THE JOURNAL FOR MEMBERS OF THE TAX INSTITUTE

Taxation in Australia

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THE TAX INSTITUTE

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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

June – what happened in tax?

The following points highlight important federal tax developments that occurred during June 2020. A selection of the developments is considered in more detail in the "Tax News – the details" column on page 5 (at the item number indicated).

Instant asset write-off

In a joint media release on 9 June 2020, the Treasurer announced that the $150,000 instant asset write-off will be extended for six months to 31 December 2020.

Foreign investment mischaracterisation

The Commissioner has issued a taxpayer alert in relation to cross-border arrangements that mischaracterise the structure used by foreign investors to invest directly into Australian businesses (TA 2020/2). **See item 1.**

Non-arm's length income: superannuation entities

The Commissioner has released a practical compliance guideline that provides a transitional compliance approach for a complying superannuation entity concerning the application of the amendments made in 2019 to the definition of non-arm's length income (s 295-550 ITAA97) (PCG 2020/5). **See item 2.**

JobKeeper: payment turnover test

The Commissioner has issued a law companion ruling about the decline in turnover test which is one of the criteria for determining eligibility for the JobKeeper payment (LCR 2020/1). **See item 3.**

Existence of partnership not established

The AAT has held that the taxpayer had failed to establish that he and his former spouse were carrying on a business in partnership during the 2012 income year and he, therefore, was not entitled to claim as a deduction a portion of the loss made by the business for that income year (*Holman and FCT* [2020] AATA 1375). **See item 4.**

Tax agent deregistration: stay issues

There are an increasing number of decisions of the AAT that have considered the issue of the grant of a stay of a decision of the Tax Practitioners Board to terminate the registration of a tax agent. Brief details of recent decisions are discussed. **See item 5.**

Allowable deductions: class action fund

The Full Federal Court has affirmed a decision of Middleton J that costs and expenses incurred by a scheme administrator of a class action settlement fund were not allowable as general deductions against the interest income of the fund (*Watson as trustee for the Murrindindi Bushfire Class Action Settlement Fund v FCT* [2020] FCAFC 92). **See item 6.**

President's Report

by Peter Godber, CTA

The new normal and our hope to get there soon

The new economic environment, future tax policy, and the wellbeing of our community.

We are all wondering a little bit about what work life will look like in 2021. Remote activity will be more of the norm, and flexible work environments more embedded in our culture. Hopefully, we will all find the balance in our work environment that suits us best.

Economically, there is also a lot of uncertainty and plenty of hope that we can return to normality as quickly as possible. However, the economy is in recession territory, and forecasts from economists will contain important messages about the speed of our return to normal.

From a revenue viewpoint, there is widespread concern about how Treasury will respond to the country's debt burden. The discussion often turns to tax collections, which have understandably slowed in 2020. Many taxpayers have accessed flexible tax debt recovery arrangements, including deferrals and extended payment plans.

However, this can only last for so long, and advisers will be called on to help clients who face imposing tax debt. Tax advisers have a productive role to play here in helping to find solutions when tax is the debt and a revenue authority is the creditor.

Given the very unusual and extraordinary position that the economy finds itself in, surely we have a fresh opportunity to proactively look at tax reform measures across all levels of government. If there is not a will to change, we risk being left with the same old debate. But I would hope that we can lever off the feeling of collaboration that many of us sense at present, across business and government, to focus on the future with better intent.

At The Tax Institute, we will be encouraging the nation's tax policy leaders to take this opportunity. With our own enhanced Tax Policy and Advocacy team, we aim to be leaders in the debate. We keep saying that we are all in this together to make things better; well, it is a pressing issue again.

Smaller "P" policy issues always remain on our agenda. Once again, the taxation of capital gains made by trusts is in the spotlight with the decision in *Peter Greensill Family Co Pty Ltd (trustee) v FCT*.[1] It makes one reflect on how the international tax treatment of trusts has changed over the last 15 years. It is not easy to follow. Understanding the law is hard enough. Understanding the underlying policy and reflecting on if and how our law might be improved for the future must also remain on our watch. Capital gains tax, trusts and residency — no better examples.

To our members and education candidates

Stepping back from that policy picture, but also thinking of the future, I'd like to note the recent work of our education candidates. While we have been adjusting to a remote work life and learning more about online communication, students in our education program have lifted their effort to complete study in eight subjects, and then sit examinations, all using remote technologies. Studying in this environment is particularly challenging, and it may be based in home offices or at kitchen tables. Our congratulations go out to all who have given their best, with hard work and resilience, to complete these subjects.

Thanks, and appreciation, also go to our wonderful internal Knowledge and Learning team who oversaw the educational delivery. At The Tax Institute, we take pride in the quality of our tax education. Though the new technology posed some challenges, it is very pleasing to see the way our team adapted to those technological challenges and saw this study period through to completion.

To our members, June and July will have seen many swamped by waves of client demands, and the tax compliance burden at its peak. This year, 2019 tax return deadlines have been overlayed with 2020 year end planning. This has been followed by an immediate demand for early lodgment of 2020 tax returns, with many clients wanting early access to tax refunds, maybe after taking advantage of tax deduction incentives. The ATO is warning of system stresses, and to be cautious not to jump too early if you don't have all tax return information available, or if you are waiting for the ATO tax return pre-filling, as that won't be completed until later in July.

Again, we express concern for the wellbeing of our members. It is wonderful to have seen the rapid response to our online health and wellbeing seminars. Moving beyond tax technical matters, The Tax Institute holds personal member wellbeing as a high priority issue, and we look forward to providing more information and open forums in this area for the benefit of members.

We are at the end of membership renewal time. I encourage you to think about how you can best engage in the activities of The Institute in the year ahead. For example, you can contribute to our journals, volunteer to speak at or help with events, and volunteer to be on committees. Generally, you should always look out for the work we are doing locally and participate where you can. Our organisation is built on the work of wonderful volunteers, just like you. Be engaged and get the benefit. But most of all, as we move into a new financial year and a new "normal", stay healthy and well.

Reference

1 [2020] FCA 559.

CEO's Report

by Giles Hurst

We are your biggest fan: advocacy "sans frontières"

What we are doing to advocate for our community, in tax policy and beyond.

As we head into a new financial year, let me start with a look back at the last few months. I am immensely proud of how far we have come — as an organisation and as a community. Recent times have been challenging for all of us, but with the help of our network of passionate and generous volunteers, I believe we have come through in good shape, and certainly stronger, as a result of what we have experienced together.

We are listening closely to members to ensure that our response to COVID-19 is appropriate and fulfills your needs. Member feedback and a genuine desire to ease the pain points of tax professionals have always been at the heart of the Institute's mission, but this has fuelled our activity in recent months more so than ever.

As you know, we recently brought on board two new team members at The Tax Institute, both with significant credentials: Robyn Jacobson, CTA, as Senior Advocate, and Andrew Mills, CTA (Life), as Director, Tax Policy and Technical.

Robyn brings with her 30 years of tax experience and a proven focus on the SME community. Her insights are proving to be vital at a time when Australian businesses need the support of tax professionals. I was thrilled to read the recent *TaxVine* preambles and the JobKeeper breakdown authored by Robyn. This brand of competent and empathetic analysis is what members need during these uncertain times, and I am confident that members are in good hands with Robyn's decision to join our team.

I am equally excited by the insight and expertise that Andrew brings to the Institute – he is certainly a powerful new voice for policy and advocacy within our ranks. Andrew previously served as president at The Tax Institute in 2006-07, and we are absolutely thrilled to be able to draw on his experience now in a different and very concentrated capacity. With more than 40 years' expertise in law interpretation and dispute prevention and resolution as Second Commissioner at the Australian Taxation Office, Andrew's contribution to the next phase of our development has only just begun.

Our team has also been developing expert-led, timely webinar events to support our community. From superannuation to private business, our swift move to online events was made possible in large part by our incredible volunteers and has allowed us to continue to offer insight and professional development opportunities to all members.

Our COVID-19 stimulus package webinar series has now concluded — though keep in mind that each session is still available free to all members in case you need or wish to revisit them. This series was born out of a desire to help untangle the emerging stimulus rules and regulations, but it grew substantially through feedback and passionate engagement from those who attended. We used later instalments of the series to address pressing concerns raised by our community. The collaborative spirit of these events was inspiring, and I feel that a lot of important knowledge and insight was gained throughout. I hope you do too.

To follow up this tax technical series, in June we launched a new, member-only health and wellbeing webinar series, as Peter mentioned in his President's Report. The response to this series was overwhelmingly positive. While the series is a departure from our usual tax technical events, I believe it is a very welcome, relevant and important one. It is led by coaching and psychology experts and covers topics such as dealing with stress in our own lives and professional practice and supporting clients and staff who are dealing with the same.

The initial three sessions, scheduled throughout June, reached registration capacity within 24 hours. In response, we have scheduled additional dates for these events, which will take place throughout July.

The success of this initiative really shows that the topic of health and wellbeing is of great importance to not only our members, but also to Tax Institute staff.

Thank you to the enormous number of members who are choosing to renew their Tax Institute membership earlier than ever this year – this helps us to action everything in a timely manner ahead of 30 June.

There are significant issues and opportunities ahead for the tax profession, and our community will be stronger if we ensure that we have one voice in the future debate on tax — we hope to have you with us on that journey.

Tax Counsel's Report

by Stephanie Caredes, CTA

A united front from the tax profession

In this month's column, tax counsel Stephanie Caredes considers the value that the united front among representatives of the tax profession has brought during the coronavirus crisis.

In the May 2020 issue of *Taxation In Australia*, senior adviser Bruce Quigley wrote in his article "We're all in this together" of the work that The Tax Institute has undertaken jointly with Chartered Accountants Australia and New Zealand, the Corporate Tax Association, CPA Australia, the Institute of Public Accountants and the Law Council of Australia on policy and administrative initiatives that would further ease the burden on businesses, employees and tax practitioners during the coronavirus crisis.

While life has calmed down somewhat and most of us have settled into a new normal following the significant changes to the way businesses, and society more broadly, are now functioning, the joint work of the abovenamed associations continues. It is this united front from the representatives of the tax profession that is making the difference for tax professionals in this difficult time. Working together to effect change for all of our members, to find ways to relieve the pressure points bearing down on tax professionals and to smooth out the rough edges of rushed legislation (albeit by force of circumstance), is what forming a united front has been all about.

Lodgment deferrals

The associations jointly worked on getting a blanket deferral for all outstanding 2019 lodgments as we could all see the immense pressure that our members were under in having to advise their clients on the influx of new stimulus package measures, in particular the JobKeeper and cash flow boost schemes. Tax professionals were caught up trying to help their clients access the money from these schemes while managing pressing lodgments that were due amidst the chaos on 15 May 2020 and 5 June 2020. A second joint submission was lodged on 21 May 2020.

Resulting from not only this submission, but also from many negotiations by myself and representatives from the other associations with senior ATO officers was a "win" in the form of no late lodgment penalties applying if returns were lodged by 30 June 2020 and no impact on tax agent performance percentages under the lodgment program.

The balancing act here involved finding the best way to alleviate some of the pressure from the lodgment dates on tax professionals without creating a snowball effect that pushed the pressure further down the line to other lodgment dates close by — that would not have been a good outcome.

Division 7A

A joint submission was lodged on 26 May 2020 for Div 7A, again asking the federal Treasurer to make an announcement further delaying the start date of the 2018-19 Budget measure entitled *Tax Integrity — clarifying the operation of the Division 7A integrity rule* from 1 July 2020 (already delayed from 1 July 2019) to 1 July 2022. We also requested that thorough consultation on this measure occur before it is implemented.

By the time you read this, 1 July 2020 will have passed, and I hope that we will have seen an announcement further delaying the start date of this measure. Such an announcement will provide certainty to taxpayers affected by the measure.

R&D tax incentive

Also with the aim of obtaining certainty, a joint submission was lodged on 5 June 2020 in relation to the R&D tax incentive. At the time of writing, the Treasury Laws Amendment (Research and Development Tax Incentive) Bill 2019 was before the Senate Standing Committee on Economics. The Committee's review had been postponed due to the coronavirus crisis, with its report not due until 7 August 2020. This is not such great timing, as the measure was due to apply from 1 July 2019!

Again, the joint bodies requested:

- that R&D tax claims made in relation to the 2019-20 and 2020-21 income years will be subject to the current enacted legislation; and
- that the start date for Treasury Laws Amendment (Research and Development Tax Incentive) Bill 2019 will be deferred until 1 July 2021.

By the time you read this, I hope we will have seen an announcement giving effect to the above.

Superannuation guarantee amnesty

The joint bodies have also written to Senator Jane Hume requesting that the end date for the superannuation guarantee (SG) amnesty period (due to end on 7 September 2020) be extended to 7 March 2021 in light of the crisis. In addition, a request was made to permanently extend the Commissioner's discretion to reduce "Pt 7 penalties" beyond the end of the SG amnesty period, particularly as many businesses are currently facing cash-flow problems and are likely to have great difficulty meeting their general SG obligations.

Such is the value of the united front, an additional body, the Self-managed Independent Superannuation Funds Association, also signed up to this submission.

The value of the united front formed by the joint bodies facing this crisis cannot be underestimated. Our intention is that, even when we are no longer facing a crisis, the united front continues.

Tax News – the details

by TaxCounsel Pty Ltd

June – what happened in tax?

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

The Commissioner's perspective

1. Foreign investment mischaracterisation

The Commissioner has issued a taxpayer alert in relation to cross-border arrangements that mischaracterise the structure used by foreign investors to invest directly into Australian businesses (TA 2020/2).

Relevant arrangements typically display one or more of the following features:

- the Australian resident entities are unable to obtain capital from traditional external debt finance sources on normal terms;
- the foreign investor either already participates in the management, control or capital of the Australian entity at the time of investment, or starts to participate in the management, control or capital as part of the investment;
- the investment has features that are not consistent with vanilla debt or equity investments; and
- the investment may provide the foreign investor with direct exposure to the economic return from a particular business or assets exploited therein (whether ongoing profit or a gain on disposal).

The ATO will review the tax characterisation adopted by the taxpayer and test its appropriateness having regard to the factual circumstances, relevant tax laws and applicable tax treaties.

The ATO will consider applying the general anti-avoidance rules (Pt IVA of the *Income Tax Assessment Act 1936* (Cth) (ITAA36)) in circumstances where arrangements are contrived (including, in the case of significant global entities, by diverting profits) to reduce the amount of taxable income, or the amount of withholding tax payable by a taxpayer. The general anti-avoidance rules may apply where a tax benefit or a diverted profits tax benefit is obtained in connection with these arrangements.

Also, the ATO will consider applying the *Income Tax Assessment Act 1997* (Cth) (ITAA97) transfer pricing provisions where parties are not dealing wholly independently in relation to the terms or conditions of the arrangements, including as they affect amounts deducted by the Australian entity in connection with the arrangements.

2. Non-arm's length income: superannuation entities

The Commissioner has released a practical compliance guideline that provides a transitional compliance approach for a complying superannuation entity concerning the application of the amendments made in 2019 to the definition of non-arm's length income (s 295-550 ITAA97) and which apply where a superannuation entity incurs certain non-arm's length expenditure in gaining or producing ordinary or statutory income (PCG 2020/5).

Section 295-550 ITAA97 sets out rules as to when a complying superannuation fund (or a complying approved deposit fund or a pooled superannuation trust) will derive non-arm's length income (NALI). Amendments to the section made by the *Treasury Laws Amendment (2018 Superannuation Measures No. 1) Act 2019* mean that NALI may be derived in circumstances where the entity incurs "non-arm's length expenditure". The amendments first apply in relation to income derived in the 2018-19 income year, regardless of whether the scheme was entered into before 1 July 2018.

In LCR 2019/D3, the Commissioner expressed the preliminary view that certain non-arm's length expenditure incurred by a complying superannuation fund may have a sufficient nexus to all ordinary and/or statutory income derived by the fund for that income to be NALI (for example, fees for accounting services). This can be contrasted to non-arm's length expenditure that has a more direct nexus to particular ordinary or statutory income derived by the fund (for example, expenditure relating to the acquisition of an income-producing asset).

The ATO recognises that trustees of complying superannuation funds may not have realised that the amendments will apply to non-arm's length expenditure of a general nature that has a sufficient nexus to all ordinary and/or statutory income derived by the fund in an income year. Also, the amendments apply in relation to the 2018-19 and later income years which may result in all income derived by a fund during the 2018-19 and 2019-20 income years being classified as NALI where it has incurred non-arm's length expenditure of a general nature.

The practical compliance guideline states that, pending the finalisation of LCR 2019/D3, the ATO considers it appropriate to apply a transitional compliance approach. Under that approach, the ATO will not allocate compliance resources to determine whether the NALI provisions apply to a complying superannuation fund for the 2018-19, 2019-20 and 2020-21 income years where the fund incurred non-arm's length expenditure (as described in para 9 to 12 of LCR 2019/D3) of a general nature that has a sufficient nexus to all ordinary and/or statutory income derived by the fund in those respective income years (for example, non-arm's length expenditure on accounting services).

This transitional compliance approach does not apply where the fund incurred non-arm's length expenditure that directly related to the fund deriving particular ordinary or statutory income.

3. JobKeeper: payment turnover test

The Commissioner has issued a law companion ruling about the decline in turnover test which is one of the criteria for determining eligibility for the JobKeeper payment (LCR 2020/1).

This test requires an entity to calculate "current GST turnover" and "projected GST turnover" as defined for GST purposes but subject to modifications to those definitions by the rules that apply for the purposes of the JobKeeper payment rules.

To assist in working out whether the decline in turnover test is met, the ruling covers the following:

- step A: what supplies are relevant when calculating projected GST turnover and current GST turnover;
- step B: how supplies are allocated to relevant periods;
- step C: how you determine the value of each supply that has been allocated to a relevant period; and
- the ATO compliance approach, which effectively allows step B and step C to be worked out at the same time.

The ruling sets out the Commissioner's view of the law, and if it is followed in good faith, it will be administratively binding on the Commissioner. The ruling also recognises that the application of the law may be practically difficult for certain entities depending on their circumstances, and that those circumstances will vary considerably between entities. Accordingly, the ruling also sets out practical compliance approaches which can be applied by an entity to calculate its turnover.

It is explained that the ruling supplements guidance on the ATO website in relation to the payments and benefits rules. It is not the ATO's intent to focus compliance resources on circumstances where an entity has already used guidance on the ATO website in good faith to determine whether the decline in turnover test is satisfied. The reason for the ruling is that the ATO is continuing to receive questions about some aspects of the decline in turnover test that require further explanation in an appropriate product. The ruling is intended to assist those who have not yet applied the test and are still considering whether they are eligible for JobKeeper. The ruling is not, however, intended to provide comprehensive advice on all aspects of the payments and benefits rules.

It may be noted that the ruling is only administratively binding on the Commissioner. It can not be made legally binding as the provisions on which it provides advice are not within the legally binding framework for public rulings.

The Commissioner has also released guidance on key elements of the modified decline in turnover test for certain group structures.

Recent case decisions

4. Existence of partnership not established

The AAT has held that the taxpayer had failed to establish that he and his former spouse were carrying on a business in partnership during the 2012 income year and he, therefore, was not entitled to claim as a deduction a portion of the loss made by the business for that income year (*Holman and FCT*[1]).

In 2011, the taxpayer's then spouse registered an Australian business number and business name for a clothing retail business under the name "Sansisterz Boutique" (the business). She also registered the business for GST.

On 9 October 2012, the taxpayer wrote to the ATO requesting a private ruling as to whether his spouse's retail outlet business was being operated in a partnership with himself. Ultimately, the ruling that issued was adverse to his contentions and the Commissioner assessed the taxpayer for the 2012 income year on the basis that there was no partnership. The taxpayer unsuccessfully objected and, on review, the AAT affirmed the Commissioner's objection decision.

Some points made by the AAT are:

- joint ownership of assets and joint liability for debts are indicative of a partnership. There was no evidence before the tribunal concerning the business' assets in the 2012 financial year;
- the business name was registered solely in the name of the taxpayer's then spouse which was not indicative of the business being conducted as a partnership;
- the relevance of a joint bank account is that it demonstrates whether the profits and losses of the business are being shared, which is a key feature of a partnership. There was, however, no evidence that the bank considered that the business was being operated in partnership and no bank statements were in evidence;
- the taxpayer said that he provided the funds to purchase the business, but no records relating to the transaction were provided;
- very limited business records had been provided. The taxpayer relied on a credit application made by the business in July 2011. Part of the credit application form required the business to indicate the structure of the business. The options available for selection included sole trader, partnership or company, and "sole trader" was selected;
- a retail lease form provided that the tenant was the former spouse "Trading as Sansisterz Boutique"; and
- the registered business name was in the former spouse's name only.

5. Tax agent deregistration: stay issues

There are an increasing number of decisions of the AAT that have considered the issue of the grant of a stay of a decision of the Tax Practitioners Board to terminate the registration of a tax agent. Brief details of recent decisions are given below.

Birdseye

Stays were refused by the AAT in *Birdseye and Tax Practitioners Board*.[2] In concluding that no stay should be granted, the AAT said that it was not satisfied that it was desirable to grant the stays, even on the conditions sought by the applicants (a corporate tax agent and an individual).

In particular, the material before the tribunal did not provide a foundation for concluding that the applicants had reasonable prospects in the substantive reviews of having the terminations set aside — or at least the period of prohibition against re-applying for registration reduced

to a period that would be shorter than that likely to be required by the tribunal's final decision on the substantive reviews — militated against granting the stays. That, in turn, was supported by the fact that, on the material before it, the tribunal could not have a reasonable level of confidence that the applicants would comply with registration requirements during the period of any stays.

Cross

Stays were also refused by the AAT in *Cross and Tax Practitioners Board*.[3] The board had terminated the registration of an individual and of a partnership in which he was a partner (along with another registered agent) and had imposed a two-year period during which reregistration could not be sought.

The conduct that formed the basis of the termination decisions was that the applicant had lodged at least 125 self-managed superannuation fund annual returns prior to audit and there were eight funds that had not been audited for 10 years or more.

In declining to grant a stay, the tribunal accepted that the applicants, and others, would suffer financial loss as a result of the termination decisions coming into effect and that this weighed in favour of the grant of the stays, as did the possibility of the partnership's substantive application being rendered nugatory (because the partnership would cease to exist). However, the tribunal was not persuaded, on the material presently before it, that the applicants' prospects of success in their substantive applications were sufficient to justify the granting of the stays. Also, the public interest weighed against the grant of the stays. The factors weighing against the grant of the stays outweighed those in favour.

Cvek

A stay was, however, granted by the tribunal in *Cvek and Tax Practitioners Board*.[4]

The board had terminated the registrations of an individual and had imposed a four-year period during which reregistration could not be sought.

The applicant had conducted his professional activities through two corporate entities which were struck off or liquidated before he became a sole practitioner. The entities had a history of compliance breaches, breaches of remission of withholding obligations, and the non-payment of tax. A related practice entity also failed to comply with payment demand letters and to pay taxation liabilities.

On the other hand, breaches of the Code of Professional Conduct dealing with competence had not been alleged and it was in the interests of the applicant's clients and his dependants that he be able, if he wished, to be employed by another registered practitioner acceptable to the board (and, practically, to his clients) until the finalisation of the application for review.

The tribunal said that, notwithstanding the reservations about the seriousness of the repeated instances of unpaid tax liabilities, it was desirable to order a conditional stay of the board's termination decision. The tribunal found that a stay order should be granted but only on such terms that would protect the public interest until the hearing of the appeal. The stay was made conditional on the applicant not providing any tax agent services, other than as an employee of a registered practitioner approved by the board consistent with an order that might otherwise have been made pursuant to s 30-20(1)(b) of the *Tax Agent Services Act 2009* (Cth).

An application by the applicant pursuant to s 35 of the *Administrative Appeals Tribunal Act 1975* (Cth) for confidentiality orders to be made in relation to the matter was refused.

Kyriacou

A limited stay was granted by the tribunal in *Kyriacou and Tax Practitioners Board*.[5] The board had terminated the registration of an individual and of a company of which she was the sole director and the nominated supervising registered tax agent.

The tribunal considered that, on the material currently before it, it was not satisfied that it was appropriate at this point to stay the decisions until the final determination of the reviews. Rather, the decisions should be stayed for the period of eight weeks sought by the applicants, which struck a reasonable balance in the particular circumstances, mitigating the risk to clients and the integrity of the tax agent registration regime. During that period, some of the extant difficulties (an undetermined objection by the individual applicant against large assessments, along with the interaction between issues raised in the objection and the tax affairs of associated companies; the apparent errors in the materials put to and considered by the board and referred to in the board's reasons for its decisions; and the unparticularised nature of the allegations regarding the tax affairs of clients) might be clarified.

The stays were made by the tribunal subject to conditions for the protection of the public interest, including a condition that the applicants not undertake tax agent services for new clients during the period of the stays. This would provide protection for potential new clients but not for existing clients. A further condition was that, before providing any new or continuing tax agent services to existing clients, the applicants must advise the client in writing that: the applicants' registrations had been terminated; the applicants had applied to the tribunal for review of the termination decisions; and the implementation of the terminations had been stayed by the tribunal for a period of eight weeks.

Mavrokokki

A stay was granted by the tribunal in *Mavrokokki and Tax Practitioners Board*[6] where the board had terminated the registrations of an individual and had imposed a one-year period during which reregistration could not be sought.

The tribunal said that the fundamental difficulty with not granting a stay was that it was unlikely that the substantive review application would occur within the next 12 months, being the period of the sanction imposed on the applicant. If the applicant were to be ultimately successful, this would result in the sanction being imposed in any event, thus undermining the effectiveness of the review process.

In the circumstances and on the evidence before it, the tribunal was satisfied that a conditional stay was necessary to secure the effectiveness of the review process. The conditions imposed were that the applicant:

- was not to engage or take on any new clients;
- was to notify all of his existing clients and employees within a specified time by letter or email of the board's termination decision and that this decision had been stayed by the tribunal pending final determination of the applicant's appeal to the tribunal; and
- provide to the board evidence of each and every such notification sent within 14 days of the date of the tribunal's order.

6. Allowable deductions: class action fund

The Full Federal Court (Kenny, Davies and Thawley JJ) has unanimously affirmed a decision of Middleton J at first instance that costs and expenses incurred by a scheme administrator of a class action settlement fund were not allowable as general deductions against the interest income of the fund (*Watson as trustee for the Murrindindi Bushfire Class Action Settlement Fund v FCT*[7]).

A class action was commenced in August 2012 in the Victorian Supreme Court on behalf of the victims of the Murrindindi Bushfire (one of the "Black Saturday" bushfires) against AusNet and others. Maurice Blackburn acted as the solicitors for the representative plaintiff, with Mr Watson being the principal with carriage of the matter.

On 6 February 2015, the parties agreed to settle the proceeding by entering into a deed of settlement which was subsequently approved by the Supreme Court. The deed of settlement provided that the defendants would pay amounts totalling $300m, inclusive of costs, to a "reserve fund" within 90 days and, once the deed of settlement was approved by the Supreme Court and the plaintiffs' legal costs and disbursements (approximately $20m) were paid out, the remainder of the reserve fund (approximately $280m, being the "distribution sum") would be transferred to an interest-bearing bank account opened by Maurice Blackburn for the purposes of ultimate distribution to group members.

The terms of the deed of settlement and the associated settlement distribution scheme (the SDS) did not require Mr Watson, when acting in his capacity as scheme administrator (being the "taxpayer"), to derive a return on the distribution sum or for the fund. Indeed, the taxpayer's only responsibility in respect of the investment or financial management of the distribution sum was to deposit it in an interest-bearing bank account. In this respect, the terms of the SDS were very prescriptive: aside from choosing between various Australian banks and different deposit terms, the taxpayer was contractually obliged to invest the fund by depositing the distribution sum in an interest-bearing bank account with an authorised deposit-taking institution.

In keeping with the approach that he had applied to previous scheme administrations, the duties carried out by the taxpayer included:

- ongoing development, implementation and monitoring of internal processes for assessing claims, including the development of IT system requirements and infrastructure and the recruitment, training and supervision of administrator staff;
- delegating to staff the responsibilities to perform the functions necessary and convenient for the efficient implementation of the SDS;
- engaging barristers, medical practitioners and processional loss assessors or adjustors to assist in the assessment of claims;
- managing and administering the fund, including estimating costs and the process for distribution;
- liaising with organisations regarding workflow and assessment rates, and the taxation of interest accrued on the distribution sum;
- implementing practices to monitor and estimate the costs of administering the fund; and
- investing the distribution sum while the assessment of claims proceeded.

The outgoings incurred by the taxpayer in the course of administering the fund totalled $4,341,327. The outgoings were comprised almost entirely of Maurice Blackburn staff costs in relation to a variety of different tasks. The outgoings were also made up of other professional fees paid to legal counsel, medical practitioners and loss assessors who were also engaged to assist in the administration of the fund.

All of the costs of administering the fund that were approved by the Supreme Court were to be paid from the interest on the distribution sum as the first port of call.

The taxpayer lodged an income tax return for the relevant income year in which he declared the interest Income ($8,355,722) but did not claim any deductions for the outgoings. The Commissioner assessed the taxpayer on the basis that s 99A ITAA36 applied. The taxpayer objected to the assessment on the ground that he was entitled to deduct the outgoings from the interest income which would in turn reduce the fund's tax liability. On 1 March 2018, the Commissioner issued an objection decision disallowing the taxpayer's objection in full.

Middleton J at first instance held that the outgoings were not deductible under either of the positive limbs of the general deduction provision (s 8-1 ITAA97) and were, in any event, precluded from deductibility because they were of a capital nature. The taxpayer appealed to the Full Federal Court which has now affirmed the decision of Middleton J.

In a joint judgment, the Full Court said that the occasion of the outgoings related to the assessment of claims and the distribution of the fund, and were not in any real practical or business sense to be found in the task of deriving the interest income of $4,341,327 or of choosing which Australian deposit-taking institution the funds should be deposited with. Any connection between the occasion of the expenditure and the earning of interest on the bank deposits was insufficient and too indirect to qualify the costs as deductions under s 8-1(1)(a) ITAA97 (that is, "incurred in gaining or producing your assessable income").

Further, Middleton J was correct to conclude that the taxpayer's activities did not amount to the carrying on of a business.

On the capital question, the Full Court said that, properly analysed, the costs of administering the scheme were costs incurred in the course of effecting the distribution

of the settlement sum to claimants entitled to share in the settlement sum, and thus were costs incurred on capital account. The requirement that the settlement sum be held in interest-bearing accounts pending distribution as part of the distribution scheme did not give the costs of administering the scheme the character of revenue outgoings.

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1 [2020] AATA 1375.
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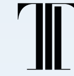

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Tax Tips

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Discretionary trusts: some practical issues

A recent decision of the Tasmanian Supreme Court canvasses issues of interest that arose in relation to the administration of a family discretionary trust.

Background

The prevalence of the discretionary trust for the carrying on of a business, or for the holding of assets, for a family group inevitably means that issues will, in some cases, arise as to the administration of the trust, particularly if the founder dies. These issues can involve the correct construction of the trust deed, and the validity and effectiveness of decisions and actions purportedly taken by the trustee which will typically be a company. In many cases, there will be taxation implications.

The recent decision of the Tasmanian Supreme Court (Brett J) in *McCarthy v Saltwood Pty Ltd*,[1] which involved litigation between members of a family group for whom a discretionary trust was established, shines a light on some of the practical issues that can arise. As will be seen, it is considered that, in some respects, the decision is somewhat unsatisfactory.

The basic facts

The litigation arose out of a dispute between members of a family in relation to the distribution of profits from the family's farming enterprise over many years. The family unit consisted of the plaintiff, her husband (John McCarthy (John)), and their six children (who included Andrew and Karren). John passed away on 27 March 2015.

Prior to his death, John had, from a practical point of view, been primarily responsible for and in charge of the family's farming operations. However, since 1 October 1977, the legal position was that those operations were conducted by the first defendant (the trustee) as trustee for a family discretionary trust, known as the JD McCarthy Family Trust (the trust). The deed by which the trust was established conferred various discretionary powers on the trustee, which included the power to distribute the net income earned by the trust from the farming operations in each financial year to and among the beneficiaries, who included John, the plaintiff and the children. As is common with trusts of this nature, whether and to whom income was distributed, and in what amounts, were matters solely within the discretion of the trustee.

According to the financial records of the trust, most of the income for each year was distributed to John and the plaintiff. They received some of this money by way of direct payments and payment of expenses on their behalf, throughout the year. Any difference between the amount distributed and the sums actually paid to them or on their behalf throughout the year would be treated as a debt by the trustee on behalf of the trust to them. This debt was recorded on an ongoing basis in the financial statements of the trust in an account (the loan account) nominated as a joint loan from John and the plaintiff to the trustee. The plaintiff asserted that, on John's death, she acquired the sole beneficial ownership of the loan account by virtue of the principles of survivorship or, alternatively, pursuant to John's will.

Subsequent to John's death, a dispute arose between the plaintiff and the three natural defendants in respect of the control of the trust (a dispute that was resolved by agreement between the parties so that Andrew and Karen were the current trustees) and the extent to which the trust was indebted to the plaintiff pursuant to the loan account.

Proof of indebtedness

The plaintiff claimed the payment to her of the current balance due under the loan account. In effect, this was the balance disclosed in the financial statements of the trust as at 30 June 2015. The plaintiff relied solely on the disclosure of the joint loan account in the financial statements of the company, in particular, the balance sheets for the 2014 and 2015 financial years. She asserted that these were prima facie evidence of the matters stated or recorded in them, by virtue of the provisions of s 1305 of the *Corporations Act 2001* (Cth).

Section 1305 provides:

> "**Admissibility of books in evidence**
>
> (1) A book kept by a body corporate under a requirement of this Act is admissible in evidence in any proceeding and is prima facie evidence of any matter stated or recorded in the book.
>
> (2) A document purporting to be a book kept by a body corporate is, unless the contrary is proved, taken to be a book kept as mentioned in subsection (1)."

The plaintiff relied on this provision to establish, at least on a prima facie basis, the existence of the relevant debt. However, Brett J said that judicial consideration of the provision had demonstrated its limitations. He referred to the judgment of Sloss J in *Shot One Pty Ltd (in liq) v Day*[2] in which several judicial statements in relation to the operation of s 1305 were quoted, including the following statement made by Maxwell P and Buchanan JA in their joint judgment in *Livingspring Pty Ltd v Kliger Partners*:[3]

> "LS [the applicant] called in aid on the appeal s 1305(1) of the Corporations Act, which, it was said, established 'a presumption that company accounts are prima facie true and correct and accurate'. The provision does no such thing. All that s 1305(1) provides is that a company's books (relevantly, its financial reports and records) are admissible and are 'prima facie evidence of any matter stated or recorded' in them. As the Full Federal Court said in *Whitton v*

> *Regis Towers Real Estate Pty Ltd*, s 1305 does not elevate an entry in a book of account to the status of prima facie evidence of the transaction(s) which the entry purports to record. The same must be true of an entry purporting to record the existence, and value, of an asset."

The defendants attacked the reliability of the financial statements. The attack was not on the authenticity of those documents. It was clear enough that the financial statements were those prepared primarily for submission to the ATO, but also to comply with relevant provisions of the *Corporations Act 2001*, by the accountant engaged for that purpose by John. It was also apparent that the documents were signed by the family members whose signatures appeared on the documents. The issue was whether the records correctly reflected actual financial transactions, and, if so, the validity and lawfulness of those transactions. The prima facie evidence provided by the records was subject to the evidence concerning the actual existence of the asserted debt.

The plaintiff also relied on the provisions of s 68 of the *Evidence Act 2001* (Tas). Brett J said that this provision did not advance the evidentiary value of the records beyond that established by s 1305 of the *Corporations Act 2001*, except that it did make relevant not only the company records, but also those of the trust, and any other documents properly admitted as business records. Brett J said that the provision did not otherwise affect the determination of the matters in dispute in the litigation.

Brett J concluded that, having regard to the evidence that had been adduced, it was a reasonable inference that the entries in the general ledger recorded actual transactions, which ultimately were properly debited against the loan account. There was also no reason to doubt that the end of year financial statements accurately reflected the entries made in these records.

The loan account

As indicated, the loan account was an accounting device used to capture, on an ongoing basis, the amount due by the company to John and the plaintiff for amounts of income purportedly distributed pursuant to the trust deed, but not actually paid in the relevant financial year. Payments made to or on behalf of John and the plaintiff during the financial year were recorded in separate accounts as drawings or expenses paid on their behalf.

The usual practice appeared to be that, at the end of each financial year, the balance of these accounts was debited to the loan account. The loan account was credited with income distributed in accordance with the purported resolutions. There was no reason to doubt that, to the extent that these transactions were so recorded, they reflected actual transactions. The primary issue was the reliability of the quantum of the loan account, having regard, first, to the validity of the trust distributions and, second, to other accounting entries which had significantly increased the loan account, but which, the defendants asserted, did not reflect actual underlying financial transactions.

Brett J said that the prima facie position in respect of the loan account at the conclusion of the relevant period was as follows. According to the balance sheet of the company, the balance of the loan account as at 30 June 2014 was $1,412,231. It was common ground that payments of cash made to the plaintiff in the 2015 financial year reduced this balance. However, on 19 September 2015, at a directors' meeting attended by Andrew, Karen and the plaintiff, it was resolved to make the following distributions from the net income of the trust in the 2015 financial year: $80,536 to John (who had by then died) and $80,535 to the plaintiff. In the end of year financial statements of the trust, these distributions were reflected in a loan account in the name of the plaintiff only in the combined sum of $161,072. This sum was actually paid to the plaintiff by cheque on 25 September 2015. The balance of the joint loan account was disclosed in the balance sheet of the trust as $1,087,313. The combined total of the loan accounts as at 30 June 2015 was therefore $1,248,385. This aggregate sum was shown as the balance of the joint loan account in the company balance sheet for the 2015 financial year.

The primary issue raised by the defendants with respect to the calculation of the loan account concerned the validity of the purported distributions of trust income to John and the plaintiff by the trustee between 2004 and 2015. It did not seem to be disputed on the pleadings that purported distributions were made in respect of each year during this period and that these, at least in part, explained the creation of the loan account. However, the defendants claimed that each of the purported distributions was invalid and ineffective because:

- the trust deed required that the distribution be made within the financial year to which it related, and each distribution was made well after the end of the particular year; and
- the distributions were not made as a lawful act of the company. In particular, although in some years there were purported resolutions of the directors of the company, which appeared on their face to make the distributions, these were not made at lawfully constituted meetings of directors (because of the lack of a quorum and the deficiency of notice).

Distribution of trust income

The distribution of trust income under the trust deed was provided for in cl 4 which, so far as is relevant, was as follows:

> "4(i) The Trustees shall in each accounting period until the Distribution Date pay apply or set aside the whole or such part or parts (if any) as they shall think fit of the NET INCOME of the Trust Fund of that accounting period for such charitable purposes and/or to or for the benefit of or for all or such one or more exclusive of the others or other of the General Beneficiaries living from time to time in such proportions and in such manner as the Trustee shall … in their sole and absolute discretion determine and the Trustees shall not be bound to assign any reason therefore and any amounts set aside for any General Beneficiary as aforesaid shall not form part of the capital of the Trust Fund as defined in Clause 1(6) hereof but shall upon such setting aside be thenceforth held by the Trustees as a separate trust fund on trust for such General Beneficiary absolutely …

(ii) The Trustees shall hold so much of the income of the Trust Fund as the Trustees shall not pay apply or set aside pursuant to the powers contained in paragraph (i) of this Clause in trust for the persons successively described in paragraphs (a) (b) (c) and (d) of Clause 5 hereof as though each date on which such income becomes subject to the trusts hereof were the Distribution Date.

(iii) Notwithstanding anything contained in paragraphs (i) and (ii) of this Clause the Trustees may in their absolute and uncontrolled discretion before the expiration of any accounting period determine to accumulate all or any part of the income arisen or arising during such period and such accumulation shall be dealt with as an accretion to the Trust Fund."

The primary beneficiaries of the trust were John, the plaintiff and each of their children. The definition of "general beneficiaries" included "the brothers and sisters spouses and children" of the primary beneficiaries and their "spouses and children".

Brett J was satisfied that the evidence established that the usual practice was that a decision about the distribution of trust income by the trustee was made by John, in consultation with the accountant, at the time of preparation of the end of year financial statements and taxation returns relevant to the company and the trust, for the financial year in question. His Honour said that, "as would be expected", this generally took place some months after the end of the financial year when John would take the financial accounts and visit the accountant. In most years, the documents contained what purported to be a minute of a meeting of the "Board of Directors of Saltwood Pty Ltd As Trustee of the JD McCarthy Family Trust". The date of the purported meeting shown on such documents was at a time which, it could be inferred, was relevant to the preparation of the statements and tax returns. The minute invariably purported to record the following:

"The directors noted the following distribution to the beneficiaries for the year:"

and then set out the name of the beneficiary and an amount. The minutes for each relevant year until 2013 recorded John as the only person present at the meeting. Those minutes also recorded that he was appointed chairman of each meeting. There was provision for the chairman to sign the minute. Only one of the minutes was actually signed by John, that dated 27 February 2013. For the year ended 30 June 2014, the minute in question depicted the only person present as the plaintiff, with the plaintiff appointed chairman of the meeting. It appeared that the plaintiff had signed the minute. That meeting was dated 11 May 2015. As already noted, the distribution for the 2015 financial year was pursuant to a decision taken at a meeting on 19 September 2015, attended by Andrew, Karen and the plaintiff.

Brett J said that it was clear that the intention of the minute was to record a decision by directors of the corporate trustee as to how the income of the trust for the financial year in question was to be distributed. In his Honour's view, the minutes clearly evidenced a purported decision by John as a director of the company to resolve how the trust income was to be distributed, so that those sums could be included in the financial statements and tax returns. This would accord with what one would expect would take place in the circumstances. His Honour inferred this as a fact, notwithstanding the absence of complete records and signed minutes for each relevant year.

Brett J pointed out that the absence of other directors at such meetings was a matter which potentially affected the validity of resolutions adopted at the meetings. However, that fact was also consistent with the history of the family and, in particular, the nature of John's role as the family patriarch and determining mind of the entire farming operation, including the company and the trust. After stating that the absence of other directors did not detract from the inference that John was purporting to make these decisions on behalf of the company, Brett J said that whether the purported distributions were validly made was a different question.

The validity of the purported distributions: 2004 to 2014

As indicated, it was argued by the defendants that the purported distribution resolutions were not lawfully made because, if made, they were invalid due to of the lack of the requisite quorum (at least two directors), and the lack of notice of the meeting to Andrew and Karen.

It was also argued that the exercise of discretion to effect a distribution under cl 4 of the trust deed had to be made before the end of the relevant financial year, and that this did not occur in any of the relevant years. The defendants argued that the invalidity of these decisions resulted in the application of the default provision with respect to the trust income in each year.

Brett J said that it was obvious on the face of the records that the relevant meetings did not comply with the legal requirements in respect of quorum and notice. That made relevant the provisions in s 1322 of the *Corporations Act 2001*. That section, insofar as it is relevant, provides as follows:

"(1) In this section, unless the contrary intention appears:

(a) a reference to a proceeding under this Act is a reference to any proceeding whether a legal proceeding or not; and

(b) a reference to a procedural irregularity includes a reference to:

(i) the absence of a quorum at a meeting of a corporation, at a meeting of directors or creditors of a corporation, at a joint meeting of creditors and members of a corporation or at a meeting of members of a registered scheme; and

(ii) a defect, irregularity or deficiency of notice or time.

(2) A proceeding under this Act is not invalidated because of any procedural irregularity unless the Court is of the opinion that the irregularity has caused or may cause substantial injustice that cannot be remedied by any order of the Court and by order declares the proceeding to be invalid."

Brett J said that the adoption of a resolution at a meeting of directors is a proceeding for the purposes of this section. Further, the absence of a quorum at a meeting of directors, and the failure to give notice of the meeting, each appeared to fall under the definition of a procedural irregularity, contained in s 1322(1)(b). The apparent effect of s 1322(2) was that the adoption of the resolutions concerning the distribution of income were not invalidated by the lack of

notice of the meeting, nor the failure to achieve a quorum, unless the court was of the opinion that the irregularity had caused, or may cause, substantial injustice. After considering various issues, Brett J concluded that the proceeding in each of the relevant years, in particular the adoption of the relevant resolution at the meeting, was not invalidated because of the absence of a quorum or the failure to give notice of the meeting.

The timing issue

As indicated, the defendants also relied on the timing of the purported distributions in support of their claim that the distributions were invalid. This argument related to each financial year between 2004 and 2015 and was based on the wording of cl 4(i) of the trust deed (for which see above) which provided for the trustee *in each accounting period, to pay apply or set aside the whole or such part or parts (if any) as they shall see fit of the net income of the trust fund of that accounting period* for the benefit of one or more of the beneficiaries. "Accounting period" was defined in cl 1 to mean "each period of twelve months ending on thirtieth of June in each year". It was submitted by the defendants that the words "in each accounting period" imposed a strict time requirement and that compliance was only achieved if the resolution was made within the financial year relevant to the distribution.

Brett J, in rejecting the defendants' contentions, said:[4]

> "Whether the words 'in each accounting period' impose a strict time limitation will depend upon an assessment of the settlor's intention, determined by reference to the terms of the trust deed. The discretion conferred on the trustee to distribute income pursuant to cl 4 can be appropriately described as a mere power. It is so described because it affords not only discretion as to how, but also as to whether to distribute the trust income in any particular financial year. It is well-established that such a power can be limited by temporal restrictions contained in the trust deed and, in the absence of such restrictions, a requirement to exercise a power within a reasonable time may be implied from the terms of the trust instrument. Such a power can be distinguished from a trust power, under which the trustee is obliged to distribute income, but with a discretion as to how that distribution shall take place. The duty arising under such a power remains effective irrespective of a time limitation. See *Re Lockyer's Settlement* [1977] 1 WLR 1323.
>
> The discretion afforded to the trustee under cl 4(i) is to 'pay apply or set aside the whole or any part … of the net income of the trust fund …'. 'Net income' is not defined, but cl 1 defines 'Income' to include 'anything which is treated as assessable income under' applicable taxation legislation. Having regard to this definition and the overall context, the term 'net income' can only mean the result of a calculation whereby the aggregate gross assessable income of the trust over the whole financial period is reduced by the expenses of the trust incurred in deriving that income, which are properly deductible under the applicable taxation legislation. Income, as defined, will presumably be received by the trust incrementally throughout the financial year, but net income can only be determined at the conclusion of the year. The nature of the calculation required to determine that result necessarily requires consideration of the aggregate of income and expenses over the whole financial year.
>
> It would seem impossible, therefore, to make a decision about paying, applying or setting aside the net income for the financial year until the year is complete and the calculation of net income is possible. It was suggested in argument that distributions by resolution within the financial year could be achieved prior to the calculation of the net income for that year, by using percentages of the anticipated net income to determine its distribution. This is apparently a common requirement of modern discretionary trust deeds, and is utilised to comply with expectations of the Commissioner of Taxation arising from requirements of taxation legislation. I do not think that taxation requirements or expectations, now or even in the relevant past, are of any significant assistance in construing the terms of this trust deed. The Commissioner's expectations relate to and reflect statutory provisions affecting the derivation of income in the year of assessment for tax purposes. It may well be that modern trust deeds are drafted to reflect those expectations, but I was not referred to contemporary taxation expectations nor given any other basis that would make relevant such considerations in respect of the words used in this trust deed."

Brett J then said that, in any event, such methodology did not accord with the mechanisms implied by the definitions in the trust deed. The definition of "set aside" required the placement of "sums" to the credit of a beneficiary in the books of the fund. By that definition, this is not an amount actually paid, but rather "a sum" noted as a credit in the books in favour of the recipient beneficiary. It was possible of course to make such notations on an incremental basis within a financial period in respect of "income" as defined, but if the "sum" is to derive from the whole or part of the net income of the trust, this could only occur when the net income is capable of calculation on a numeric basis. It followed, his Honour said, that the setting aside of the whole or part of the net income could only occur after the end of the relevant financial year.

Brett J then went on:[5]

> "Accordingly, the term 'in each accounting period' in cl 4(i) should be construed as 'in respect of each accounting period'. This construction provides the temporal limitation with appropriate meaning and efficacy, and accords with the clear intention of the settlor. It is also consistent with the overall scheme and wording of cl 4. Clause 4(iii) permits the trustee to determine to accumulate rather than distribute all or any part of the income which has arisen or arises during the relevant financial period. That provision requires an express determination by the trustee to be made 'before the expiration of' the relevant accounting period. This is also consistent with the use of the term 'arising' in the present tense. There can be no doubt about the intention to place a clear and strict temporal limitation upon the exercise of the discretion to accumulate income into the trust fund. The scheme of cl 4 is that income which is not accumulated under cl 4(iii), will be available for distribution in accordance with the provisions of cl 4(i) and if not so distributed, will be held on trust in accordance with the default provisions contained in cl 4(ii). If it had been intended by the settlor to place a strict temporal limitation on the exercise of the discretion under cl 4(i), then the same or similar wording as that used in cl 4(iii), could have been used in that provision."

Accordingly, his Honour concluded that cl 4(i) contemplated an exercise of discretion after the conclusion of the financial year, at or before the time of preparation and completion of the books of the trust fund for that year. At that time, the net income of the trust fund would be capable of calculation, and a decision could be made as to whether to pay, apply

or set aside some or all of that net income for one or more of the beneficiaries. The setting aside of income is achieved by placing the relevant sums to the credit of the beneficiary concerned "in the books of the trust fund".[6]

In particular, the need for such a limitation is apparent from the operation of cl 4(ii). Any part of the net income of the fund which is not paid, applied or set aside in accordance with cl 4(i) at the time of settlement of the final accounts of the fund for the financial year, was to be held on trust in accordance with the default provisions set out in cl 4(ii).

In his Honour's view, the methodology actually employed in respect of the trust fund over the relevant years by the company was therefore consistent with the intended operation of cl 4. In particular, the exercise of discretion under cl 4(i) at the time of preparation of the end of year accounts, and the setting aside of the whole or part of the net profit of the trust for beneficiaries, in particular, John and the plaintiff, after accounting for moneys actually paid to or on their behalf during the financial year, accorded with the intended operation of the relevant provisions. The defendants' claim of invalidity on the basis of the timing of the resolutions was to be rejected.

Observations

Procedure

The decision of Brett J in *McCarthy v Saltwood Pty Ltd* illustrates the importance of adopting proper procedural steps for meetings (including of the directors of a corporate trustee) that are needed in relation to the operation of a discretionary trust. Resort should not need to be made to statutory exculpatory provisions (which may well involve litigation to resolve). More widely, proper procedural steps must be taken in any situation (not only in the context of discretionary trusts) that needs meetings. The limitation that Brett J pointed out in relation to the operation of s 1305 of the *Corporations Act 2001* will be noted.

It is submitted that the decision in so far as it relates to the procedure adopted in relation to the making of the distributions should not be relied on to formulate a course of action; the decision in this respect should only be called in aid if there is a problem that has arisen in relation to procedures that have already taken place.

Timing

The decision, in so far as it relates to the construction of cl 4(i) of the trust deed and the time for the making of a distribution of income, is, it is submitted with respect, open to considerable doubt.

To a large extent, the construction of cl 4 adopted by Brett J as to timing was driven by perceived taxation considerations (the derivation of income and the preparation of the trust tax return). However, the perceived taxation considerations did not include a fundamental issue. By adopting the construction of cl 4(i) that he did, his Honour consigned the net income of the trust for the income years in question to be taxed to the trustee at the penal rates of tax under s 99A ITAA36. This has nothing to do with "expectations" of the Commissioner; it is simply the way the courts have consistently held that the relevant provisions of Div 6 ITAA36 in fact operate.[7] For a beneficiary to be assessable under s 97 ITAA36, the present entitlement of the beneficiary to income for an income year must arise before the end of the particular income year.

It would seem that Brett J in fact held that, on the proper construction of cl 4 of the trust deed, the trustee could not exercise the discretion to pay, apply or set aside the net income of the trust for a financial year until the financial year had ended. That would be a strange construction because, as pointed out, it would mean that the trustee would be assessable in respect of the whole of the net income of the trust for each year at the rate applying for the purposes of s 99A ITAA36.

If a discretionary trust deed, on its proper construction, only permitted the trustee to make a distribution of the income of an income year after the end of the income year, there would, of course, be no question of invalidity but there would, as pointed out above, inevitably be an adverse tax impost on the trustee under s 99A ITAA36.

It may be noted that Brett J said that he was not referred to contemporary taxation expectations nor given any other basis that would make relevant taxation requirements or expectations in construing the words used in the trust deed. But, if his Honour, by referring to "contemporary taxation expectations", was referring to no such expectations at the time when the trust deed was entered into, it is submitted with respect, that this does not appear to be the case. In this regard, reference may be made to IT 328 (withdrawn in August 2011). This ruling recognised what the strict position was to the timing of present entitlement to income under the provisions of Div 6 ITAA36 (that is, on or before 30 June) and offered a purely administrative concession. That ruling was issued in May 1966 and was in force when the trust deed for the JD McCarthy Family Trust was entered into.

When considering the construction of cl 4(i) of the trust deed, Brett J referred to the expression "set aside" which was defined in the trust deed. His Honour did not consider the term "apply", which so far as is known was not defined in the trust deed. The concept of "apply" in the context of trust income has been considered in several cases. For example, in *Commissioner of Inland Revenue v Ward*,[8] a majority of the New Zealand Court of Appeal held that, in the context of a statutory provision relating to trusts, a resolution deliberately arrived at and recorded was sufficient of itself to effect an immediate vesting of a specific portion of the trust income and amounted to an application within the meaning of the relevant provision.

It is also submitted that, when construing the expression "in each accounting period" in cl 4(i), the word "in" should receive the following meaning given to it in the *Macquarie Dictionary*: "2. Inclusion within, or occurrence during the course of or at the expiry of, a period or limit of time." This construction would have the merit that, in the absence of a timely distribution resolution, the default income provision would be activated and s 99A ITAA36 would not be called into play.

It is not known whether there will be an appeal to the Tasmanian Full Supreme Court from the decision of Brett J.

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References

1 [2020] TASSC 19.

2 [2017] VSC 741 at [240].

3 [2008] VSCA 93.

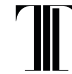
4 [2020] TASSC 19 at [53] to [55].

5 [2020] TASSC 19 at [57].

6 Brett J noted that the stated construction of cl 4(i) did not mean that there was no temporal limitation on the exercise of the discretion. A requirement that the discretion be exercised within a reasonable time could be implied from the terms of the trust deed: *Re Gulbenkian's Settlements (No. 2)* [1970] Ch 408. Brett J said that it could be concluded that, in most circumstances, a reasonable time for the exercise of the discretion afforded by cl 4(i) would coincide with the time at which the final yearly accounts of the trust were settled. This must necessarily follow, his Honour said, from the fact that the determination would be in respect of the net profit of the trust, and if money was to be set aside, that would be achieved by an appropriate entry in the books of the trust fund.

7 *Trustees of the Estate Mortgage Fighting Fund Trust v FCT* [2000] FCA 981; *FCT v Ramsden* [2005] FCAFC 39; *Pearson v FCT* [2006] FCAFC 111; *Colonial First State Investments Ltd v FCT* [2011] FCA 16.

8 69 ATC 6050. See also *Case* E47, 73 ATC 385 and IT 347.



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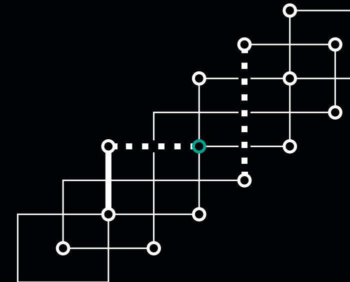

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Mid Market Focus

by Daryl Jones, CTA, HLB Mann Judd

Capital gains and foreign resident beneficiaries

The tax treatment of capital gains distributed by a discretionary trust to a foreign resident is at the forefront of recent guidance by the Commissioner.

Introduction

The capital gains tax provisions in the *Income Tax Assessment Act 1997* (Cth) (ITAA97) operate such that, where a CGT event happens to a CGT asset of a foreign resident individual (where that CGT asset is not taxable Australian property (TAP), any capital gain or capital loss from that CGT event can be disregarded.[1]

As the discussion below highlights, the outcome is different where the non-resident is a beneficiary of an Australian resident trust.

TD 2019/D6

On 30 August 2019, the Commissioner released TD 2019/D6, which provides his long-held view on the treatment of capital gains derived by the trustee from the disposal of assets that are not TAP of a resident discretionary trust that was attributable to a foreign resident beneficiary pursuant to the resolution by the trustee. In summary, the Commissioner's view is that:

- s 115-220 ITAA97 operates to assess the trustee under s 98(3) of the *Income Tax Assessment Act 1936* (Cth) (ITAA36) on the capital gain attributable to the foreign beneficiary;
- the foreign resident beneficiary is also taken to have made capital gains under s 115-215(3) ITAA97, with a credit being allowed to that beneficiary under s 98A(2) ITAA36 for tax paid by the trustee; and
- as the trust is not a fixed trust, s 855-40 ITAA97 does not apply to disregard the foreign resident's capital gain, nor does s 855-10 ITAA97 apply to disregard the capital gain which the foreign resident beneficiary is taken to have made under Subdiv 115-C ITAA97.

Federal Court decision

On 28 April 2020, the Federal Court handed down its decision in *Peter Greensill Family Co Pty Ltd (trustee) v FCT.*[2] The case considered whether capital gains distributed to a foreign resident beneficiary were assessable to the resident trustee (Peter Greensill Family Co Pty Ltd). The case also considered whether the capital gains were disregarded under s 855-10(1) ITAA97 where the beneficiary was deemed to have made the capital gains under Subdiv 115-C ITAA97.

The case considers the interaction of the trust provisions in the ITAA36 (Div 6 and Subdiv 6E) and the CGT provisions in the ITAA97 (Subdiv 115-C and Div 855). As you may recall, Subdiv 6E was enacted and Subdiv 115-C was changed following the landmark decision in *FCT v Bamford*.[3]

When deciding the case and examining the provisions, *Thawley J* considered the concepts of statutory interpretation examined by the High Court in *FCT v Consolidated Media Holdings Ltd*.[4]

In the *Greensill* case, an Australian resident discretionary trust made a substantial capital gain ($58m in the 2015 to 2017 income years) on shares in an Australian company, such shares not being TAP. The trustee both resolved to distribute the capital gains to a foreign resident beneficiary (a resident of the United Kingdom) and transferred some other shares in the same company to the foreign resident in specie (also giving rise to a capital gain by the trustee).

The applicant argued that the capital gains distributed to Mr Greensill were "capital gains from a CGT event" that could be disregarded by the operation of s 855-10 ITAA97. In particular, s 855-10 states:

> "(1) Disregard a capital gain or capital loss from a CGT event if:
>
> (a) you are a foreign resident, or the trustee of a foreign trust for CGT purposes, just before the CGT event happens; and
>
> (b) the CGT event happens in relation to a CGT asset that is not taxable Australian property."

In summary, the court held in favour of the Commissioner, finding that s 855-10(1) ITAA97 did not apply because:

- the trustee (ie the taxpayer) was not a foreign resident;
- it was of no consequence that the beneficiary was a foreign resident; and
- the trust was not a foreign trust.

Further, and importantly, the provisions taxing capital gains required amounts to be calculated which were included in assessable income of the trust and the beneficiary. The court found that the amounts were not a capital gain from a CGT event but were amounts that the CGT provisions required to be calculated that did not have any particular character.

The court also found that the ITAA97 includes specific provisions[5] to exclude capital gains made by beneficiaries of a fixed trust which in turn indicated that s 855-10(1) did not apply where a capital gain is made by beneficiaries of a non-fixed (such as a discretionary) trust.

Principles of statutory interpretation in the Greensill case

As highlighted above, the importance of the interpretation of the relevant provisions was essential to the decision of *Thawley J.* His Honour stated:[6]

> "That Div 855 should be understood, through the process of statutory construction, as having been intended to operate in this way is supported by the legislative history and extrinsic material.

The role which legislative history and extrinsic material can take in the task of statutory construction was explained by the High Court in *Commissioner of Taxation v Consolidated Media Holdings Ltd* … (2012) 250 CLR 503 at [39] (citations omitted):

> 'This Court has stated on many occasions that the task of statutory construction must begin with a consideration of the [statutory] text'. 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."

His Honour went on to highlight the *Tax Laws Amendment (2006 Measures No. 4) Act 2006* that enacted Div 855 and noted that the explanatory memorandum (EM) said nothing about Div 855 changing the taxation of capital gains deemed to be made by foreign resident beneficiaries under s 115-215 ITAA97. His Honour noted that the EM stated at para 4.113:

> "Amendments made by this Bill move a specific treatment for capital gains and capital losses made by foreign residents from interests in, or through interests in, fixed trusts from Subdivision 768-H into Division 855. The general operation of the CGT and foreign resident rules will ensure that a capital gain or capital loss on an interest in a fixed trust made by a foreign resident is disregarded if that interest is not taxable Australian property. The provisions specifically dealing with the distribution of capital gains to foreign beneficiaries will continue to operate."

In relation to the applicant's arguments, his Honour stated:[7]

> "Much of the applicant's argument proceeded upon the assumption that there existed a policy objective of not taxing foreign beneficiaries of resident trusts in respect of CGT events in relation to CGT assets which were not taxable Australian property. The applicant's process of construction then analysed the statutory provisions through this lens. This approach falls foul of the caution expressed in *Certain Lloyd's Underwriters v Cross* … (2012) 248 CLR 378 at [26] that a danger to be avoided in construing a statute is making an *a priori* assumption about a statute's purpose and construing the statute to coincide with the assumption. The correct process is the inverse: the purpose is to be derived from what the legislation says, not from an assumption about the desired or desirable operation of the provisions. The policy objective asserted by the applicant is not to be found in the legislative history identified above and nor is it supported by the terms of former s 160L of the ITAA 1936 or the capital gains tax regime when it was introduced."

Conclusion

The decision in the *Greensill* case largely endorses the Commissioner's views in TD 2019/D6, subject to any appeal. The case also highlights the ongoing traps in the interactions between the taxation of trusts and not only the CGT provisions, but also the income tax laws in general. It should be a reminder of the long-awaited reforms to the taxation of trusts first announced by the then Assistant Treasurer on 21 November 2011.

Daryl Jones, CTA
Director – Tax Consulting
HLB Mann Judd

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3 [2010] HCA 10.
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Foreign beneficiaries beware of discretionary trusts following Greensill

by Thomas McKenzie, Lawyer, EY

Longstanding international taxation law principles assert that the taxation of ordinary income and statutory income such as capital gains should be determined based on the residency of the taxpayer and the source of the income. It appeared that this was accepted by the ATO with respect to foreign capital gains flowing through an Australian discretionary trust to a foreign resident up until an ATO consultation on these matters in 2016. The ensuing departure from this position became public knowledge by virtue of TD 2019/D6 and TD 2019/D7 and was recently tested in the Federal Court decision in *Peter Greensill Family Co Pty Ltd (trustee) v FCT*. For the reasons set out in the decision and discussed in this article, the result is that the trustee of an Australian discretionary trust is taxable on foreign capital gains distributed to foreign beneficiaries.

Introduction

Longstanding international taxation law principles assert that the taxation of ordinary income and statutory income such as capital gains should be determined based on the residency of the taxpayer and the source of the relevant income.

These principles were historically adopted when determining a trustee of an Australian resident trust estate's liability to tax where a foreign resident is presently entitled to a share of the net income of the trust. However, following a consultation on these matters in 2016, the ATO adopted the following views that are inconsistent with that approach:

– a foreign resident beneficiary presently entitled to a capital gain of an Australian resident non-fixed trust on an asset which is not taxable Australian property (TAP) is assessable on the capital gain even though that would not occur if the foreign resident made the same gain directly rather than through a discretionary trust (TD 2019/D6); and

– a foreign resident beneficiary of an Australia resident trust is assessable on non-TAP gains regardless of whether the gain has a source in Australia or not (TD 2019/D7).

These views were recently tested in *Peter Greensill Family Co Pty Ltd (trustee) v FCT*[1] (the *Greensill* decision), where a trustee was assessed on a number of foreign capital gains distributed to a foreign beneficiary.

Thawley J declared a number of important distinctions in the *Greensill* decision:

– the source requirement in s 98 of the *Income Tax Assessment Act 1936* (Cth) (ITAA36) does not apply where the trustee is assessed on a capital gain under Subdiv 115-C of the *Income Tax Assessment Act 1997* (Cth) (ITAA97), given the assumptions enunciated in Div 6E ITAA36;

– by virtue of Subdiv 115-C, a capital gain made by the trustee is added to any amount otherwise assessed under s 98 (that is, in addition to rather than as a result of s 98);

– the amount of a capital gain that the beneficiary is "treated" as having which formed part of the net income of their discretionary trust estate is a legal fiction that does not have broader application other than allowing the beneficiary to access certain benefits (ie offsetting capital losses and applying the CGT discount);

– accordingly, s 855-10 ITAA97 does not disregard a capital gain made by a trustee of a resident trust estate as it only applies to CGT events that occur for individuals; and

– a beneficiary that is absolutely entitled to a capital gain triggering CGT event E4 does not override Subdiv 115-C.

The result of the above points is that trustees of Australian resident trust estates are subject to Australian tax on foreign capital gains distributed to foreign beneficiaries.

For completeness, it is noted that the judgment considered the policy rationale for disregarding non-TAP capital gains flowing through fixed trusts at some length, although it was not at issue in the case. While Thawley J had sympathy for the international tax law principles of source and residence, his Honour ultimately concluded that there was no legislative basis for interpreting or construing Div 855 ITAA97 to support this position.

History of trustee taxation and source

Historically, it was uncontentious that the trustee of an Australian resident trust estate was only taxable on income and capital gains attributable to sources in Australia.[2]

The longstanding view, as enunciated in *Nathan v FCT*,[3] was that the source of income (including a capital gain) is a "practical, hard matter of fact". Generally, it was thought that the source of a capital gain would usually be the country in which the asset was situated.[4] This was consistent with the taxation of foreign residents more broadly where they held assets directly as they would only be subject to tax on ordinary and statutory income (including capital gains) derived from Australian sources (ss 6-5(3) and 6-10(5) ITAA97).

In December 2016, the ATO released a discussion paper on capital gains and non-resident beneficiaries.[5] The discussion paper focused on the following scenarios:

- a resident trustee makes a capital gain on an Australian asset (but one which is not TAP) and a foreign beneficiary is entitled to the gain. The former view was that Australia should not claim tax on the basis that, had the investor owned and sold the asset itself, no Australian tax would have been payable; and
- a resident trustee makes a capital gain on a foreign asset and a foreign beneficiary is entitled to the gain. Again, the previous position was that Australia should not claim tax. The country where the asset is located might claim tax and the country where the investor resides might also claim tax but Australian should be irrelevant in this structure.

Following the 2016 consultation and disregarding the policy rationale for the above assertions that appear abundantly clear, the ATO formed the view that Australia's income tax legislation does not produce these outcomes.

The ATO released the following draft taxation determinations to assert this view:

- TD 2019/D6, which concludes that a foreign resident beneficiary presently entitled to a capital gain of an Australian resident non-fixed trust on an asset which is not TAP is assessable on the capital gain even though that would not occur if the foreign resident made the same gain directly rather than through the trust; and
- TD 2019/7, which concludes that a foreign resident beneficiary of a resident trust is assessable on non-TAP gains whether or not the gain has a source in Australia

The legislative provisions that the ATO relies on in these taxation determinations were at issue in the *Greensill* decision and are as follows:

- the regime for taxing trust income where a beneficiary is a non-resident at the end of the relevant year of income contained in Div 6 of Pt III ITAA36;
- certain rules about trusts with net capital gains in Subdiv 115-C of Pt 3-1 ITAA97 and Div 6E of Pt III ITAA36; and
- certain rules concerning the capital gains of foreign residents provided for in Div 855 of Pt 4-5 ITAA97.

The legislative provisions and the findings of Thawley J in the *Greensill* decision are set out below.

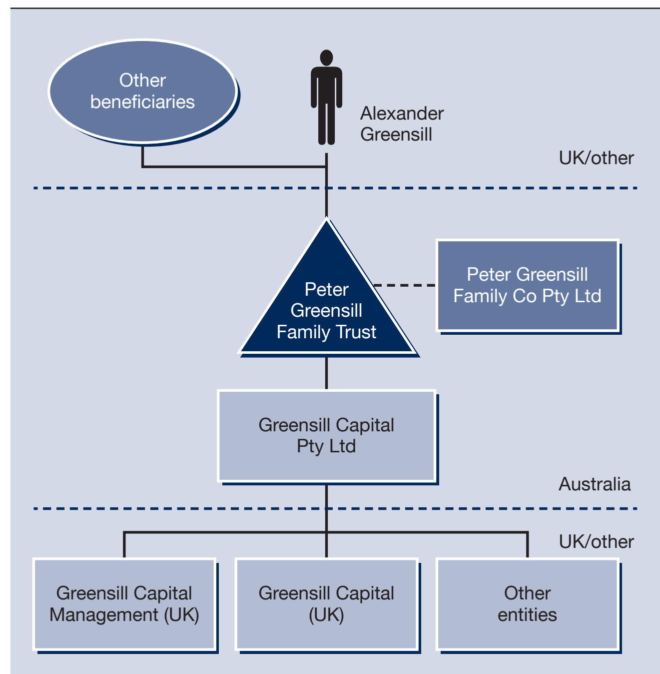
Summary of facts in the Greensill decision

The structure set out in Diagram 1 depicts the relevant interests held by the Peter Greensill Family Trust (PGFT) during the relevant periods.

The following transactions took place and crystallised certain capital gains:

- in FY2015, the PGFT disposed of 37,860 ordinary shares in Greensill Capital Pty Ltd (GCPL), resulting in a capital gain of $13,074,628.00;
- in FY2016, the PGFT disposed of 19,731 ordinary shares and 18,599,999 non-redeemable preference shares in GCPL, resulting in a capital gain of $10,070,680.73; and
- in FY2017, the PGFT disposed of 36,220 ordinary shares and 54,444 B class shares in GCPL, resulting in a capital gain of $35,213,910.

Diagram 1. Relevant interests held by the Peter Greensill Family Trust



The PGFC made resolutions such that the capital gains were accreted to trust capital and the trustee distributed 100% of those gains to Alexander Greensill.

The ATO issued assessments to Peter Greensill Family Co Pty Ltd (PGFT Trustee) on the basis that the capital gains were assessable to the trustee and were not otherwise disregarded.

On the other hand, the taxpayer argued that the capital gains ought to have been disregarded and there was no amount assessable to the trustee.

Trustee taxation under Div 6 and Div 6E ITAA36

Division 6 of Pt III ITAA36 requires the trustee to calculate the "net income" of the trust estate as defined in s 95(1) ITAA36 and to allocate the liability to tax on that net income among the beneficiaries and the trustee on a proportional basis.[6]

Section 98 relevantly provides:

> "**98 Liability of trustee**
>
> …
>
> (2A) If:
>
> (a) a beneficiary of a trust estate who is presently entitled to a share of the income of the trust estate:
>
> (i) is a non-resident at the end of the year of income; and
>
> (ii) is not, in respect of that share of the income of the trust estate, a beneficiary in the capacity of a trustee of another trust estate; and
>
> (iii) is not a beneficiary to whom section 97A applies in relation to the year of income; and
>
> (iv) is not a beneficiary to whom subsection 97(3) applies; and

(b) the trustee of the trust estate is not assessed and is not liable to pay tax under subsection (1) or (2) in respect of any part of that share of the net income of the trust estate;

subsection (3) applies to the trustee in respect of:

(c) so much of that share of the net income of the trust estate as is attributable to a period when the beneficiary was a resident; and

(d) *so much of that share of the net income of the trust estate as is attributable to a period when the beneficiary was not a resident and is also attributable to sources in Australia.*

(3) A trustee to whom this subsection applies in respect of an amount of net income is to be assessed and is liable to pay tax:

(a) *if the beneficiary is not a company — in respect of the amount of net income as if it were the income of an individual and were not subject to any deduction*; or" [emphasis added]

The beneficiaries must include an amount equal to the capital gain assessed against the trustee under s 98 in their hands pursuant to s 98A ITAA36. It should be noted that this provision is seldom effectual as the beneficiary will receive a credit for tax paid by the trustee. The interaction between s 98A and s 98 has not been considered in detail in this article on the basis that this was not a material issue in the *Greensill* decision.

With respect to s 98, the taxpayer argued that the capital gains on the disposal of the shares in GCPL were foreign sourced and accordingly should not be subject to trustee taxation. The taxpayer put forward a number of policy reasons for this conclusion consistent with the historic position regarding trustee taxation as set out under the "History of trustee taxation and source" section of this article.

Division 6E of Pt III ITAA36 provides certain assumptions for determining a beneficiary's and trustee's liability to tax under s 97, 98, 98A, 99A or 100 ITAA36 which override the general rules.

As summarised by Thawley J at para 25 of the *Greensill* decision:

"The practical effect of this [Div 6E] is that beneficiaries are not assessed under Division 6 in respect of capital gains of a trust estate. Beneficiaries are taxed on capital gains of a trust estate through Subdiv 115-C of the ITAA 1997."

This interpretation mirrored TD 2019/D7 which, although issued subsequent to the taxpayer's assessments in the *Greensill* decision, provided that:

"Section 115-220 does not test whether the beneficiary's attributable gain satisfied the conditions in section 98 of the ITAA 1936 …"

The consequence of the operation of Div 6E is that the capital gain does not require an Australian source for the trustee of an Australian resident trust to be assessed. See the analysis below of the operative provisions of Subdiv 115-C which the Commissioner and Thawley J applied in favour of Div 6.

Subdivision 115-C: rules about trusts with net capital gains

Section 115-220 ITAA97 addresses the assessment of trustees under s 98 ITAA36. It provides:

"**115–220 Assessing trustees under section 98 of the Income Tax Assessment Act 1936**

(1) This section applies if:

(a) you are the trustee of the trust estate; and

(b) on the assumption that there is a share of the income of the trust to which a beneficiary of the trust is presently entitled, you would be liable to be assessed (and pay tax) under section 98 of the *Income Tax Assessment Act 1936* in relation to the trust estate in respect of the beneficiary.

(2) *For each capital gain of the trust estate, increase the amount (the assessable amount) in respect of which you are actually liable to be assessed (and pay tax) under section 98 of the Income Tax Assessment Act 1936 in relation to the trust estate* in respect of the beneficiary by:

(a) unless paragraph (b) applies — the amount mentioned in subsection 115-225(1) in relation to the beneficiary; or

(b) if the liability is under paragraph 98(3)(b) or subsection 98(4), and the capital gain was reduced under step 3 of the method statement in subsection 102-5(1) (discount capital gains) — twice the amount mentioned in subsection 115-225(1) in relation to the beneficiary.

(3) To avoid doubt, increase the assessable amount under subsection (2) even if the assessable amount is nil." [emphasis added]

Section 115-220(2) requires the calculation of an amount under s 115-225(1), which is then added to that in respect of which the trustee is liable to be assessed under s 98. Further, s 115-215(3) deems a beneficiary to have a capital gain which reflects the capital gain of the trust estate but does not result in a CGT event occurring to the beneficiary.

Thawley J sets out the operation of these provisions at para 39:

"(3) Subdiv 115-C applies in relation to the trust estate's capital gains, because the trust estate had a net capital gain in the relevant income years, which was taken into account in working out the trust estate's net income: s 115-210(1); Div 6E of the ITAA 1936.

(4) Mr Greensill, as a presently entitled beneficiary, is assessed under s 115-215. The purpose of that section 'is to ensure that appropriate amounts of the trust estate's net income attributable to the trust estate's capital gains are treated as a beneficiary's capital gains when assessing the beneficiary' so that the beneficiary can apply any available capital losses or discount percentage against those gains: s 115-215(1).

(5) The amount of the capital gains that the beneficiary is 'treated' by s 115-215 as having is determined by reference to the calculation under s 115-215(1), headed 'Attributable gain'.

(6) The trustee is assessed under s 98 of the ITAA 1936 in accordance with s 115-220 of the ITAA 1997."

A number of important distinctions follow this section of the judgment:

- the source requirement in s 98 does not apply where the trustee is assessed on capital gains under Subdiv 115-C;
- the capital gain is added to any amount otherwise assessed on the trustee under s 98; and
- the amount of a capital gain that the beneficiary is "treated" as having is a legal fiction that does not have broader implications other than allowing the beneficiary

certain benefits (ie offsetting capital losses and applying the CGT discount).

Division 855

Section 855-10(1) provides:

> "**855–10 Disregarding a capital gain or loss from CGT events**
>
> (1) Disregard a capital gain or capital loss from a CGT event if:
>
> (a) you are a foreign resident, or the trustee of a foreign trust for CGT purposes, just before the CGT event happens; and
>
> (b) the CGT event happens in relation to a CGT asset that is not taxable Australian property.
>
> Note: A capital gain or capital loss from a CGT asset you have used at any time in carrying on a business through a permanent establishment in Australia may be reduced under section 855-35."

The taxpayer argued that that the reference in s 115-220(2) to "the amount mentioned in subsection 115-225(1) in relation to a beneficiary" means that Mr Greensill's capital gain is disregarded by s 855-10 ITAA97.

Following the interpretation that the capital gain attributed to a beneficiary under Subdiv 115-C is a legal fiction and does not apply broadly, Thawley J concluded that the statutory language does not permit the taxpayer's argument as:

– s 855-10(1) applies to individuals and does not apply to disregard the capital gains of a resident trust estate;

– the capital gain calculated under Subdiv 115-C is added to s 98 and accordingly is not a capital gain to which s 855-10(1) could apply; and

– an amount calculated under Subdiv 115-C is not a capital gain from a CGT event as is required under s 855-10(1). Rather, it is an amount which is calculated by reference to CGT events which occurred in respect of CGT assets of a trust.

This finding is rather innocuous when seeking to apply a plain reading of the statute and goes no further than confirming well-established principles requiring the foreign resident to hold an asset directly to access s 855-10.

> *"… the capital gain attributed to a beneficiary under Subdiv 115-C is a legal fiction …"*

Non-TAP capital gains through fixed trusts

Section 855-40(1) to (4) provides:

> "**855–40 Capital gains and losses of foreign residents through fixed trusts**
>
> (1) The purpose of this section is to provide comparable taxation treatment as between direct ownership, and indirect ownership through a fixed trust, by foreign residents of CGT assets that are not taxable Australian property.
>
> (2) A capital gain you make in respect of your interest in a fixed trust is disregarded if:
>
> (a) you are a foreign resident when you make the gain; and
>
> (b) the gain is attributable to a CGT event happening to a CGT asset of a trust (the ***CGT event trust***) that is:
>
> (i) the fixed trust; or
>
> (ii) another fixed trust in which that trust has an interest (directly, or indirectly through a chain of trusts, each trust in which is a fixed trust); and
>
> (c) either:
>
> (i) the asset is not taxable Australian property for the CGT event trust at the time of the CGT event; or
>
> (ii) the asset is an interest in a fixed trust and the conditions in subsections (5), (6), (7) and (8) are satisfied.
>
> Note: Section 115-215 treats a portion of a trust's capital gain as a capital gain made by a beneficiary, and applies the CGT discount to that portion as if the gain were made directly by the beneficiary.
>
> (3) You are not liable to pay tax as a trustee of a fixed trust in respect of an amount to the extent that the amount gives rise to a capital gain that is disregarded for a beneficiary under subsection (2).
>
> (4) To avoid doubt, subsection (3) does not affect the operation of subsection 98A(1) or (3) of the *Income Tax Assessment Act 1936* (about taxing beneficiaries who are foreign residents at the end of an income year)."

While this was not an operative section in the *Greensill* decision as the trust was discretionary rather than fixed, Thawley J set out some helpful obiter relating to the interpretation of this provision.

The explanatory memorandum to the New International Tax Arrangements (Managed Funds and Other Measures) Bill 2004, which inserted the predecessor to s 855-40, stated:

> "1.7 Another change is to disregard a capital gain made by a foreign resident in respect of the taxpayer's interest in a fixed trust if the *gain relates to an asset without the necessary connection to Australia*. For example, this will apply where the capital gain arises from the disposal by an Australia fixed trust of a portfolio interest in an Australia public company. Again, this is appropriate because a foreign resident would not be assessed on such a gain if the asset were held directly.
>
> …
>
> 1.12 These amendments are not confined to foreign residents with interests in widely held unit trusts. The amendments will apply to interests in closely held trusts and trusts that are not unit trusts. This is to ensure the benefits of the measures apply as widely as possible, irrespective of the trust arrangements through which the foreign resident has invested and all relevant trusts in the chain must meet the definition of 'fixed trust' in the *Income Tax Assessment Act 1997* (ITAA 1997). This is to ensure that there is no discretion available to the trustee to provide benefits to parties which are not beneficiaries of the trust. This is important to the integrity of the amendments."

The *Tax Laws Amendment (2006 Measures No. 4) Act 2006* (Cth), which enacted Div 855, said nothing about changing the taxation of capital gains deemed to be made by foreign resident beneficiaries under s 115-215. It did state:

> "4.113 Amendments made by this Bill move a specific treatment for capital gains and capital losses made by foreign residents from interests in, or through interests in, fixed trusts from Subdivision 768-H

> into Division 855. The general operation of the CGT and foreign resident rules will ensure that a capital gain or a capital loss on an interest in a fixed trust made by a foreign resident is disregarded if that interest is not taxable Australian property. The provisions specifically dealing with the distribution of capital gains to foreign beneficiaries will continue to operate."

Thawley noted that much of the taxpayer's argument was predicated on the policy objective that Australia should not tax foreign beneficiaries of resident trusts in respect of CGT assets that were non-TAP. As stated above, this was how the provisions were administered by the ATO up until its consultation in 2016 and is consistent with the international principles of taxation based on residency and source.

It appears that Thawley J had sympathy for this position as he set out the policy rationale for source-based taxation at length in his judgment on a matter which was not at issue. However, his Honour concluded that interpreting the rules of taxation as they relate to trustees and foreign beneficiaries through this lens offends the principle that the purpose of the legislation should be read by reference to the statute itself, "not from an assumption about the desired or desirable operation of the provisions".

He went on to note at para 70 that:

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

While ultimately finding in favour of the Commissioner, one reading of this section of the judgment suggests that Thawley J considered the outcome asserted by the taxpayer as a desirable operation of the provision. The author will leave it to the reader to judge on this matter.

CGT event E4

The taxpayer haphazardly argued that an in specie distribution of trust capital triggered CGT event E4 which overrode the general provisions relating to trustee taxation and the taxation of beneficiaries of Australian resident trusts. The taxpayer asserted this on the basis that they had become specifically and absolutely entitled to the shares which had formerly been an asset of the trust. There was another school of thought that an in specie distribution might create a fixed trust over the specific capital gain being distributed and could entitle the non-resident beneficiary to access s 855-40. Thawley J did not opine on this issue at length other than stating that the mechanisms for calculating capital gains for trusts and individuals under Subdiv 115-C prevail over CGT event E4.

Perhaps his Honour would form a different conclusion if the trust were wound up and the beneficiary became absolutely entitled through a dissolution.

Conclusion

It is an unfortunate state of affairs when local revenue authorities apply domestic income tax laws to assert the right to tax a foreign individual on foreign sourced income. The fact that a foreign individual holds an investment through an Australian discretionary trust is not, in the author's view, sufficient justification to depart from the internationally entrenched principles of source and residence. As set out in this article, Thawley J took a legalistic approach to s 98, Div 6E, Subdiv 115-C and Div 855 when determining the outcome of the *Greensill* decision. For now, and until either an appeal or legislative amendment, foreign beneficiaries should be advised that distributing foreign capital gains through a discretionary trust is subject to trustee taxation in Australia.

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EY

References

1 [2020] FCA 559.

2 See the decisions of the High Court in *FCT v Belford* [1952] HCA 73 and *FCT v Angus* [1961] HCA 18.

3 [1918] HCA 45.

4 See *Liquidator, Rhodesia Metals Ltd v Taxes Commissioner* [1940] AC 774.

5 Australian Taxation Office, *Discussion paper: Capital gains and non-resident trust beneficiaries.* Available at www.ato.gov.au/General/Gen/Capital-gains-and-non-resident-beneficiaries.

6 See *FCT v Bamford* [2010] HCA 10 at [43]-[45].

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Split central management and control and dual residency

by Gordon Thring, CTA, Tax Partner, Deloitte

The ATO's approach to central management and control (CMAC) in TR 2018/5 and PCG 2018/9 introduces a new controversy into corporate residency by potentially treating a single board meeting as the exercise of CMAC in multiple jurisdictions. This article argues that such an approach is inconsistent with the foundation of CMAC first set out in *De Beers* case, and followed in previous dual CMAC decisions such as the *Union Corporation* case, that a company resides where CMAC actually abides and the real business of the company is carried on.

Introduction

The concept of central management and control (CMAC) as a test of corporate residency has been in the taxation lexicon for over a century and, since 1930, has been adopted in s 6(1) of the *Income Tax Assessment Act 1936* (Cth).

Despite this, CMAC has once again become a contentious issue after the ATO's new approach to corporate residency in TR 2018/5 and the accompanying PCG 2018/9 issued in response to the decision in *Bywater Investments Ltd v FCT*.[1] Particularly controversial is when "split CMAC" causes multiple residency.[2]

This article examines the principles surrounding what constitutes CMAC in situations of split CMAC. It then relates those principles to the approach of the ATO in PCG 2018/9.

De Beers case

As is customary, Lord Loreburn LC's dictum in *De Beers Consolidated Mines Ltd v Howe*[3] is the starting point for this analysis:

> "[Previous decisions] … involved the principle that a company resides for income tax purposes where its real business is carried on … I regard that as the true rule, and the real business is carried on where the central management and control actually abides."

De Beers was a company incorporated in the British colony of the Cape of Good Hope where it had its head office. It owned extensive diamond mines in the Cape Colony. According to the case, an essential part of De Beers' business was the sale of the diamonds from its mines to a syndicate of merchants. The annual contract was negotiated through the De Beers' London office with the London diamond merchants. The terms of the contract with the syndicate enabled De Beers to control the diamond trade and was "an essential part of the business of the company".

The control of the company was vested in three life governors (two of whom resided in the United Kingdom) and 16 directors (nine directors resided in the UK; the chairman, Cecil Rhodes, and six ordinary directors resided in the Cape Colony). Meetings were held weekly in the Kimberley and London.[4] The chairman (and one other Cape Colony director) travelled regularly to London to attend London board meetings when important matters were to be discussed.

The proceedings of the two boards were governed by by-laws. The Kimberley board could deal with the technical management of the company's works and operations of the mines and could authorise expenditures of up to £25,000 (£50,000 with the chairman's approval), with larger expenditure requiring a majority of all directors' approval. The policy of the board regarding matters such as the sale of diamonds, the disposal of assets and the application of profits were to be determined by the majority of directors. It was accepted that, as the London board had the majority of directors, in practice that board determined such policy matters.

The directors in London appointed four committees, including a diamond committee which reported weekly to the London board on the sale of diamonds.

The Revenue contended, and the Commissioners of Income Tax concluded, that: (1) the trade or business of De Beers constituted one trade or business which was carried on by the company within the UK at its London offices;[5] and (2) the directing power of the company was in London. As such the Revenue contended that De Beers was resident in the UK; alternatively, it was carrying on a trade or business in the UK where all of its profits were derived. Either way, it was fully assessable in the UK on its income.

As indicated, the House of Lords determined that De Beers was a UK resident. Lord Loreburn LC simply noted that the conclusions of fact (including that De Beers' trade or business constituted one trade or business exercised in the UK) "cannot be impugned".[6] The implication being that the "one" business of marketing the diamonds was controlled in London by the London board.

Since the decision in the *De Beers* case, the concept of CMAC has been refined, but the essential premise remains. In the *Bywater* decision, the joint judgement[7] described the concept of CMAC (as encapsulated in the s 6(1) definition of "resident") as being:[8]

> "… that a company's central management and control is located at the place where the company's operations are controlled and directed and the question of where a company's operations are controlled and directed is invariably a question of fact to be determined, not according to the construction of the company's constitution, but upon a scrutiny of the course of business and trading."

Split CMAC

At para 10 of TR 2018/9, the ATO makes the point that CMAC is the process of control and direction, and that CMAC is

not a physical location. However, the question invariably is whether that process of control and direction is, sufficiently, present in a jurisdiction (eg Australia).

As the *De Beers* decision exemplified, board meetings in two jurisdictions and directors travelling between jurisdictions to attend meetings is not new. However, technological developments and modern cross-border travel arrangements have resulted in this being more common. As such, the question arises as to what level of presence of the control and direction of a company's operations needs to be in a jurisdiction to conclude that it is being centrally managed and controlled from that jurisdiction?

The leading authorities on this are the decision in the *Koitaki Para Rubber Estates Ltd v FCT*[9] and the UK Court of Appeals decision in *Union Corporation Ltd v Commissioners of Inland Revenue*.[10]

The *Koitaki* case involved a New South Wales company which had its head office in Sydney (where its board met). While this resulted in the company being an Australian resident (and CMAC being exercised in Australia), the taxpayer also sought to establish that it was a Papua New Guinea resident on the basis that CMAC was being exercised in PNG. The taxpayer relied on the fact that the company's rubber plantation operations were all in PNG, where they were managed by a PNG resident manager who had a power of attorney to manage, carry on and conduct the company's business in PNG. In doing so, he sent weekly reports to the chairman of directors in Sydney.

In concluding that the production of rubber and the power of attorney in the manager were not the control of the general affairs of the company as to matters of policy or of finance (that is, they were not the exercise of CMAC), his Honour noted:[11]

> "The better opinion, however, appears to be that a finding that a company is a resident of more than one country ought not be made unless the control of the general affairs of the company is not centred in one country but is divided or distributed among two or more countries. The matter must always be one of degree and residence may be constituted by a combination of various factors, but one factor to be looked for is the existence in the place claimed as a residence of some part of the superior or directing authority by means of which the affairs of the company are controlled."

The *Union Corporation* case involved a company that was incorporated in South Africa, with a head office in Johannesburg. It was a holding company for other South African companies and some UK companies. A minority of the directors resided in South Africa, the majority in the UK. While some meetings of the board, or committees of the board, occurred in South Africa, on matters of policy and matters generally affecting the company's affairs, the supremacy rested with the board in London. On this basis, the Court of Appeal found that the real and ultimate control over the company's activities was in London and that the company was a UK tax resident. However, it was potentially relevant to the particular UK tax provision under discussion as to whether the company was also resident overseas.

Quoting with the approval Dixon J in the *Koitaki* case, Sir Raymond Evershed MR made the following observations before determining that the company was also resident in South Africa:[12]

> "The company may be properly found to reside in a country where it 'really does business', that is to say, where the controlling power and authority which, according to the ordinary constitution of a limited liability company, is vested in its board of directors, and the exercise of that power and authority, is to some substantial degree to be found."
>
> "… in other words, that there must, in order to constitute residence, be not only some substantial business operations in any given country but also present some part of the superior and directing authority."

While it is always perilous to codify principles in relation to a question of fact, the observations in the *Koitaki* and the *Union Corporation* cases indicate that, for CMAC to exist in a particular place, it is necessary to identify in that place:

- a substantial degree of the superior and directing authority by means of which the affairs of the company are controlled,
- such that it can be concluded that the company really does business there.

The cases to date involving questions of dual residency as a result of CMAC have invariably involved considering "discrete" conduct in the two jurisdictions — recognising that the management of a company is normally coordinated, discrete in the sense of being conducted at different times usually by different people. For example, in the *Union Corporation* case, it was the UK and the Johannesburg boards meeting separately, in the *Koitaki* case, it was a Sydney board and a PNG manager with a power of attorney, and in *Waterloo Pastoral Co Ltd v FCT*,[13] it was board meetings in Sydney and site visits by two directors to the Northern Territory farm to make decisions. So, the relevant consideration was whether what was done in Johannesburg, in PNG and in the Northern Territory, respectively, in isolation, constitutes CMAC resulting in tax residency. Some may say that this is coincidence. However, I consider that focusing on what is done in the jurisdiction, only, reflects the correct factual analysis as to whether the superior and directing authority was exercised in that jurisdiction.

"… focusing on what is done in the jurisdiction, only, reflects the correct factual analysis …"

ATO approach in TR 2018/5 and PCG 2018/9

Strangely, one of the more contentious issues with the ATO's new approach to CMAC is with split CMAC. It is strange because the decision in *Bywater* did not involve split CMAC (CMAC all abided in Australia), nor is there discomforting obiter as with *Malayan Shipping Co Ltd v FCT*[14] (in fact, the discussion in respect of the *Koitaki* case in *Bywater* is consistent with what has been outlined above in this article). There is no obvious catalyst for the ATO to have changed its approach to split CMAC in TR 2004/15 (see paras 16,

17 and 50). The approach in TR 2004/15 is not only more practical, but it also accords with the authorities discussed above.[15]

However, the ATO's new approach, particularly in PCG 2018/9, has caused concern that a minority of directors of a foreign subsidiary of an Australian group occasionally attending, in Australia, a board meeting remotely (eg by videoconference), or occasionally signing in Australia a circular resolution, could lead to Australian residency due to CMAC occurring in Australia. It is understood that some groups are reluctant to place Australian residents on the boards of foreign subsidiaries for fear that they will not always be available to travel overseas to attend board meetings or to sign circular resolutions. Such is the concern that there is an ongoing compliance approach (OCA) to deal with such (minor) use of "modern communication methods".

So how does the ATO express its view concerning split CMAC? Paragraph 10 of TR 2018/5 notes that CMAC is not a location and that it "may ultimately be exercised in more than one location". In para 31 of the ruling, the ATO discusses multiple places of CMAC and concludes:

> "However, a company's central management and control will only be exercised in a place for the purposes of the central management and control test if it is exercised in that place to a substantial degree, sufficient to conclude that the company is really carrying on business there."

TR 2018/5 then footnotes the *Union Corporation* case and the judgment of William J in the *Koitaki* case.

The comments in TR 2018/5 are not controversial and perhaps can only be criticised for the lack of detailed explanation (which has been left to PCG 2018/9[16]).[17]

Paragraph 76 of PCG 2018/9 sets out the reasons why split CMAC may occur:

> "76. A company's decisions may be made in more than one place in two basic situations. The directors may:
>
> – physically meet in multiple different locations where they exercise central management control of the company — for example, they regularly hold board meetings in more than one country, or
>
> – not physically meet in person to make decisions — for example, decisions are made by the directors by phone or video conference, written circular resolution or by email while they are in different locations."

While the first situation appears to involve different exercises of board authority (ie different board meetings) in different jurisdictions, the second involves the single exercise of the superior directing authority of the company (eg a board meeting) in multiple jurisdictions. It is the handling of that situation by PCG 2018/9 that is of most concern and the focus of this article.[18]

At the outset, it should be noted that there appears to be no direct authority directly dealing with the second situation.[19] As noted previously, the decided cases deal with different decision-making being conducted for the company in two jurisdictions, so they are more like the ATO's first situation. As such, the ATO's approach to the second situation is somewhat exploratory.

In PCG 2018/9, the most pertinent example to the second situation is example 13, possibility A, involving a foreign incorporated company carrying on a substantial business in the country of its incorporation. Two of its directors are residents of the foreign country and the third, Chris, is an Australian who "travels to [the foreign country] to make the high-level strategic decisions of the company during regular board meetings". Due to Chris suffering an injury and being unable to fly, a one-off videoconference board meeting is set up to enable Chris to attend from Sydney.

As the videoconference board meeting is a one-off and inconsistent with the normal way that the company exercises CMAC in its home jurisdiction, ie face-to-face meetings, the ATO accepts that CMAC is not exercised substantially in Australia.

The implication here appears to be that participation by a minority of directors (in Australia) on other than a one-off basis is an issue. As such, regular (but not every time) attendance by a minority of directors at board meetings in Australia via videoconference or signing circular resolutions in Australia would appear to be an issue for the ATO.

The relevance of Chris' injury preventing him from travelling overseas is puzzling. Is it meant to suggest that even a one-off attendance in Australia at a board meeting of a foreign company is an issue for the ATO if it is not caused by an unforeseen event such as a medical emergency?[20]

Due to the business community's concerns with the implications of Australians being on boards of foreign companies and not always being able to travel overseas to attend board meetings, the ATO introduced the OCA. However, the OCA highlights the difficulty with the ATO's approach as much as it alleviates concerns.

The conduct that is "permitted" by PCG 2018/9 may (or indeed may not), in the AT0's view, result in Australian residency. The OCA simply indicates that the Commissioner will not *normally* apply his resources to seek to treat the company as resident where the stringent requirements are met, as he considers the situation to be low risk.

The conduct analysed under the OCA is where directors regularly participate in board meetings from Australia using modern communications technology. As one of the requirements is that the substantial majority[21] of the company's CMAC is exercised in the foreign jurisdiction in which it is a tax resident, the OCA reflects that the the regular participation from Australia of a minority of directors via videoconference could potentially (in the ATO's opinion) cause the company to have its CMAC in Australia. Put another way, merely having the substantial majority of your board participation overseas will not mean that you will not have a residency issue and need to satisfy the other requirements of the OCA.

The conditions for the OCA to apply include that board meetings are:

– not part of an artificial or contrived arrangement affecting the location of CMAC;

– not part of a tax avoidance scheme involving residency issues;

– not part of an arrangement in place to conceal the ultimate beneficial or economic ownership of the company; and

– in the foreign jurisdiction, which is not a tax haven, where the majority of CMAC is located.

But the OCA only applies to listed or public groups. As such, private groups using "modern communications technology" cannot rely on the "concession". Further, the substantial majority of the CMAC needs to be exercised in a foreign jurisdiction where the company is treated as a tax resident. This is problematic where there are directors in several (non-Australian) countries who attend via videoconference or sign circular resolutions outside the jurisdiction in which the company is a tax resident.

Given that, in TR 2018/5, the ATO adopts the test in the *Union Corporation* case, how does the approach in relation to the second situation in para 76 of PCG 2018/9 reconcile with that test?

While not clear from the final version of PCG 2018/9, from discussions with the ATO during the consultation process, the Commissioner seems to adopt a particular approach as to how a "substantial" exercise of the controlling power and authority is to be found. The approach is that, in relation to a known exercise of CMAC such as a board meeting, where a substantial *part* of that exercise of CMAC is in Australia (for instance ¼, as in when one of four directors was present in Australia), the exercise of the company's controlling authority may in some substantial degree be found in Australia.

This does not appear correct to the author. An exercise of CMAC by three directors who are overseas, with the participation of one director (with no special powers) in Australia, is not the exercise of CMAC to a substantial degree in Australia. The Australian director cannot bind the company on their own. The participation by one Australian director in the exercise of CMAC which is conducted overseas by the other three directors should not be considered the exercise of CMAC, to a substantial degree, in Australia.[22]

It should be remembered that the test for CMAC, as set out in the *De Beers* case and reiterated in many other cases including the *Union Corporation* case, is: where does the company really do its business, in the sense of exercising its superior and directing authority? The participation by one director in Australia in the exercise of CMAC conducted overseas by the other three directors does not make Australia where the superior and directing authority resides, such that it can be said the company is carrying on its real business in Australia, as Lord Loreburn LC envisaged in *De Beers*.

These points were put to the ATO during consultation on PCG 2018/9. Needless to say, we agreed to disagree.

Conclusion

The CMAC test has proved to be adaptable over the years. The ATO's approach to "split" CMAC, seeking to include as a substantial exercise of CMAC in Australia a participation by a minority of directors in Australia, is an extension of that concept.

If a taxpayer wishes to avoid issues with the ATO under PCG 2018/9, they will need to be careful in having Australian directors on the boards of foreign subsidiaries where they attend board meetings from Australia, say via videoconference, to comply with the OCA.

However, as argued here, the ATO approach is inconsistent with the principle that a company resides where its superior and directing authority abides and the company truly carries on its business. Where it is not possible (such as for private groups) to comply with the OCA, arguably, residency does not result from the minority (eg one out of four) participation in Australia in a board meeting which is conducted (predominantly) overseas.[23] Such an approach is consistent with the approach in the previous tax ruling, TR 2004/15. For example, where a minority of directors regularly (but not always) participates in board meetings from Australia using modern communications technology, they should not be considered to be sufficiently carrying on CMAC in Australia such that the company is considered to be carrying on its real business in Australia. However, as CMAC "is invariably a question of fact to be determined, not according to the construction of the company's constitution, but on a scrutiny of the course of business and trading", the facts of each situation require careful consideration.

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Disclaimer

The views expressed in this article are those of the author and do not reflect the views of Deloitte.

References

1 [2016] HCA 45.

2 In the past, the author may have referred to dual residency and dual exercise of CMAC. However, as we will see, the ATO's approach in PCG 2018/9 alludes to the single exercise of control (eg the same board meeting) being the simultaneous exercise of CMAC split across multiple jurisdictions. Accordingly, the term "split CMAC" is used in this article.

3 [1906] AC 455 at 458.

4 As Phillimore J at first instance noted, this possibly meant that De Beers had two residences.

5 It is evident from the lower court judgements that this one business was the [essential} business of the control of the diamond trade through the marketing of diamonds to the syndicates.

6 In the Court of Appeal ([1905] 2 KB 612), Collins MR noted that "… it appears clear that the real business of this company was that of diamond merchants carrying on business in London." Mathew LJ indicated that the real character of the business "was one business – namely, firstly to dig for diamonds in Africa, and then to secure the sale of them on the London market under such conditions as to enable the company to obtain the control of the market for diamonds". Phillimore J at first instance agreed De Beers was carrying on trade and business in the UK, but found it unnecessary to decide if that brought all the income into the UK tax net.

7 French CJ, Kiefel, Bell and Nettle JJ. Gordon J ([2016] HCA 45 at [116]) referred to the decision in *Koitaki Para Rubber Estates Ltd v FCT* (1941) 64 CLR 241 at 248-249: "The question of where 'central management and control' is located is answered by ascertaining 'where the real business of the company is carried on, not in the sense of where it trades but in the sense of where its operations are controlled and directed. It is the place of personal control over and not the physical operations of the business which counts'."

8 [2016] HCA 45 at [40].

9 (1940) 64 CLR 15.

10 (1952) 1 All ER 646.

11 In the Full High Court decision in the *Koitaki* case, Williams J expressed the principle of dual CMAC as follows (at 250): "In order that a company may acquire a residence in two countries for the purposes of income tax, therefore, the central management and control must be divided between such countries so as to 'abide' in them both. The company through the central management and control is then metaphorically speaking both bodily present and residing by analogy in both countries."

12 (1952) 1 All ER 646 at 657 and 662.

13 [1946] HCA 30.

14 [1946] HCA 7.

15 The Board of Taxation is conducting a review of the corporate residency test and its recommendations have been sent to government. One option discussed is to reinstate the previous approach to the CMAC test in s 6(1), including with regard to split CMAC.

16 See paras 73 to 101 of PCG 2018/9 for the discussion on split CMAC, and paras 105 to 107 for the discussion on the OCA.

17 As a result of the current pandemic, the ATO has currently administratively suspended this approach (from ATO website): "If the only reason for holding board meetings in Australia or directors attending board meetings from Australia is because of the effects of COVID-19, then we will not apply compliance resources to determine if your central management and control is in Australia."

18 However, similar comments can be made about the holding of a single board meeting in Australia not resulting in CMAC.

19 It appears, in part, that this could be the case because no revenue authority (including the ATO until recently) had sought to take such an approach.

20 Example 14 in PCG 2018/9 makes it clear that, in the finely balanced situation of equal directors within and outside Australia, CMAC will be treated as being exercised in Australia. The only rider, which is a rider in all of the examples in PCG 2018/9, is if one of the directors is the real decision-maker and the other directors are passive "puppets" to that director's decisions: example 14, possibility B.

21 The author takes the ATO's use of this phrase to mean a majority by a substantial margin.

22 The view that split CMAC truly occurs based only on the conduct in each jurisdiction is more easily reconcilable to the corporate residency test being analogous to individual residency as espoused in the *De Beers* case.

23 This, as always, is subject to the requirement that the real decision-maker is not in Australia, and that the foreign directors truly exercise CMAC overseas.

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Options and NSW duty: practical considerations

by Cullen Smythe, CTA, Commissioner of State Revenue, Revenue NSW

The use of options in real estate transactions is common. However, the NSW duty implications of these arrangements are not always well understood by advisers. Failure to understand the duty position can result in multiple imposts of duty — a cost that often arises when a taxpayer is least able to afford it. This article outlines the NSW duties regime applying to options, including the nature of options, and discusses issues around option transfers, the nomination of another person to exercise the option, novations, the assignment of option rights, and issues arising from simultaneous put and call options. The article also outlines a number of practical issues that should be considered by taxpayers and their advisers before entering into these arrangements.

Introduction

While the use of options is common in real estate transactions, the duties consequences are not well understood by many legal and commercial practitioners. This is apparent in the often poor drafting of options (from a revenue perspective), resulting in double and sometimes triple duty being payable. What makes this worse is that the additional liability may only become apparent when the documents are lodged for stamping and the purchaser is not in possession of the financial resources to meet their transfer duty obligations.

The purpose of this article is to raise awareness of some of the common New South Wales duty issues that arise from property options. Of course, the comments are *general in nature.* Due to the technical nature of duties law, careful attention should be given to the specifics of each document and arrangement associated with an option. It should also be noted that these comments are limited in application to the position under the NSW *Duties Act 1997* (Duties Act), and cannot be taken to apply to any other jurisdiction.

Basics

So, what exactly is an option?

For current purposes, an option is usually a right to enter into a real property transaction, subject to certain conditions. However, there is a "standing controversy"[1] as to the precise legal nature of an option, and depending on where a particular arrangement falls, the duty consequences can be completely different.

The two arms of the "standing controversy" were summarised by Gibbs J in *Laybutt v Amoco Australia Pty Ltd*:[2]

> "One view is that an option to purchase is 'a contract for valuable consideration, viz., to sell the property (or whatever the subject matter may be) upon condition that the other party shall within the stipulated time bind himself to perform the terms of the offer embodied in the contract': per Griffith C.J. in Goldsborough, Mort & Co. Ltd. V. Quinn … (1910) 10 CLR 674, at p 678. The other view is that 'an option given for value is an offer, together with a contract that the offer will not be revoked during the time, if any, specified in the option': per Latham C.J. in Commissioner of Taxes (Q.) v. Camphin … (1937) 57 CLR 127, at p 132."

In reaching their decision, the High Court carefully considered the precise terms of the arrangement, and while Gibbs J found that this particular arrangement amounted to a conditional contract, he left open the possibility that a different form of arrangement would have a different result:[3]

> "… I consider that an option to purchase (at least one in a form similar to that in the present case) is a contract to sell the land upon condition that the grantee gives the notice and does the other things stipulated in the option."

Subsequent courts, when considering the nature of particular "options", have followed a similar process of careful consideration of the terms of each arrangement[4] — a process that practitioners would be wise to follow. This is particularly important, given the different ways in which the term "option" is used, for example, lease options (that allow for further terms of a lease) are usually in the form of a conditional agreement, subject to acceptance, rather than the irrevocable offer[5] which is a common method of drafting commercial property arrangements.

There is little doubt that a conditional contract is in fact an agreement that is sufficient to trigger the liability provisions of the Duties Act,[6] and this is where the characterisation of the arrangement is critical — a conditional contract dealing with dutiable property will generally attract duty under Ch 2 of the Duties Act as a dutiable transaction, whereas (subject to the comments below) an option arrangement generally will not. A failure to appreciate the difference can land both the taxpayer and their legal adviser in all sorts of hot water.

NSW duties regime

Chapter 2 transactions

The Duties Act imposes a number of duties on different transactions and arrangements. Chapter 2 of the Duties Act imposes duty on "dutiable transactions" over "dutiable property". A "dutiable transaction" is defined in s 8 to include, among other things, transfers, agreements to transfer and declarations of trust.

The term "dutiable property" is defined in s 11 to include, among other things, "land in New South Wales"[7] and "an option over land in NSW".[8] "Dutiable property" is also defined to include an interest in dutiable property. However, specifically excluded from this definition is an interest that

arises only as a result of having an option over the property. The aim of this provision was to ensure that the type of "interests" on which duty is imposed is limited but it does not override the express inclusion of an option over land in NSW.

Where a liability arises under Ch 2, duty is calculated at rates of up to $5.50 per $100, or part, of the greater of the unencumbered market value of the dutiable property dealt with and the consideration for the transaction (up to $7 per $100, or part, for premium residential property[9]). In the case of the transfer of an option, this will generally be the value of the option rather than the underlying property (subject to the comments below).

A liability will generally arise on the exercise of the option which involves the formation of a legally binding agreement to transfer, and a transfer instrument. While both of these instruments can be liable to duty, s 18(2) will usually operate to ensure that, where ad valorem duty is payable on the agreement, duty of $10 will be payable on a transfer that conforms with the agreement.[10]

Dutiable property and s 9B

In addition to the dutiable transaction provisions outlined above, s 9B of the Duties Act operates to treat the following dealings as transfers where they occur for valuable consideration:

- the nomination of another person to exercise the option;
- the nomination of a person as purchaser/transferee; or
- a person agrees to a novation of the option or relinquishes rights under an option so that another person obtains rights to exercise the option or purchase the land.

While not defined in the Duties Act, at common law, a "novation" generally occurs where a new contract is substituted for an old contract.[11] This may occur where, for example, rather than assigning the option, the grantee and the grantor agree that the existing option will be rescinded and a new option on materially the same terms will be granted to a third party.

Where s 9B is triggered, the duty is calculated in accordance with s 21 as the greater of the consideration for the "transfer" and the unencumbered value of the option (not the underlying land).

Example 1

Mark holds a call option to acquire commercial property for $5.8m. Kevin pays Mark $250,000 to be nominated as the person able to exercise the option.

The nomination of Kevin for valuable consideration will be treated as a transfer under s 9B(1)(a). Duty of $7,222 will be calculated in accordance with s 32 on the $250,000 option fee. The subsequent exercise of the option will trigger a liability to duty on the $5.8m purchase.

Example 2

Candice has an option to acquire commercial property for $50m. In exchange for a payment of $500,000 and with the agreement of the grantor of the option, she agrees to novate the option to William.

Example 2 (cont)

The novation for consideration will be treated as a transfer under s 9B(1)(c), and duty of $17,932 will be payable. If the option is exercised, additional duty will be payable on the transfer of the $50m property.

Nominations

As noted above, the definition of "dutiable transaction" includes both a transfer and an agreement to transfer. However, s 18(2) of the Duties Act operates to mitigate what would otherwise be a double impost of duty by providing that duty of $10 is payable on a transfer that is made in conformity with an agreement where duty has already been paid. Section 18(2) extends this concession to a limited range of transfers that are not in conformity (for example, involving certain related entities).

The meaning of "in conformity" has been the subject of judicial consideration in a stamp duty context on a number of occasions. A key element when considering whether a transfer is "in conformity" is whether the transferee under the transfer is the same as that named in the agreement — if it is, the transfer will be "in conformity" and subject to duty of $10. Conversely, as noted by Jordan CJ of the NSW Supreme Court in the decision of *Lake Victoria v Commissioner of Stamp Duties*:[12]

> "A conveyance is not made in conformity with the agreement, unless it is made to the purchaser, or if the agreement provides that it is to be made not to the purchaser but to some other person, to that other person."

This position was further considered by the High Court in the case of *Vickery v Woods.*[13] That case involved a transfer to a named company that was not in existence at the time the agreement was entered into. When considering whether the transfer was in conformity with the agreement, Dixon CJ referred to the statement of Jordan CJ above, and noted:[14]

> "Clearly enough Jordan C.J. was here speaking of a person identified in the contract as opposed to any nominee, but I am not inclined to think that it makes any difference if the identifiable person is a contemplated company yet to be clothed with legal personality."

It is clear from these cases that, if the transferee is identifiable from the stamped agreement, a transfer to that party will attract duty of $10 in accordance with s 18(2), regardless of whether the transferee is the purchaser, a different (but named) transferee, or one of a list of possible transferees all of which are named. Subject to the operation of s 18(3), a transfer clause in the agreement that involves language such as, "The property will be transferred to the Purchaser or nominee" without naming the nominee within the agreement, will not be viewed as a transfer in conformity. In such cases, full ad valorem duty will usually be payable on each of the agreement and the transfer instrument.

Section 18(3) of the Duties Act operates to extend the concessional duty treatment for certain transfers between related persons or self-managed superannuation fund custodians. This provision is applied strictly, and care should be taken when drafting documents that seek to rely on it.

The Chief Commissioner's interpretation of s 18(2) and (3) is detailed in Revenue Ruling DUT 010 version 2, which also provides a number of scenarios illustrating when the sections will be applied.

Example 1

An agreement between XYZ Co Ltd as vendor and Mark as purchaser is appended to an option for a $10m commercial property. The agreement contains the following transfer clause: "Transfer to Purchaser or SW Enterprises Pty Ltd". At the time the option is exercised and the agreement is entered into, SW Enterprises Pty Ltd has not been incorporated. Two weeks later, the company is incorporated and the property is transferred to the company.

Duty of $535,302 is payable on the agreement within three months of its execution.[15] As SW Enterprises Pty Ltd was identified in the agreement (although it was not in existence at the time the document was executed), the transfer will be in conformity with the stamped agreement, and additional duty of $10 will be payable on the transfer under s 18(2).

Example 2

An agreement between XYZ Co Ltd as vendor and Gary as purchaser is appended to an option for a $10m commercial property. The agreement contains the following transfer clause: "Transfer to Gary or nominee". The term "nominee" is not defined in the agreement. Gary nominates Michele as transferee and the property is transferred to her. Assuming that Gary and Michele are not related persons and that none of the relationships in s 18(3) apply, duty of $535,302 would be payable on the agreement by Gary, and duty of $535,302 would be payable on the transfer by Michele.

Chapter 3: certain transactions treated as transfers

Chapter 3 of the Duties Act contains provisions that treat certain transactions as transfers and, relevantly for the current discussion, specifically covers arrangements involving put and call options.[16]

Arrangements involving simultaneous (or near simultaneous) put and call options are often used to commercially lock in a transaction, particularly where financing is being arranged. Merely entering into an arrangement involving both a put and a call option will not trigger a liability to transfer duty in NSW.[17] However, a subsequent "assignment" of the rights under the call option is treated as a transfer and will attract duty at transfer rates. What often surprises taxpayers caught by these provisions is that the duty on the value of the underlying property is payable by the transferor, rather than the transferee,[18] of the option. The reason for this is that the assignment of the option is treated as crystalising the effective transfer established by the put and call arrangement.

For the purposes of Pt 2 of Ch 3 of the Duties Act, an "assignment of rights" is interpreted broadly to include the following arrangements:

- a relinquishment of rights under a call option for valuable consideration;
- an assignment of the rights; or
- the nomination of another person for valuable consideration.

It is important to remember that surcharge duty may also apply where the property the subject of the option is residential, and the assignor of the call option is a "foreign person" for the purposes of the Act.[19]

Example

Jenny owns a commercial property worth $1.5m. She enters into an option arrangement with Jane where Jane has a call option for the next 30 days, and if it is not exercised within that time, a put option will become active that allows Jenny to assign the property to Jane. Jane assigns her call option to William for $20,000.

Jane will liable to duty under s 108(1) of the Duties Act calculated on the value of the commercial property (that is, duty of $67,802 will be payable). William will be liable on the acquisition of the option as a transfer of dutiable property, and duty of $265 will be payable. This amount can be offset against Jane's liability[20] so that she will only need to pay $67,537 (that is, $67,802 – $265).

Other option issues

Declarations of trust

It is surprisingly common for declarations of trust to occur in all manner of commercial documents where the trust itself is merely ancillary to the primary purpose of the document. In many cases, these trusts are declared over non-dutiable items such as proceeds of sale, or the benefit of promises (for example, in financing arrangements[21]). However, there is a particular risk in real property related documents where a declaration of trust can actually be made over identified dutiable property. In such cases, there is a risk that the duty payable will be calculated by reference to the value of the identified property at full ad valorem rates.[22]

> *"There is little doubt that a conditional contract is in fact an agreement that is sufficient to trigger the liability provisions of the Duties Act ..."*

It would be a rare transaction indeed where such an amount would not be significantly more than was envisaged by a taxpayer. Where this has resulted from poor drafting or deal management, the result may well be legal action against the solicitor drafting the documentation.

Landholder duty: put and call options as uncompleted agreements

Chapter 4 of the Duties Act imposes duty at transfer rates on certain dealings in "landholders".[23] A "landholder" is a unit trust scheme, a private company or a listed company that has landholdings (held directly or indirectly through downstream entities[24]) in NSW above a certain threshold.[25]

Special rules apply to treat a landholder as being entitled to real property subject to "uncompleted contracts".[26] In addition to an ordinary contract for sale that is yet to complete, an uncompleted contract is defined to include an arrangement that includes both a put option and a call option.[27] This means that a company that has no freehold or leasehold property at the time of its acquisition can still be liable for landholder duty. While a refund of duty is available where the conditional contract does not complete,[28] failure to manage this liability can result in cashflow issues and, in some situations, in action against the legal or tax advisers.

Conclusion

There are only a few issues that need to be considered from a duty perspective when using options. However, it is all too common for advisers to overlook the duty implications of entering into put and call options or to fail to consider the implications of a nomination. The consequences of these oversights can be devastating to both clients and advisers alike.

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Revenue NSW

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1 In *Braham v Walker* (1961) 104 CLR 366 at 376.

2 [1974] HCA 49 at [10].

3 [1974] HCA 49 at [16].

4 See, for example, the judgment of Gummow J in *Sydney Futures Exchange Ltd v Australian Stock Exchange Ltd and Australian Securities Commission* (1995) 56 FCR 236 at 451 regarding "context", and that of Senior Member Pascoe in *'VAN' and FCT* [2002] AATA 1313 for an outline of the characterisation process.

5 For example, see *Whitemore Pty Ltd v OF Gamble Pty Ltd* (1991) 6 WAR 110 at 116 where the terms of the "option" clause are discussed.

6 For example, see the decision of the Full Court of the Supreme Court of Qld in *Pacific Fair Shopping Centres Pty Ltd v Commissioner of Stamp Duties (Qld)* [1979] Qd R 410.

7 S 11(1)(a) of the *Duties Act 1997* (NSW).

8 S 11(1)(k) of the *Duties Act 1997* (NSW).

9 S 32A of the *Duties Act 1997* (NSW).

10 S 18(3) of the *Duties Act 1997* (NSW) extends the definition of "in conformity" and is dealt with in more detail in Revenue Ruling DUT 010 version 2.

11 See *ALH Group Property Holdings Pty Ltd v Chief Commissioner of State Revenue (NSW)* (2012) 245 CLR 338 at 346; *Olsson v Dyson* [1969] HCA 3.

12 (1949) 49 SR (NSW) 262 at 265.

13 [1952] HCA 7.

14 [1952] HCA 7 at [1].

15 S 16(1) of the *Duties Act 1997* (NSW).

16 Ss 106 to 111 of the *Duties Act 1997* (NSW).

17 This treatment is not uniform across Australia. See, for example, s 45 of the *Duties Act 2008* (WA).

18 S 108(1) of the *Duties Act 1997* (NSW). While additional duty may also be payable by the transferee under Ch 2 (s 108(3)), this amount may be credited against the call option assignment duty payable by the assignor (s 108(4) of the *Duties Act 1997* (NSW)).

19 S 108A(3) of the *Duties Act 1997* (NSW). The definition of "foreign person" is found in s 104J(1) of the *Duties Act 1997* (NSW).

20 S 108(4) of the *Duties Act 1997* (NSW).

21 In such cases, duty is often $500 (s 58(1) of the *Duties Act 1997* (NSW)).

22 For an example (albeit in relation to shares rather than real property), see the decision of the NSW Court of Appeal in *Chief Commissioner of State Revenue v Platinum Investment Management Ltd* [2011] NSWCA 48 where a trust declared over identified but unissued shares was liable to duty.

23 The making of a "relevant acquisition" — generally 50% in a private company or unit trust or 90% in a listed entity (s 148 of the *Duties Act 1997* (NSW)). This can be through a direct acquisition of a majority interest, an acquisition of a lesser amount that, when combined with interests already held or acquired by the acquirer or an associate, amounts to 50%/90%.

24 S 158A of the *Duties Act 1997* (NSW).

25 S 146 of the *Duties Act 1997* (NSW).

26 S 160(1) of the *Duties Act 1997* (NSW).

27 S 160(3A) of the *Duties Act 1997* (NSW).

28 S 160(3) of the *Duties Act 1997* (NSW).

A Matter of Trusts

by Timothy Colcutt, Sladen Legal

Trading trusts and the oppression remedy

The law relating to oppression remedies being applied to trading trusts remains shrouded in uncertainty. What has caused this uncertainty? And can certainty be restored?

Introduction

Since rising to prominence in Australia a number of decades ago, trading trusts have become an integral part of the Australian economic landscape. They are used extensively for business structuring and succession planning across a wide range of businesses, from small family operated businesses to larger, more complex business structures. It is common knowledge that trading trusts are usually set up for asset protection and tax planning purposes. However, an important aspect of trading trusts that is often overlooked when the trust is being set up, is what recourse the beneficiaries of the trading trust will have if the trustee manages the affairs of the trust in an oppressive manner.

This article explores whether the conduct of a corporate trustee of a trading trust can be regulated by the oppression provisions of the *Corporations Act 2001* (Cth) (Corporations Act), and where this area of the law is heading. The focus of the article is on the application of the oppression remedies on any trading trusts other than managed investment schemes, regulated or statutory superannuation trusts or charitable trusts, as those types of trusts are regulated by legislation which falls outside the scope of this article.

The article first considers the oppression provisions under the Corporations Act and how they apply to shareholders of companies, before looking at how those oppression provisions have been applied to trading trusts.

Oppression provisions under the Corporations Act

The rights and remedies that are available to shareholders who are oppressed by the conduct of the affairs of the company under Ch 2F of the Corporations Act, and how that area of the law operates, is well-established in Australia. In describing oppressive conduct in the context of corporate law in Australia, Brockett states:[1]

> "… the Courts have held that oppression connotes a lack of probity and fair dealing[2] (although this is not a necessary condition),[3] is something which is burdensome, harsh or wrongful,[4] or is inequitable or unjust,[5] or exhibits commercial unfairness."

Grounds for finding oppression under s 232

The grounds on which the court can make a finding of oppression, and hence enliven its power to make orders under s 233 of the Corporations Act to relieve a shareholder from such oppression, are set out in s 232 of the Corporations Act. That section provides:

> "The Court may make an order under section 233 if:
>
> (a) the conduct of a company's affairs; or
>
> (b) an actual or proposed act or omission by or on behalf of a company; or
>
> (c) a resolution, or a proposed resolution, of members or a class of members of a company;
>
> is either:
>
> (d) contrary to the interests of the members as a whole; or
>
> (e) oppressive to, unfairly prejudicial to, or unfairly discriminatory against, a member or members whether in that capacity or in any other capacity."

Forms of relief available to shareholders under s 233

On the court making a finding of oppression under s 232, the court has a broad discretion to make any orders under s 233 that it considers appropriate in relation to the company. The orders that a court can make under s 233 include winding up the company, appointing a receiver of any or all of the company's property, regulating the conduct of the company's affairs, and requiring a person to do, or not to do, a specified act. However, the most common form of relief that the court will order under s 233 is for the majority shareholder(s) of the company to buy the shares of the minority shareholder(s) at fair value. Austin and Ramsay state that:[6]

> "… the present breadth of the oppression provision and the range of flexible remedies a court is able to order has made it 'one of the most widely used corporate law remedies'."

The oppression remedy and the oppressed beneficiary

Trusts and the conduct of trustees are regulated by the states' trust legislation, common law and equity. An examination of the range of remedies available to an oppressed beneficiary under the states' trust legislation, common law and equity is beyond the scope of this article. Different lines of authority have emerged in the New South Wales and Victorian Supreme Courts, however, as to whether the oppression provisions under the Corporations Act are also able to be used to regulate the conduct of corporate trustees. This has created much uncertainty in this area of the law.

The line of authority endorsed by the Supreme Court of NSW

Judgments of the Supreme Court of NSW have consistently held that the oppression provisions under the Corporations Act do not extend to trusts. That line of authority was encapsulated in the judgment of Windeyer AJ of the Supreme Court of NSW in *Trust Company Ltd v Noosa*

Venture 1 Pty Ltd[7] where it was found that it was not within the court's power to make an order under s 233 of the Corporations Act requiring one trust beneficiary to buy out the interest of another trust beneficiary, because such an order would be an order in relation to the trust, not in relation to the company.

The Supreme Court of Victoria's divergent line of authority

The Supreme Court of Victoria on the other hand has ruled on more than one occasion that, by virtue of s 53 of the Corporations Act, the oppression provisions under the Corporations Act can also be applied to regulate the conduct of corporate trustees where that conduct is found to oppress a beneficiary of the trust, where that beneficiary is also a shareholder of the corporate trustee.

In her seminal judgment in *Vigliaroni v CPS Investment Holdings Pty Ltd* (*Vigliaroni*),[8] where she found that s 53 of the Corporations Act gives the court the power to apply the oppression provisions under the Corporations Act to trusts with corporate trustees, Davies J of the Supreme Court of Victoria expressly departed from the line of authority endorsed by the Supreme Court of NSW. When referring to the cases which form the line of authority that the Supreme Court of NSW has followed, and considering the operation of s 53 of the Corporations Act, Davies J stated:[9]

> "None of those cases considered the scope of the oppression power and jurisdiction of the Court to grant relief having regard to s 53, although s 53 appeared in the legislation at the time those cases were decided in terms similar to the provision as it now appears. It would appear that s 53 was not brought to the attention of the Courts in those cases. Section 53 has been brought to my attention and I must decide in light of s 53 whether my powers are circumscribed so that I cannot make an order under s 233 in respect of a trustee company. In my view, s 53 puts beyond any doubt that the Court's jurisdiction and powers under the statutory oppression provisions are not circumscribed in respect of a trustee company and accordingly I conclude that I should depart from the view expressed by Young J in Kizquari and the cases which have supported that view, in view of s 53. I would also respectfully disagree with the view that Chesterman J expressed in Re Polyresins Pty Ltd which Young JA cited with approval in McEwan that the equitable interests in the trust cannot be dealt with by the Court under s 233."

Davies J's decision in *Vigliaroni* has since been approved by Ferguson J of the Supreme Court of Victoria in *Wain v Drapac*,[10] confirming that the lines of authority endorsed by the Supreme Courts of NSW and Victoria on this matter have clearly diverged.

The need for legislative reform?

There has been a groundswell of commentary and debate on this area of the law since Davies J's decision in *Vigliaroni,* with Ferguson J endorsing that decision in *Wain v Drapac*. In light of that debate and the uncertainty that has arisen as a result of those decisions, the Attorney Generals of Victoria and NSW have each asked their respective Law Reform Commissions to review and report on, among other things, the application of oppression remedies to trading trusts.

Victorian Law Reform Commission report

In 2013, the Victorian Law Reform Commission (VLRC) was asked to review and report on the desirability of having similar legislative remedies in Victoria to protect the rights of the beneficiaries of trading trusts who may be subject to oppressive conduct by a trustee as those remedies that are available to shareholders for oppressive conduct by a corporation under s 233 of the Corporations Act.[11] In conducting its review, the VLRC was to have regard to, among other things, whether adequate remedies for beneficiaries subject to oppressive conduct by the trustee of a trading trust are already available under Victorian statute or the common law and the interaction between state and Commonwealth laws.[11]

The VLRC released its report in January 2015 (the VLRC report). The VLRC report provided a comprehensive analysis of the oppression remedies under the Corporations Act, the state of the law as it then was in relation to how the oppression provisions under the Corporations Act applied to trading trusts, and what steps could be taken to address the oppression of beneficiaries of trading trusts in Victoria. The VLRC report has formed the basis of much of the commentary on this topic since that report was released.

The VLRC report found that, among other things:

- the existing remedies under the equitable doctrines, corporations or trusts legislation are inadequate for beneficiaries of trading trusts facing oppression;[12]
- the existing oppression remedies under the Corporations Act alone will not be sufficient to protect all beneficiaries of trading trusts because a beneficiary seeking to access the remedy must also be a shareholder in the corporate trustee;[13] and
- trading trusts and corporations should be treated in a similar fashion as regards oppression remedies.[12]

The VLRC report recommended, among other things, that the *Trustee Act 1958* (Vic) should be amended to:[14]

- provide for the beneficiaries of trading trusts who are subject to oppressive conduct to be able to apply to the Supreme Court of Victoria for a remedy in respect of any trading trust other than a managed investment scheme, a regulated or statutory superannuation trust or a charitable trust; and
- empower the Supreme Court of Victoria to make any order that it considers appropriate in relation to the trading trust, in terms similar to s 233 of the Corporations Act.

New South Wales Law Reform Commission report

In 2017, the New South Wales Law Reform Commission (NSWLRC) was asked to review aspects of the law of trusts in NSW, including whether oppression remedies available to shareholders under the Corporations Act should be extended to beneficiaries of trading trusts.[15] The NSWLRC was also asked to consult and report on whether NSW should adopt the recommendations of the VLRC report.[16] The NSWLRC released its report (NSWLRC report) in May 2018.

Contrary to the VLRC report, the NSWLRC report recommended that the oppression remedies available to

shareholders under company law should not be extended to beneficiaries of trading or other trusts under the law of trusts.[17] In reaching that conclusion, the NSWLRC report considered, among other things, that:

– there is not a sufficient case for providing a discretionary remedy for oppression similar to that of s 233 of the Corporations Act in the context of the law of trusts. The NSWLRC noted that such a remedy would be inconsistent with a fundamental feature of a discretionary trust, namely, that the trustee has a discretion to discriminate between beneficiaries, and that having such a remedy available for some trusts but not others is not desirable because there would be difficulty in identifying those trusts to which it should apply;[18]
– the current law of trusts provides adequate and appropriate remedies for a beneficiary who is oppressed in the sense in which that term is used in company law;[19] and
– the differing approaches of the Victorian and NSW courts to the availability of the Corporations Act remedy where there is a corporate trustee may be resolved at the appellate level. If it is not, the appropriate response is for the Corporations Act to be amended, not the states' trust laws.[20]

Conclusion

It is clear from the decisions of the Supreme Courts of Victoria and NSW, and the findings of the VLRC and NSWLRC in their respective reports, that the law in relation to how the oppression remedies under the Corporations Act apply to trading trusts is uncertain.

In the author's view, it is inevitable that this disunity in the law, and the uncertainty that it creates, will have a detrimental impact on how trading trusts conduct their business affairs. It is therefore important not only for the stakeholders involved with trading trusts, but also for the broader economy, that uniform laws are developed to restore certainty to this area of the law. In order to achieve that, the author suggests that the state and federal governments would have to engage in legislative reform of the trust laws in unison. While the author appreciates that this could be an extensive undertaking that could take years to complete, it would be a worthwhile endeavour in order to provide much needed certainty to this area of the law.

Irrespective of how this area of the law develops, one thing will remain certain: it is important that advisers remain aware of what recourse beneficiaries have against trustees who manage the affairs of the trust in an oppressive manner.

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18 New South Wales Law Reform Commission, *Laws relating to beneficiaries of trusts*, May 2018, para 1.7.

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Superannuation

by Daniel Butler, CTA, Shaun Backhaus, and Zac Galloway, DBA Lawyers

Electronic execution of deeds by individuals

The electronic execution of a deed by individuals can occur in Victoria until 24 October 2020 and in NSW until 22 October 2020.

The longstanding position at common law has been the formality that a deed must be written on parchment, vellum or paper. Accordingly, it has been widely accepted that a deed cannot be made electronically.

The first key change to this position was in 2018 when the New South Wales Government amended the *Conveyancing Act 1919* (NSW) to include s 38A to authorise a deed to be made and signed in electronic form. However, as explained below, this change has had limited application until recently.

Given COVID-19 developments, states and territories across Australia have been passing their own unique legislation to allow for more documents, especially wills and powers of attorney, to be signed and witnessed electronically.

Note also that, on 22 May 2020, Queensland passed the *Justice Legislation (COVID-19 Emergency Response — Wills and Enduring Documents) Amendment Regulation 2020* (Qld) which amended the *Justice Legislation (COVID-19 Emergency Response — Wills and Enduring Documents) Regulation 2020* (Qld) to allow for, among other things, deeds to be made electronically. The Queensland regulations are quite extensive and do not lend themselves to a succinct summary here. Accordingly, this article only summarises the position in NSW and Victoria.

It is possible that other jurisdictions may still pass legislation to allow for deeds to be signed and witnessed electronically and the status of each of these jurisdictions should be carefully monitored.

Broadly, the legislation only has temporary application, with the authorisation only lasting until 24 October 2020 in Victoria, and 22 October 2020 in NSW (with the exception of s 38A of the *Conveyancing Act 1919* (NSW) which has ongoing application).

This article focuses on the execution of *deeds by individuals* (as compared to deeds by companies and other documents such as contracts and other documents).

NSW position

New South Wales has for some time allowed deeds to be made by individuals via technology (see s 38A of the *Conveyancing Act 1919* (NSW)). However, uncertainty regarding witnessing that has limited the spread of this practice.

On 22 April 2020, the NSW Government made the *Electronic Transactions Amendment (COVID-19 Witnessing of Documents) Regulation 2020* which inserted Sch 1 into the *Electronic Transactions Regulation 2017* (NSW Regulation). Broadly, the NSW Regulation authorises signatures on deeds and certain other documents to be witnessed via audio-visual link until 22 October 2020.

Under the NSW Regulation, for electronic witnessing to be effective, the witness must:

- observe the person signing the document (the signatory) in real time;
- attest or otherwise confirm that the signature was witnessed by signing the document or a copy of the document;
- be reasonably satisfied that the document the witness signs is the same document, or a copy of the document, signed by the signatory; and
- endorse the document with a statement:
  - specifying the method used to witness the signature of the signatory; and
  - that the document was witnessed in accordance with the NSW Regulation.

The NSW Regulation expressly states that the requirement for the presence of a witness, in an Act or another law, is taken to be satisfied if the witness, signatory or other person is present by audio-visual link.

Victorian position

On 12 May 2020, the Victorian Government made the *COVID-19 Omnibus (Emergency Measures) (Electronic Signing and Witnessing) Regulations 2020* (Vic Regulations), which amended provisions of the *Electronic Transactions (Victoria) Act 2000* to permit electronic signatures and the witnessing of deeds and certain other documents by audio-visual link until 24 October 2020.

The Vic Regulations modify the definition of a "transaction" to include, among other things, transactions in the nature of deeds.

Section 9(1) of the *Electronic Transactions (Victoria) Act 2000* provides:

> "If, by or under a law of this jurisdiction, the signature of a person is required, that requirement is taken to have been met in relation to an electronic communication if —
>
> (a) a method is used to identify the person and to indicate the person's intention in respect of the information communicated; and
>
> (b) the method used was either —
>
> (i) as reliable as appropriate for the purpose for which the electronic communication was generated or communicated,

in the light of all the circumstances, including any relevant agreement; or

(ii) proven in fact to have fulfilled the functions described in paragraph (a), by itself or together with further evidence; and

(c) the person to whom the signature is required to be given consents to that requirement being met by way of the use of the method mentioned in paragraph (a)."

The Vic Regulations confirm that the other party's consent is required for documents to be signed electronically. Interestingly, the Vic Regulations inserted s 9(1A) in the *Electronic Transactions (Victoria) Act 2000* which provides:

"The fact that a person proposes to use a method referred to in subsection (1)(a) involving an electronic signature is not of itself sufficient reason to refuse to give the consent referred to in subsection (1)(c)."

It appears that this was included to protect parties who wish to sign electronically from having their request refused without a valid reason. For example, some parties (such as suppliers and financial institutions) may still insist on traditional execution rather than having to carefully scrutinise whether a deed executed electronically satisfies the relevant criteria to ensure that it is legally effective. This aspect is likely to impose extra costs on the counterparty who may not wish to execute the deed electronically, or who may seek to have the cost of their legal advisers approved (who may be instructed to review the electronic deed) before they will execute electronically.

The Victorian Department of Justice and Community Safety posted an article on the Vic Regulations and provided the following guidance for signing a document electronically:[1]

"You can electronically sign a document in a number of ways including signing a PDF on a tablet, smartphone or laptop using a stylus or finger. Where an electronic signature is used the person signing must write or stamp under their signature a statement indicating that the document was electronically signed in accordance with the Regulations."

An example of a valid statement is:

This document was electronically signed in accordance with the COVID-19 Omnibus (Emergency Measures) (Electronic Signing and Witnessing) Regulations 2020."

Note that witnessing is not a strict legal requirement for deeds that are made in Victoria. This leaves open the question as to whether a deed made electronically should be witnessed. The authors' view is that, while this is not a legal requirement, it is best practice to have a witness attest to the execution of a deed as most people expect this to occur. However, a deed remains valid in Victoria despite there being no witnesses.

The *Electronic Transactions (Victoria) Act 2000* also requires the witness to write a statement that indicates that the deed was witnessed by audio-visual link in accordance with the requirements. In the absence of this statement, the requirements are not taken as being met. The Department of Justice and Community Safety provided the following as an example of a valid statement:[1]

"This document was witnessed by audio-visual link in accordance with the COVID-19 Omnibus (Emergency Measures) (Electronic Signing and Witnessing) Regulations 2020."

While not expressly stated in the Vic Regulations, a witness attesting to the execution of a deed electronically should be satisfied of the following:

– the identity of the signatory;
– that the signatory has decision-making capacity;
– that there is no defect such as undue influence, duress or unconscionable conduct apparent in the transaction; and
– that the signatory is signing freely and voluntarily.

The Vic Regulations also authorise deeds to be signed and witnessed in counterparts.

Regulation 12(4) of the Vic Regulations provides:

"None of the following circumstances prevents those requirements from being taken, under section 9(1) of the **Electronic Transactions (Victoria) Act 2000**, to have been met —

(a) some of those signatures appearing on only some of the copies of the document; or

(b) there being a copy on which not all the signatures appear; or

(c) there being no copy on which all the signatures appear."

The requirements are taken to be met provided every signatory or party whose consent is required under the Vic Regulations receives every copy of the document on which a signature appears. This overcomes the need for each party to sign the same document.

When making a deed electronically, any copy, counterpart or electronic document must include the entire contents of the document (ie not simply the execution page). Advisers who seek to take short-cuts by merely putting in front of a client the pages that require signing might render that document ineffective.

Should you make a deed electronically?

Self-managed superannuation fund, trust and similar deeds form an integral part of people's retirement, estate and succession plans. Accordingly, care should be taken when making a deed electronically so that it is legally effective.

If you seek to make a deed electronically, it is vital that you comply with all of the requirements of the jurisdiction in which the deed is being made. Currently, NSW, Victoria and Queensland are the only Australian jurisdictions where this can be done. Other jurisdictions may still introduce similar changes. As noted above, failure to comply with the formalities can result in a deed being ineffective, with consequential risk exposure.

Of course, those who make a deed electronically can, and arguably should, go above and beyond what is required by the regulations. For example, parties may wish to record the audio-visual link to refer to later on just in case the deed is ever challenged. Detailed file notes, copies of identities, time records etc should also be made, especially if an adviser is involved. Furthermore, parties may choose to sign a hard copy and then scan and send it to the next party to sign and/or witness while maintaining an audio-visual link.

Care should also be given to ensure that the documents being signed and witnessed electronically are drafted in a manner that meets the relevant requirements. There are many document suppliers who are still supplying out-of-date

documents and who are not capable, or qualified, to provide this type of service.

Electronic execution of deeds by companies

Despite temporary relief for companies being introduced from 6 May 2020 by the *Corporations (Coronavirus Economic Response) Determination (No. 1) 2020* (Determination) which ceases on 5 November 2020, it is recommended that company constitutions be updated to expressly authorise the appropriate use of technology rather than relying on the temporary relief measure in the Determination. This is because there are still some who have concerns as to whether s 127 of the *Corporations Act 2001* (Cth) overcomes all of the common law requirements relating to deeds.

Conclusion

The electronic execution of a deed by individuals can occur in Victoria and NSW for a temporary period that ends on 24 October 2020 in Victoria and 22 October 2020 in NSW.

Individuals should await specific legislation before seeking to execute a deed via electronic execution in any other jurisdiction.

Companies that are a party to a deed should have an up-to-date constitution that expressly empowers the electronic execution of documents to minimise risk.

A full version of the deed should always be made available to each party before and at the time of execution.

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Reference

1 Department of Justice and Community Safety, Victoria, *Electronic signing and remote witnessing during coronavirus (COVID-19) restrictions*. Available at www.justice.vic.gov.au/electronicwitnessing.

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Alternative Assets Insights

by Sach Pelpola and Peter Collins, FTI, PwC

Hybrid mismatch rules: proposed changes

Proposed amendments to the Australian hybrid mismatch rules seek to clarify a number of problematic operational issues.

In brief

On 13 May 2020, proposed amendments to the Australian hybrid mismatch rules were introduced into parliament. The measures include a range of refinements reflecting consultation in relation to exposure draft law released on 13 December 2019.

The majority of the proposed amendments are retrospective and likely to be viewed as beneficial to taxpayers as they clarify interpretative uncertainties and should reduce the compliance burden for a range of taxpayers. However, some of the proposed measures may cause difficulties for taxpayers.

In detail

The Australian hybrid mismatch rules were released in draft form in late 2017, were enacted in August 2018, and took effect for tax periods commencing on or after 1 January 2019. Australian income tax returns impacted for the first time by the hybrid mismatch rules are those due to be lodged in the next few months for the income year ended 31 December 2019.

In the authors' experience, it continues to be the case that many taxpayers find it challenging to interpret and apply this complex and novel legislation. A key element of difficulty is the requirement under the hybrid mismatch rules to make judgments about the operation of foreign tax laws, as well as the presumption that the Australian taxpayer has perfect knowledge of the overseas group structure, relevant foreign law, and the flow of payments through the group structure which arises from deductions in Australia. Another common difficulty is the broad scope of the imported mismatch rules which can impact any related-party cross-border payments that are deductible for Australian income tax purposes. For example, this rule can affect deductions for the cost of goods sold, as well as interest, royalties and management fees.

The Treasury Laws Amendment (2020 Measures No. 2) Bill 2020, which was introduced into parliament on 13 May 2020, includes a range of amendments to the hybrid mismatch rules. Although the Bill is likely to be passed into law without any further changes, it is unclear as to when it will be passed by parliament, and accordingly, affected taxpayers should monitor progress of the proposed amendments.

The proposed amendments are broad-reaching and highly technical. However, the key elements of the proposed amendments are summarised below.

Trusts and partnerships

The proposed amendments clarify the operation of aspects of the hybrid mismatch rules for trusts and partnerships that have been creating many practical difficulties. These clarifications include:

- "flow-through" trusts are not to be viewed as a "liable entity" (ie a taxpayer) for Australian tax purposes. This should limit and simplify the application of the deducting hybrid (ie double deduction) rule for many trusts with cross-border investments or foreign investors. The deducting hybrid rule will continue to apply where the trust is viewed as a liable entity in the foreign country (eg New Zealand or, in some cases, the United States); and
- foreign sourced income earned through a trust or partnership should now be considered "subject to Australian tax" for the purposes of calculating dual inclusion income (DII), even if that amount is not included in the Australian taxable income of a partner or beneficiary. This is a welcome change for Australian funds that have a mix of Australian and foreign investors and invest in offshore assets.

These changes are proposed to apply to income years commencing on or after 1 January 2019.

New hybrid requirement for deduction/deduction mismatches

The proposed amendments narrow the operation of the deducting hybrid mismatch rule that is applicable to deduction/deduction mismatches which occur when an entity receives a deduction in two countries for the same payment. The new definition excludes entities that are a "liable entity" in both deducting countries (provided they are not a dual resident taxpayer or a member of an Australian income tax consolidated group). In practice, the key effects of this change are:

- some entities operating through a foreign branch may no longer be considered a deducting hybrid. However, where the entity with the branch is part of an Australian or a foreign tax group, the outcome may not change; and
- individuals and certain trusts (including superannuation funds) should no longer be considered deducting hybrids where they are regarded as the taxpayer in both deducting countries.

These changes are proposed to apply to income years commencing on or after 1 January 2019.

Dual inclusion income

Dual inclusion income is an important concept because it can reduce the amount of a hybrid payer or deducting hybrid mismatch that would otherwise lead to an increase in Australian taxable income.

The proposed amendments include a number of simplifications to the DII rules, including:

- under the current law, DII is reduced where foreign income tax paid in respect of an assessable amount counts toward a foreign income tax offset. This was a departure from the OECD's recommendations in relation to DII. Under the proposed amendments, this departure will be limited to corporate tax entities;
- under the current law, superannuation funds with an Australian tax rate of 15% are faced with the prospect of a denial of deductions in relation to certain foreign investments, as well as complex calculations in respect of each investment, creating a significant compliance burden. Similarly, many widely held trusts find it difficult to comply with the existing rule because of a need to understand the tax profile of all of the trust's investors. The proposed amendments should reduce a significant amount of uncertainty and complexity for superannuation funds and trusts that invest into foreign jurisdictions, where the income and deductions from the investment are subject to tax in Australia and in a foreign country;
- the concept of "dual inclusion income group" (DIIG) will be expanded. The DIIG rule allows entities to effectively "share" amounts of DII. The existing definition requires that there is only a *single* "liable entity" in respect of the profits of all members of the DIIG. The proposed amendments will relax this requirement which should allow certain partnerships and their wholly-owned entities to be included in a DIIG (this expansion is likely to be particularly relevant to inbound fund manager/advisory companies that are "disregarded" entities owned by a foreign partnership). In addition, the proposed amendments seem to be intended to ensure that members of an Australian tax consolidated group are members of a DIIG. Furthermore, under the proposed amendments, the circumstances where a foreign tax consolidation or fiscal unity may qualify as a DIIG have been expanded, but the operation of foreign laws will continue to be a critical element of this test; and
- the DII on-payment rule will be expanded. The DII on-payment rule provides an increase in the amount of income or profits of an entity that is considered subject to Australian or foreign income tax. Under the proposed amendments, the test will be satisfied if it is reasonable to conclude that the funding of income or profits must be subject to Australian or foreign taxes. This is intended to ensure that the on-payments rule can apply to a series of payments within a DIIG.

These changes are proposed to apply to income years commencing on or after 1 January 2019.

Definition of foreign income tax

There has been some uncertainty about whether foreign income tax includes foreign municipal and state taxes. Under the proposed amendments:

- for the purposes of applying the hybrid mismatch rules, foreign income tax will generally not include foreign municipal and state taxes. This will alleviate concerns that it is necessary to consider the taxation consequences for a payment at multiple levels of government in a foreign jurisdiction (eg 50 states of the US) for the purpose of determining, for example, whether a hybrid mismatch arises. It is acknowledged in the explanatory memorandum to the Bill that this would place an unreasonable compliance burden on taxpayers; and
- for the purposes of applying the unilateral low tax lender "integrity" rule, foreign municipal and state taxes will be recognised for determining whether a payment has been subject to foreign tax at a rate of 10% or less.

These changes are proposed to apply to income years commencing on or after 1 January 2019.

Low tax lender rule

Australia's hybrid mismatch rules include a low tax lender rule which is designed to prevent the use of interposed conduit-type entities that effectively pay no (or "low") tax to fund investments in Australia.

The low tax lender rule does not apply if, among other things, the payment gives rise to a hybrid mismatch under one of the particular hybrid mismatch rules, notwithstanding that the deduction may not be neutralised because, for example, Australia is the secondary response country or the deduction has been sheltered by DII. Similarly, the low tax lender rule does not apply to timing mismatches under the hybrid financial instrument mismatch rule. Under the proposed amendments, the integrity rule will be extended to apply to certain payments that are subject to the deducting hybrid rule or the hybrid financial instrument mismatch rule.

The proposed amendments also extend the operation of the low tax lender rule to payments by subsidiaries of tax consolidated groups in accordance with the original intent of the rules.

These changes are proposed to apply to income years commencing on or after 2 April 2019 (income years commencing after the date of announcement).

Changes to when Australia's "secondary response" is required

In broad terms, the secondary response rules are intended to allocate taxation rights in circumstances where the hybrid mismatch rules of two or more countries may operate to neutralise the same hybrid mismatch outcome. Broadly, this is based on whether a foreign country has "foreign hybrid mismatch rules", or another law that has "substantially the same effect" as foreign hybrid mismatch rules. There has been some uncertainty in relation to the operation of these rules that can affect direct and imported mismatches and whether an Australian response (ie denial of deduction or income inclusion) is required. Under the proposed amendments:

- it is made clear that the foreign law only needs to correspond to a particular type of hybrid mismatch (not all of the Australian rules);
- for the secondary response to not be required in relation to Australian and offshore hybrid mismatches, it is not sufficient that the foreign country has foreign hybrid mismatch rules or a law that has substantially the same effect as foreign hybrid mismatch rules. It will be

necessary that the particular mismatch is "covered by" the relevant foreign laws. According to the explanatory memorandum, for example, a mismatch relating to service fees would not be "covered" by a foreign hybrid mismatch rule that applies only to interest and royalties. Importantly, the explanatory memorandum also makes it clear that it is not necessary to determine whether the foreign jurisdiction has actually applied the foreign hybrid mismatch rules to neutralise the mismatch to satisfy the "covered by" test; and

- in the context of "indirect importations" under the imported hybrid mismatch rules, the Australian secondary response will not be required if there is a foreign income tax deduction in any country that has a law corresponding to any of the particular types of mismatches in the Australian hybrid mismatch rules.

The changes are proposed to apply to income years commencing on or after 1 July 2020. However, it should be noted that the explanatory memorandum explains that the proposed amendments "are intended to clarify the operation of the existing law but apply prospectively because they have not been previously announced".

Additional tier 1 capital

Under the proposed amendments, if all or part of the distribution made on an additional tier 1 capital instrument gives rise to a foreign income tax deduction, franking benefits will be allowed on the distribution. However, an amount equal to the amount of the foreign income tax deduction will be included in the assessable income of the entity.

The takeaway

Overall, the proposed changes should be welcomed by taxpayers as they clarify interpretative issues and should reduce the compliance burden for a range of taxpayers. However, not all of the changes are beneficial, and many apply retrospectively from 1 January 2019.

The proposed changes will be of particular relevance to many trusts that have a 30 June tax year end that are approaching their first full-year distribution cycle in which the hybrid mismatch rules apply. In addition, the changes should be of immediate interest to taxpayers with a 31 December tax year end because annual tax returns for the year ended 31 December 2019 are due to be lodged in the next few months. The tax return requires extensive disclosure in relation to the potential operation of the hybrid mismatch rules, including restructuring designed to remove hybridity and the existence of offshore hybrid mismatches. Another common practical difficulty is the broad scope of the imported mismatch rules which can impact any related-party cross-border payments that are deductible for Australian income tax purposes, including, for example, the cost of goods sold, as well as interest, royalties and management fees.

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Events Calendar

July/August 2020

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Online		
Health & Wellbeing Series – Part 1: It's a matter of choice – life through a new lens	3/7/20	1
Business Structures Online – Part 4: The broke trustee	3/7/20	1
Regional Tax Masterclass Series – Part 3: The only constant is change … restructuring	6/7/20	1
Health & Wellbeing Series – Part 2: Upside of stress	6/7/20	1
Young Tax Professionals Series – Part 3: Business solvency – salvaging what you can! Tax and accounting considerations!	6/7/20	1.5
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Trusts Intensive – Part 3: Developments in the interpretation and application of s 100A	7/7/20	1.5
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Health & Wellbeing Series – Part 3: Looking after the wellbeing of your clients and staff	9/7/20	1
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Regional Tax Masterclass Series – Part 4: The path to knowing they'll be ok – succession planning	13/7/20	1
Trusts Intensive – Part 4: Contentious issues practitioners need to have on their radar	14/7/20	1.5
Private Business Online – Part 4: Navigating the maze of base rate entities	15/7/20	1
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Giving back to the profession

The Tax Institute would like to thank the following presenters from our June CPD sessions. All of our presenters are volunteers, and we recognise the time that they have taken to prepare for the paper and/or presentation, and greatly appreciate their contribution to educating tax professionals around Australia.

George Bendall

Mark Brabazon, SC, CTA

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Vale Paul Lawrence Dowd

by David Williams, CTA (Life), past president (2010)

The tax profession has a lost a good person (Paul would have said "man", but let's not quibble). This is not faint praise because he was a very good person who was motivated in his actions by good intentions.

Paul was someone you could always rely on to do what he committed to do. He never said "yes" when he did not mean it.

Paul's advice, help and assistance were always incredibly practical, and he never beat around the bush when clarity was required. He mentored many younger practitioners, both formally and informally.

Where he viewed things as being for the greater good, Paul often undertook them when no one else could be induced to do so, particularly in the context of Tax Institute representation on external committees and internal roles and functions.

Paul was awarded the Meritorious Service Award in New South Wales because his contribution to The Tax Institute was exactly that.

The recurrent reaction from members of the Pat Mayes Tax Discussion Group when informed of his death was to focus on the "immense contribution he had made to the people in the profession", the personal relationships he had with so many, the fact that he was "a real down-to-earth person", "life was never dull when Paul was around", how he "loved his reds", and how he had held the group together for a significant period after the death of Pat Mayes.

At the most recent meeting, we raised a glass of red wine and remembered our friend "Dowdie".

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