referring to para 4.37 of the explanatory memorandum to the Bill that enacted the new rules, LCR 2019/D4 merely restates that the return on a membership interest, debt interest or non-share equity interest held by the sovereign entity in the test entity (which is regarded as non-assessable non-exempt income) will also include returns that are passed through a managed investment trust (MIT), ie dividends (including non-share dividends, interest and revenue gains arising on

the disposal of interest in the test entity). It also provides that fund payments made by an MIT other than fund payments attributable to non-concessional MIT income will also be regarded as non-assessable, non-exempt income.

... public moneys

LCR 2019/D4 expresses the Commissioner’s view that the phrase “public moneys” means moneys of a foreign government (including tax revenue, and the proceeds from the issue of government bonds and the privatisation of assets) which are held for a public purpose and which would be accounted for in the foreign government (or part of a foreign government) equivalent to Australia’s Consolidated Revenue Fund (ACRF). This seems to require each sovereign country to consider its equivalence to the ACRF, and forming a uniform approach to this is challenging.

The examples in the draft LCR provide that public moneys will include funds out of prior-year budget surpluses of the foreign government, but will not include superannuation funds administered by a foreign government for its employees which are not equivalent to ACRF or the moneys that are transferred out of ACRF equivalent fund to such superannuation funds. The examples indicate that, where a sovereign entity is also a pension fund, the entity will not be funded solely by public moneys (where it is funded by a combination of employee and employer contributions). It follows that such entities would need to consider their eligibility to the exemption to withholding tax for superannuation funds for foreign residents instead of their eligibility to sovereign immunity.

LCR 2019/D4 also indicates that the Commissioner’s initial view is that public moneys will not include moneys obtained by foreign governments by way of third-party debt funding. With limited support as to how the ATO has come to this conclusion, and in view of the comment that funds raised by way of government bonds are public money, this comment raises more questions than it answers and requires clarity from the ATO. Sovereign entities will need to determine how these comments apply to their circumstances.

Public financial entity and public non-financial entity

Under the new provisions, a sovereign entity is only eligible for sovereign immunity where it is neither a “public financial entity” nor a “public non-financial entity”. The draft LCR provides common examples of public financial entities (including banks, deposit-taking financial corporations, captive financial institutions, pension/superannuation funds, insurance corporations and entities in the business of investment management, share trading or money lending) but provides limited additional guidance on what constitutes a public non-financial entity.

While LCR 2019/D4 provides guidance on the meaning of the term “principal” for the purposes of ascertaining the principal activity of the sovereign entity, ie the entity’s chief or foremost activity, the draft LCR does not currently include guidance on what it means to “trade” in financial assets and liabilities or to “operate commercially” in the financial markets.

“Central banking activities” and “consular functions”

LCR 2019/D4 provides that the activities carried out by Australia’s central bank provide a useful reference for the purposes of determining whether a public financial entity carries on central banking activities (which would exclude a sovereign entity from the “public financial entity” definition). Activities such as monetary policy development, issuing national currency, acting as a custodian of international reserves and providing banking services to government will be considered as “central banking activities”. However, a public financial entity that carries on both central banking activities and non-central banking activities (for example, commercial banking) will not be regarded as carrying on only central banking activities.

The draft LCR also provides examples of consular functions, namely, issuing passports and travel documents, helping and assisting nationals, acting as a notary and civil registrar and in capacities of a similar kind, certain functions of an administrative nature, and transmitting judicial and extrajudicial documents. Any income arising from such functions will be regarded as non-assessable, non-exempt income.

The takeaway

Foreign superannuation funds and sovereign entities should consider LCR 2019/D4 in light of their current and proposed investments, in particular noting:

- the satisfaction of the influence test requires a very broad analysis of the rights of the investors, including potential rights of the investors under the constituent documents of the investment entity, and any direct or indirect ability to influence the control and direction of the entity. It is also not limited to the composition of the board of directors but can extend to appointments to advisory or investment committees;
- helpfully, the ATO provides that irrevocably and unconditionally waiving rights to determine the identity of those who make decisions by way of a legally enforceable agreement indicates that you should not be “able” to determine those who make the decisions for the purposes of the influence test;
- where a sovereign entity is also a pension fund, that entity will not be funded solely by public moneys (where it is funded by a combination of employee and employer contributions). It follows that such entities would need to consider their eligibility to the withholding tax exemption for foreign superannuation funds for foreign residents instead of their eligibility to sovereign immunity;
- the draft LCR provides that the proceeds from the issue of government bonds should be public moneys, but sovereign entities that are funded with a mixture of government moneys and external debt will not satisfy the definition of a sovereign entity for the purposes of the exemption. As both sources of funding are in effect third-party debt sourced from private markets, further clarity will need to be sought on this;
- based on the current definition of public moneys, it appears that returns from existing investments that have

not been accounted for in the foreign government’s ACRF will not form part of public moneys. Further guidance will need to be sought to confirm whether profits, for example, in a wholly-owned special purpose vehicle, must be upstreamed to the sovereign entity and re-invested to satisfy this requirement. Ultimately, this may be driven by the sovereign entity’s own procedures as to whether profits from investments automatically form part of its budget/ACRF; and

- the definition of “public financial entity” in the law has been drafted widely, but limited guidance has been provided in the draft LCR. For example, it does not currently include guidance on what it means to “trade” in financial assets and liabilities, or to “operate commercially” in the financial markets.

LCR 2019/D4 is welcome guidance from the ATO as it explains the Commissioner’s view on a range of new concepts. However, there are some issues that have not been addressed, and questions remain about the practical application of these rules and the positions that have been taken by the ATO which were unexpected. If further clarification is not provided in the finalised ruling, taxpayers may be left in a similar position as they were prior to the codification of these rules and continue to be required to seek private rulings with the ATO to confirm their eligibility to apply for the exemption.

Luke Bugden

Partner
PwC

Nick Rogaris

Partner
PwC

Reference

- 1 [2019] FCAFC 4.

Events Calendar

March/April 2020

STATE / EVENT	DATE	CPD
National		
The Tax Summit 2020	11/3/20	20
Queensland		
Young Tax Professionals — Toowoomba	18/3/20	1.5
Women in Tax Lunch — Brisbane	23/3/20	2
Tax Discussion Group — Gold Coast	25/3/20	2
2020 Agribusiness Intensive	2/4/20	13
South Australia		
SA Tax Foundation Seminars	18/3/20	6
Essential Business Series — Session 1	25/3/20	1
SA Super Day	27/3/20	6.5
Tasmania		
Tax Insights with Ron Jorgenson — Launceston	2/4/20	2.5
Tax Insights with Ron Jorgenson — Hobart	3/4/20	2.5
Victoria		
Breakfast Club — Melbourne	19/3/20	1.5
Breakfast Club — Geelong	20/3/20	1.5
Young Tax Professionals — Melbourne	20/3/20	1
Victorian Superannuation Intensive	26/3/20	6
Western Australia		
Tax Updates Breakfast Series — Session 1	18/3/20	1.5
Corporate Tax Series — Individual Subscription	18/3/20	4
Corporate Tax Series — Company Subscription	18/3/20	4
WA Corporate Tax — Series 1	18/3/20	1
WA Superannuation Intensive	26/3/20	9.5

For information on upcoming events, visit taxinstitute.com.au/cpd.

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General Manager, Knowledge and Learning

Alexandra Wilson

Managing Editor

Deborah Powell

Content Consultant

Bob Deutsch

Graphic Designers

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Nicole Welch

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Contacts

National Council

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Todd Want, CTA

National Office

CEO: Giles Hurst
Level 37, 100 Miller Street
North Sydney, NSW 2060

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

State Offices

New South Wales and ACT

Chair: Rae Ni Corraidh, CTA

Manager: Leanne Carter
Level 37, 100 Miller Street
North Sydney, NSW 2060

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

Victoria

Chair: Fiona Knight, CTA

Manager: Brian Martin
Level 3, 530 Collins Street
Melbourne, VIC 3000

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

Queensland

Chair: John Ioannou, CTA

Manager: Paula Quirk Russo
Level 11, Emirates Building
167 Eagle Street
Brisbane, QLD 4000

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

Western Australia

Chair: Bill Keays, CTA

Manager: Brian Martin
Level 10, Parmelia House
191 St Georges Terrace
Perth, WA 6000

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

South Australia and Northern Territory

Chair: Peter Slegers, CTA

Manager: Craig Spurr
Ground Floor, 5-7 King William Road
Unley, SA 5061

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

Tasmania

Chair: Ian Heywood, CTA

Manager: Craig Spurr
Level 3, 530 Collins Street
Melbourne, VIC 3000

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



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