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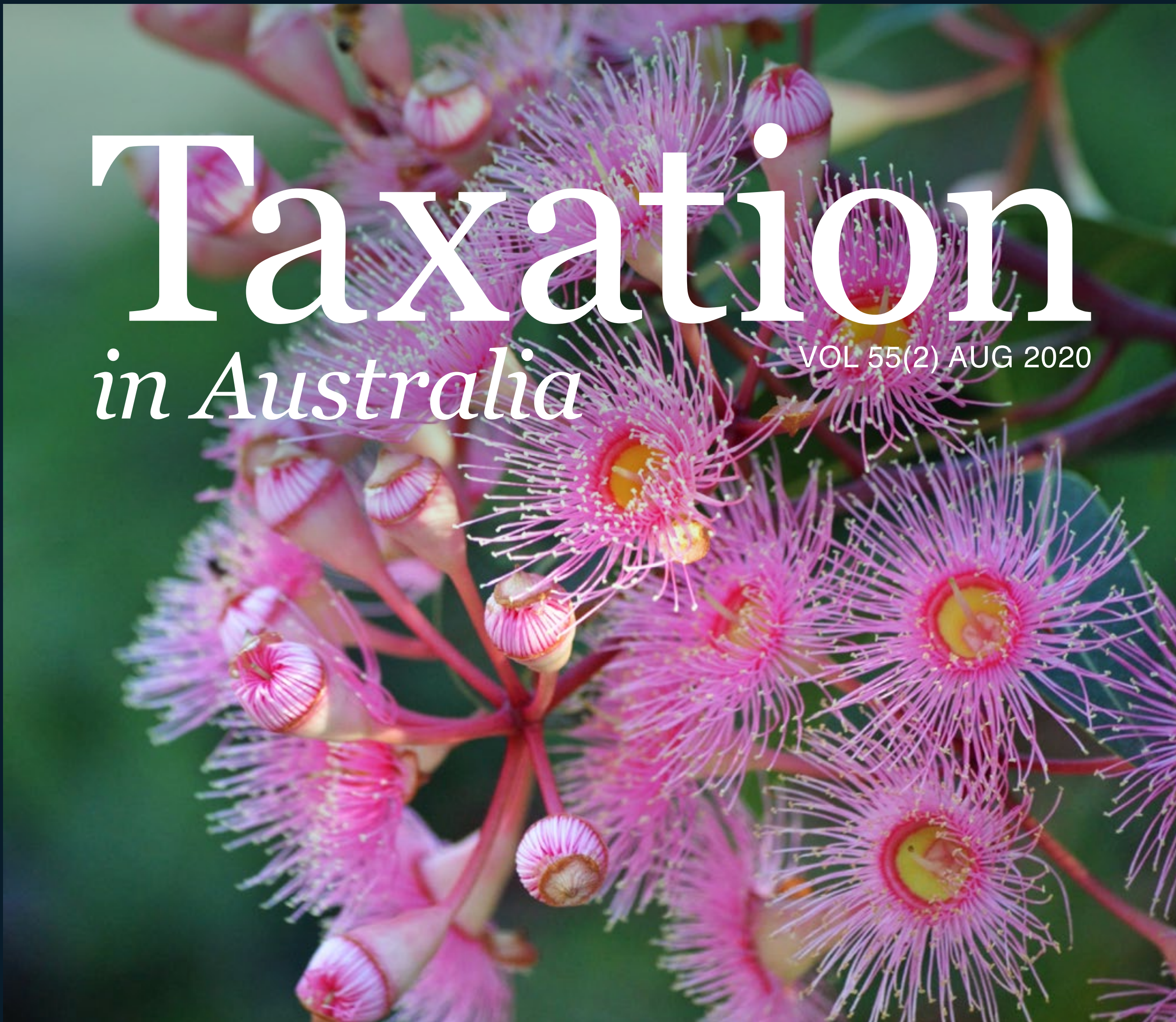

Special tax reform issue

Building a case for change.

Tax reform in the roaring 20s: some ideas from The Tax Institute

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THE TAX INSTITUTE

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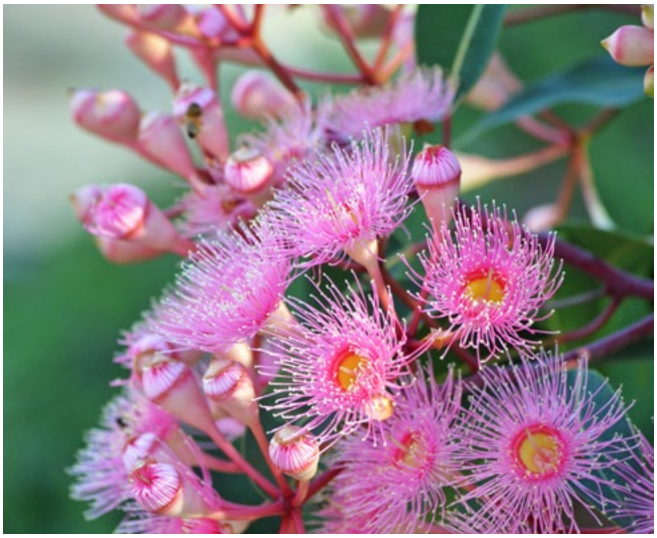

Feature articles

Insights from the Institute

Regular columns

Invitation to write

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

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

Tax News – at a glance

by TaxCounsel Pty Ltd

July – what happened in tax?

The following points highlight important federal tax developments that occurred during July 2020. A selection of the developments is considered in more detail in the "Tax News – the details" column on page 52 (at the item number indicated).

Revised start dates for proposed amendments

In a media release of 30 June 2020, the Assistant Treasurer announced revised start dates for a number of technical superannuation and taxation measures to provide clarity and certainty for taxpayers and superannuation fund managers. **See item 1.**

Division 7A: benchmark interest rate

For the 2020-21 income year, the Div 7A benchmark interest rate for private companies with a regular 30 June accounting period is 4.52%. **See item 2.**

Division 7A: loan repayment extension

When there is a complying loan agreement between a private company (and certain interposed entities) and a borrower, by virtue of s 109N ITAA36, the borrower must make the minimum yearly repayment (MYR) by the end of the private company's income year. This avoids the borrower being considered to have received an unfranked dividend, generally equal to the amount of any MYR shortfall. **See item 3.**

Travel and overtime meal allowances

The Commissioner has issued a determination that sets out the amounts that he considers are reasonable (reasonable amounts) for the substantiation exception in Subdiv 900-B ITAA97 for the 2020-21 income year (TD 2020/5). **See item 4.**

COVID-19: frequently asked questions

The Commissioner has released on the ATO legal database a frequently asked questions document dealing with COVID-19 issues. **See item 5.**

Car expenses: 2020-21 cents per kilometre rate

The rate at which work-related car expense deductions may be claimed in an income year when using the cents per kilometre method is 72 cents per kilometre for the income year commencing 1 July 2020 (MVE 2020/1). **See item 6.**

Greig case: decision impact statement

The Commissioner has issued a decision impact statement in relation to the majority decision of the Full Federal Court in *Greig v FCT* [2020] FCAFC 25. **See item 7.**

Whether Bitcoin a foreign currency

The AAT has held that Bitcoin is not a foreign currency for the purposes of Div 775 ITAA97 (foreign currency gains and losses) (*Seribu Pty Ltd and FCT* [2020] AATA 1840). **See item 8.**

Fencing assets

The AAT has held that a taxpayer was not entitled to a deduction under Subdiv 40-F ITAA97 (primary production depreciating assets) for capital expenditure incurred on a fencing asset where the fencing asset was acquired as part of a parcel of land (*AJ & PA McBride Ltd and FCT* [2020] AATA 1909). **See item 9.**

Tax agent: stay of termination decision refused

The AAT has refused applications from an individual tax agent and a registered trust controlled by her for a stay of decisions of the Tax Practitioners Board to cancel their registrations (*Yvonne Anderson and Associates Pty Ltd and Tax Practitioners Board* [2020] AATA 1881). **See item 10.**

Other AAT decisions

There have been several other recent AAT decisions that have considered various issues. **See item 11.**

President's Report

by Peter Godber, CTA

Unlocking value from the knowledge available to you

Effective sharing of knowledge is the core of what we do, writes president Peter Godber.

The objectives of The Tax Institute include the advancement of knowledge and understanding of tax laws, the encouragement and facilitation of the study of taxation, the encouragement of research into tax reform, and the dissemination of relevant information. It is worthwhile remembering this as we look at the higher priorities for the Institute in the coming six to 12 months.

You may have been hearing about the discussion that the Institute is promoting around critical tax reform, both federally and at a state/territory level. In recent times, "tax" has become much more of a debated social issue, and this is reflected in extensive "front of paper" media coverage.

There will be plenty to talk about with clients and colleagues. The Tax Institute plans to be at the forefront of thought and debate. I would encourage you to follow these developments with interest.

We know that, as tax professionals, we never stop learning, and member access to advanced and extensive knowledge helps gives us all an extra edge professionally.

The Institute has been built on the contributions of volunteers who have written for our publications and spoken at our events over our proud history. The wealth of content that has built up over the years is a great benefit to members. Finding new and better ways to make that content available to members is an important challenge for us. It requires continual monitoring of our technologies and prudent investment.

National Council has made the decision to invest more in our content management system over time. That will enable increased availability and dissemination of up-to-date information on taxation issues for the benefit of members. Improved content management will underpin the value in our website, which will also change over this time.

These changes will hopefully be noticeable over the next 12 months. This is still a time when remote access to current information remains of the highest concern to practitioners. We are doing our best to meet this need, and with the pace of technological change, it will require monitoring to ensure that our systems are the best option for members. If there is one area in which sensible investment is justified, it is in making sure that we have the best technologies in use to enable access to our vast content.

We will be working on creative ideas to bundle together the content that we have and offer it to members in manageable, useful ways. You may have missed a keynote address or a paper that holds your interest. Look out for special offers of access to these sorts of things. If you cannot find what you want, please let our member services team help you.

Recently, we have expressed concern for the wellbeing of our members. You may have taken advantage of accessing our online wellbeing seminars which ran throughout June and July. They have been very popular. We are now exploring other ways to keep in contact with members and help ensure that their personal wellbeing is being addressed.

We are a community. Disseminating information on our technical and non-technical subjects of interest to members will be best achieved by creating dialogues within our member community and by creating sub-communities who can converse and share experiences. This community aspect to our membership will become more apparent in the near future, as we use our improving technologies to disseminate information and encourage discussion on an increasingly wide range of matters.

After all, the objectives of The Tax Institute require us to do this. The core of those objectives — to advance knowledge, facilitate education and disseminate information for our members — remains as important as ever.

CEO's Report

by Giles Hurst

Looking to the future with confidence

Caring, and not complacency, will carry our tribe into the future, writes CEO Giles Hurst.

If I have learnt anything in these past months, it is just how important being a member of a community is.

As I sit down to write this, the COVID-19 situation in Victoria is concerning. In NSW, we are hoping for the best, while preparing for uncertain times ahead. The border between the two states is closed for the first time since the Spanish flu epidemic in 1919. My thoughts are with all those locked-down or facing uncertainty, especially our Institute members and staff.

Recent events have forced us once more to reassess our actions, as individuals and as an Institute. We cannot afford to be complacent. What are we doing for the people we consider part of our tribe? How are we doing it? Are we serving them as best we can?

It puts me in mind of the much-quoted interaction in which late anthropologist Margaret Mead claimed that the first sign of civilisation was a healed femur bone — a sign that the owner had been cared and provided for while they healed. A sign that the law of the jungle, in which only the fittest survive, had been put aside in favour of compassion. Caring for each other is the truest sign of human civilisation.

During the pandemic, we are all relying on each other to stay safe, stay distanced and not flout necessary guidelines. We are reminded to lean on each other for support — and that applies in a professional sense, as much as it does in a social one.

While The Tax Institute is not healing any broken femurs, we have been adding value to your tax practice and professional lives in numerous ways. From timely, tailored expert analysis of shifting rules around measures like JobKeeper, to your reliable weekly *TaxVine* newsletter, we have been keeping you up to date with news from across the spectrum of the tax discipline.

Perhaps as an endorsement of our efforts, membership renewal has been strong this year, and I am thankful that we have maintained such a connected and passionate community during these troubled times. It is so incredibly important for our profession to present a united front in the face of changing legislation and a shifting economy, so thank you to all who have renewed their ties with us this year and remain part of our tribe.

We are also aware that some of us may be struggling financially due to COVID-19. To assist in this, and to care for those members of our tribe who need it the most, we raced to introduce a monthly billing option last month. Sign-ups ended on 31 July, and this initiative allowed more of our members to maintain their connection to the Institute at the very time when they need it most.

Looking ahead

So, what is in store for the future? On a wider scale, it is hard to make any predictions regarding COVID-19 or the overall economic and social landscape it is creating. I am confident in the team we have built at the Institute, the care and dedication our members bring to their work, and the vibrant future of our tax community.

Although the outlook for the resumption of our face-to-face events remains unclear, rest assured that your CPD opportunities remain intact. We have a full schedule of webinar events, both live and recorded for your convenience, that allow you to keep your tax technical skills and knowledge as sharp as ever while working remotely and in safety. In fact, these virtual events have allowed us to connect with colleagues across the country in a way that may not have been possible, practical or even considered in a pre-pandemic world. That is an exciting new development and a silver lining I think we can all appreciate.

Prior to the October Budget later this year, The Tax Institute will be playing an energetic role in contributing to the thinking around what our tax system needs to become in order to ensure that Australia emerges from the bruising experiences of COVID-19 in the best shape possible. I believe that The Tax Institute is in a strong position to coordinate between our stakeholders drawn from government and regulatory bodies, academia, and of course our members, who are at the forefront of delivering tax advice and policy application.

Personally, I am anticipating and looking forward to an opportunity to paint a fresh vision of the future for our profession. Exactly what shape this will take is yet to be seen, but our members are certainly turning their attention towards the future of tax policy and aiming to help drive that conversation in support of positive outcomes.

Today, the Institute is sowing the seeds of a bright future for our profession and our members by taking a serious look at economic and tax policy reform, expanding the information and services we offer to members, and thinking in earnest about the *best* way forward for our community — not necessarily the path of least resistance. I am confident that those seeds will take root and that they will bloom with new opportunity and new strength for all of us.

Senior Adviser's Report

by Bruce Quigley, CTA

Transfer duty or land tax?

In this month's column, Bruce Quigley examines one of the recommendations of the draft report of the review of federal financial relations released by the NSW Treasurer in July 2020.

One of the recommendations in the recently released draft report, *NSW review of federal financial relations: supporting the road to recovery* (the Thodey draft report), commissioned by the NSW State Treasurer Dominic Perottet, recommended that the NSW Government should replace transfer duty with a broad-based land tax.

The problem with stamp duties on land

Stamp duties on the transfer of commercial and residential properties are a significant, though volatile, source of revenue, with the NSW Government raising around $7b, or 24%, of annual tax revenue in 2018-19, according to the Thodey draft report. However, the Henry review has stated that, ideally, there would be no role for stamp duties, including conveyancing stamp duties, in a modern Australian tax system.[1] Conveyancing stamp duties are inefficient taxes that distort both the residential and business use of property by discouraging transactions that might see property put to higher value uses. Thodey argues that transfer duty "therefore impacts citizens' freedom to move home throughout their lifetime and inhibits labour market matching and transfer of business assets, ultimately reducing the productivity with which land is used". It also acts as a disincentive to capital investment because it is based on improved land value rather than unimproved value.

Transfer duties are also an inequitable way of taxing land and improvements as they fall on those who need to move, irrespective of their income or wealth. The effect is to shift the cost of infrastructure and essential services onto a narrow section of the population who carry the burden simply because they decide (or are required) to move house, or sell a business more often. Thodey comments that this does not seem fair.

Taxes on land

Land is an efficient tax base for the states and territories to deliver significant and sustainable revenues. It is immobile; therefore, unlike labour and capital, it cannot move to escape tax and has no distortionary effect on how the land is used. According to Thodey, a new land tax would not penalise transfers or capital investment, and by prompting faster redevelopment of land, may boost investment and housing supply.

The efficiency of a land tax is enhanced if it is levied on as broad a base as possible, which is not the case with existing land taxes. Henry suggested that, in the long run, the land tax base should be broadened to eventually include all land. To tax more valuable land at higher rates, consideration should be given to levying land tax using an increasing marginal rate schedule, with the lowest rate being zero and with thresholds determined by the per-square-metre value.

Transitioning from transfer duty to a broad-based land tax

The design of a transition from stamp duties to land taxes is critical. The most obvious need for a transition mechanism is for owner-occupied land where existing owner-occupiers would have bought their homes with the expectation that they would be exempt from land tax.

Thodey describes four transition models, originally proposed by the Henry review:

– **switch on next sale:** transfer duty is abolished, and all properties become liable for the new land tax at their next sale. Existing properties remain exempt from the new tax until sale;

– **voluntary opt-in:** at the time of property purchase, the buyer has the option of paying transfer duty or the annual land tax. Property owners can also choose to opt-in to land tax;

– **credit for paid transfer duty:** transfer duty is abolished, and all properties become liable for the new property tax, but some or all current property owners are granted a credit to be used towards the new land tax; and

– **gradual phase in/out:** this is the model used in the ACT which is the only state or territory that has decided to abolish conveyancing stamp duty. Under this model, transfer duty rates are gradually lowered, while new land taxes are increased over a period of years.

There are various trade-offs inherent in each of the models. Thodey concludes that governments will have to balance equity for existing owners against the revenue cost of providing land tax concessions, ensuring that they investigate the options and trade-offs fully before committing to specific approaches.

As The Tax Institute's Director of Tax Policy and Technical, Andrew Mills stated in his report in *TaxVine* on 10 July 2020 that the Thodey draft report is a very welcome addition to the calls for real and fundamental change across the whole of the tax system.

Reference

1 Australia's Future Tax System Review Panel, *Australia's future tax system: report to the Treasurer* (Henry review), 23 December 2009.

Tax News – the details

by TaxCounsel Pty Ltd

July – what happened in tax?

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

Government initiatives

1. Revised start dates for proposed amendments

In a media release of 30 June 2020, the Assistant Treasurer announced revised start dates for a number of technical superannuation and taxation measures to provide clarity and certainty for taxpayers and superannuation fund managers.

The revisions are a result of the reprioritisation of government resources and the shortened parliamentary sitting period in 2020 due to the COVID-19 crisis. Table 1 sets out the revised start dates.

Table 1. Technical superannuation and taxation measures: revised start dates

Measure	Revised start date
Superannuation — increasing the maximum number of allowable members in self-managed superannuation funds and small APRA funds from four to six.	Start date revised from 1 July 2019 to royal assent of the enabling legislation.
Tax integrity — removing the capital gains discount at the trust level for managed investment trusts (MITs) and attribution MITs.	Start date revised from 1 July 2020 to the income years commencing on or after three months after the date of royal assent of the enabling legislation.
Petroleum resource rent tax (PRRT) — changing the PRRT settings to get a fair return (compliance and administration changes).	Start date revised from 1 July 2019 to the income year commencing on or after three months after the date of royal assent of the enabling legislation.
Ten-year enterprise tax plan — targeted amendments to Div 7A.	Start date revised from 1 July 2020 to income years commencing on or after the date of royal assent of the enabling legislation.
Superannuation — reducing red tape for superannuation funds (exempt current pension income changes).	Start date revised from 1 July 2020 to 1 July 2021.

The Commissioner's perspective

2. Division 7A: benchmark interest rate

For the 2020-21 income year, the Div 7A benchmark interest rate for private companies with a regular 30 June accounting period is 4.52%.

If a private company has adopted a substituted accounting period, the applicable benchmark interest rate is the "Housing loans; Banks; Variable; Standard; Owner-occupier" rate last published by the Reserve Bank of Australia before the start of the private company's substituted accounting period.

3. Division 7A: loan repayment extension

When there is a complying loan agreement between a private company (and certain interposed entities) and a borrower, by virtue of s 109N of the *Income Tax Assessment Act 1936* (Cth) (ITAA36), the borrower must make the minimum yearly repayment (MYR) by the end of the private company's income year. This avoids the borrower being considered to have received an unfranked dividend, generally equal to the amount of any MYR shortfall (referred to as "the shortfall").

The ATO understands that, as a result of the COVID-19 situation, some borrowers are facing circumstances beyond their control. To offer more support, the ATO will allow an extension of the repayment period for those borrowers who are unable to make their MYR by the end of the lender's 2019-20 income year (generally 30 June) under s 109RD ITAA36.

Requesting the extension

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

When an application is approved, the ATO will let the borrower know that they will not be considered to have received an unfranked dividend. This is subject to the shortfall being paid by 30 June 2021. It will not be necessary to submit further evidence with the application.

This streamlined process only applies to applications for an extension of up to 12 months under s 109RD for COVID-19 affected borrowers. It is still open to a borrower to apply to obtain a longer extension of time outside the streamlined process under s 109RD, or for relief on the grounds of undue hardship under s 109Q ITAA36 (which has further requirements).

4. Travel and overtime meal allowances

The Commissioner has issued a determination that sets out the amounts that he considers are reasonable (reasonable amounts) for the substantiation exception in Subdiv 900-B of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) for the 2020-21 income year (TD 2020/5).

The determination relates to claims made by employees for:

– overtime meal expenses: for food and drink when working overtime;

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

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

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

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

5. COVID-19: frequently asked questions

The Commissioner has released on the ATO legal database a frequently asked questions document dealing with COVID-19 issues.

The topics covered are:

– individuals;
– employers;
– payments and reporting;
– interest and penalties;
– cancelled supplies and events;
– international business;
– self-managed superannuation funds; and
– pausing or ceasing your business.

The document lists the following as being among other COVID-19 material published on the ATO legal database:

– PCG 2020/3: claiming deductions for additional running expenses incurred while working from home due to COVID-19;
– LCR 2020/1: JobKeeper payment – decline in turnover test;
– PCG 2020/4: schemes in relation to the JobKeeper payment; and
– JobKeeper payment: guide to the modified decline in turnover test.

6. Car expenses: 2020-21 cents per kilometre rate

The rate at which work-related car expense deductions may be claimed in an income year when using the cents per kilometre method is 72 cents per kilometre for the income year commencing 1 July 2020 (MVE 2020/1).

A car is defined (in s 995-1(1) ITAA97) as a motor vehicle (except a motorcycle or similar vehicle) designed to carry a load of less than one tonne and fewer than nine passengers.

The rate remains applicable until the Commissioner, having regard to s 28-25(5) ITAA97, determines that it should be varied.

7. Greig case: decision impact statement

The Commissioner has issued a decision impact statement in relation to the majority decision of the Full Federal Court in *Greig v FCT*.[1]

The main issue in the case was whether the taxpayer acquired shares in an Australian securities exchange (ASX)-listed company as part of a "business operation or commercial transaction". A majority of the Full Federal Court (reversing a decision of Thawley J at first instance) concluded that the taxpayer did. Therefore, since the taxpayer also had a profit-making intention in acquiring those shares (which was not in dispute), the principle in *FCT v Myer Emporium Ltd*[2] was engaged. As a result, the losses and outgoings made by the taxpayer from the compulsory transfer of those shares were deductible as general deductions (under s 8-1(1)(a) ITAA97).

The Commissioner's view is that the Full Court's finely balanced conclusion was open on the particular facts of this case and did not disturb the Commissioner's understanding of the *Myer Emporium* principle. The Commissioner is not seeking special leave to appeal to the High Court.

The ATO will review TR 92/3 and TR 93/4 and its website guidance to ensure that the Commissioner's advice and guidance reflects the view of the Full Federal Court. However, the Commissioner's preliminary view is that the decision does not represent any radical departure from the ATO's explanation of the *Myer Emporium* principle in existing advice and guidance. Rather, the decision is an example of the application of that principle to the particular facts before the Full Court.

The decision impact statement notes that non-business individual taxpayers investing in shares who are able to establish that they are within the *Myer Emporium* principle (such that gains or losses from their shares are assessable or deductible on revenue account, respectively) should also be aware of the non-commercial loss rules (in Div 35 ITAA97), which can limit the ability to utilise losses from certain business activities. The operation of the non-commercial loss rules is explained in TR 2001/14.

Recent case decisions

8. Whether Bitcoin a foreign currency

The AAT has held that Bitcoin is not a foreign currency for the purposes of Div 775 ITAA97 (foreign currency gains and losses) (*Seribu Pty Ltd and FCT*[3]).

The AAT pointed out that the expression "foreign currency" is defined in s 995-1 ITAA97 as "a currency other than an

Australian currency". The AAT said that, while the definition was expressed awkwardly, the meaning was clear enough: the reference to "an Australian currency" was plainly a reference to the unit of exchange established in the *Currency Act 1965* (Cth), and the reference to "[an]other currency" must be interpreted in light of that comparator. It followed that the "other currency" in question must be an official currency issued or recognised by a sovereign state.

Further, even if it were to be accepted that the ordinary settled meaning of the word "currency" now extended to cryptocurrencies, context made all the difference. And "context' provided an answer to the taxpayer's argument that losses and gains on dealings in Bitcoin might otherwise fall outside the income tax net. As the Commissioner pointed out in his submissions in reply, gains and losses from dealings in Bitcoin would still be assessable (under s 6-5 ITAA97) or deductible (under s 8-1 ITAA97) (as the case may be) if the Bitcoin is held on revenue account. And, if the Bitcoin were held on capital account, the capital gains and losses incurred would be dealt with under the CGT provisions (Pt 3-1 ITAA97). The scheme of the legislation did not require the interpretation favoured by the taxpayer.

9. Fencing assets

The AAT has held that a taxpayer was not entitled to a deduction under Subdiv 40-F ITAA97 (primary production depreciating assets) for capital expenditure incurred on a fencing asset where the fencing asset was acquired as part of a parcel of land (*AJ & PA McBride Ltd and FCT*[4]).

For present purposes, it may be said that the taxpayer, by contract of sale dated 24 November 2015 (the contract of sale), agreed to purchase primary production land known as the Yudnapinna Station. The contract of sale provided relevantly that the amount payable for the land and the included chattels (excluding livestock) was $5,600,000 and that, unless otherwise agreed by the parties, the purchase price was to be unapportioned. There was no apportionment of the purchase price reflecting a separate amount payable for the fences.

On 16 March 2017, the taxpayer sought a private ruling from the Commissioner to the effect that Subdiv 40-F authorised the taxpayer to claim a deduction in respect of an amount described as "the fencing portion of the purchase price" of the land. The value that the taxpayer attributed to the fencing portion of the purchase price was $2,736,000. On or around 16 December 2016, the taxpayer lodged its income tax return for the 2016 income year but did not claim a deduction in respect of the fencing.

The taxpayer lodged objections against the Commissioner's adverse private ruling and the assessment for the 2016 income year. The Commissioner disallowed the objections and the taxpayer appealed to the AAT.

The relevant provision on which the taxpayer relied to claim the deduction (s 40-551 ITAA97) provided the decline in value as "… the amount of capital expenditure you incurred on the construction, manufacture, installation or acquisition of the fencing asset".

In rejecting the taxpayer's contention, the AAT said that the meaning of "acquisition" in Subdiv 40-F did not include the acquiring of a pre-existing fence as part of a transfer of land. The meaning of "acquisition" was limited by its use in conjunction with "construction, manufacture, installation".

The AAT advanced a further reason for denying the taxpayer an immediate deduction. This was that it did not incur capital expenditure on a fencing asset. The subject of the sale was a sheep station — the taxpayer incurred capital expenditure on a sheep station. Subdivision 40-F allows a deduction for capital expenditure incurred on a fencing asset but in this case the taxpayer was seeking to claim a deduction for the value of the fencing asset it acquired as part of the purchase of the sheep station. By operation of the definition in s 40-551, the focus of Subdiv 40-F moves away from a question of value (or decline in value) to a question as to the amount of capital expenditure incurred.

The AAT also said that the taxpayer's construction of Subdiv 40-F, if accepted, would give a windfall deduction to the first primary producer after 12 May 2015 to acquire agricultural land with fencing assets affixed to it. The windfall would be a once-off; subsequent acquirers of the land would enjoy no capital allowance of any sort in respect of the fencing assets. This would be a capricious and arbitrary outcome and parliament should be presumed not to have intended it.

10. Tax agent: stay of termination decision refused

The AAT has refused applications from an individual tax agent and a registered trust controlled by her for a stay of decisions of the Tax Practitioners Board to cancel their registrations (*Yvonne Anderson and Associates Pty Ltd and Tax Practitioners Board*[5]).

One of the issues that the Board considered when making its decision was that, in the financial years ended 30 June 2017 and 30 June 2018, the trust lodged 19 income tax returns for clients which were audited by the ATO. As a result of the audits, the ATO concluded that the income tax returns required amendment to reduce claimed deductions for work-related expenses by $135,089.51. The ATO also imposed penalties on these clients totalling $52,694.55. Another issue arose out of rental expense claims of clients.

The Board contended that this indicated that the trust had failed to comply with s 30-10(9) of the Code of Professional Conduct in that it did not take reasonable care in ascertaining the state of affairs of its clients that were relevant to the preparation and lodgment of its clients' returns.

There was no substantiation by the clients of the claimed work expenses and the trust's conduct in not insisting on supporting documentation may, depending on the circumstances of those clients, constitute a fundamental breach of its duties as a registered tax agent.

Evidence indicated that the trust had previously been reviewed in relation to some clients' work-related expense claims by the ATO in 2013. In that instance, the ATO advised that the trust implement improvements to verify and substantiate clients' deduction claims to eliminate some errors that had been found. In 2017, the trust was contacted again by the ATO regarding some "unusually high" work-related expense claims made by clients. The ATO informed the trust that it would be monitoring any income tax returns lodged and would consider further action if claims continued to be substantially higher than expected.

On the whole, the clients were unable to provide the ATO with any records to substantiate the deductions claimed. Based on the responses to the Board enquiries and the submissions made, the trust may not have taken "reasonable care" to establish whether or not the work-related expense and rental expense claims were deductible.

The AAT said that, given the lack of evidence concerning the impact of the stay, it was not satisfied that a stay should be granted pending the outcome of the final hearing. In the circumstances, a stay order was not in the public interest, and the public interest outweighed the detriment which the applicants contended they would suffer if the stay was not granted.

11. Other AAT decisions

There have been several other recent AAT decisions that have considered various issues. The issues considered include:

- whether income from the IMF was exempt from Australian income tax (*Hamilton and FCT*[6]);
- the deductibility to an employee of home office expenses where working at home was required by the employer and equipment for home use was supplied by the employer (*McAteer and FCT*[7]);
- deductions for work-related expenses (including car expenses and self-education expenses) (*Hiremani and FCT*[8]); and
- whether the taxpayer, a United Kingdom citizen on a working holiday visa, was a resident for income tax purposes (*MacKinnon and FCT*[9]).

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References

1 [2020] FCAFC 25.
2 [1987] HCA 18.
3 [2020] AATA 1840.
4 [2020] AATA 1909.
5 [2020] AATA 1881.
6 [2020] AATA 1812.
7 [2020] AATA 1795.
8 [2020] AATA 1653.
9 [2020] AATA 1647.

Tax Tips

by TaxCounsel Pty Ltd

Discretionary trusts: NSW surcharge changes

Recent amendments to the NSW surcharge purchaser duty and land tax regimes mean that the operations of discretionary trusts and the provisions of their constituent deeds must be reviewed.

Background

The *State Revenue Legislation Further Amendment Act 2020* (NSW),[1] which became law on 24 June 2020, contains important amendments that potentially affect, with retrospective effect, the liability of the trustee of a discretionary trust to surcharge purchaser duty (under the *Duties Act 1997* (NSW) (DA97)) and to surcharge land tax (under the *Land Tax Act 1956* (NSW) (LTA56)).[2]

The substantive amendments operate retrospectively to the commencement of the surcharge regimes. However, importantly, the amending Act contains transitional provisions which permit amendments to be made to discretionary trust deeds by 31 December 2020 where this is necessary to prevent a retrospective liability from arising (or to enable a refund of a surcharge that has been paid). The drafting of new discretionary trust deeds and of testamentary trusts will also need to be reviewed.

The amendments to the DA97 and to the LTA56, and also the relevant transitional provisions, largely mirror each other.

This article considers the operation of the amendments made by the amending Act in relation to discretionary trusts. Apart from brief background information, it is beyond the scope of this article to consider the potential scope and operation of the surcharge regimes more widely.

Surcharge purchaser duty

New South Wales surcharge purchaser duty (currently 8%) was introduced by amendments made to the DA97 by the *State Revenue Legislation Amendment (Budget Measures) Act 2016*.[3] The surcharge is chargeable on transactions (called surcharge duty transactions) that are defined in s 104L DA97. These transactions include a transfer of residential-related property (see below) to a foreign person (see below) and other defined transactions, such as an agreement for the sale or transfer of residential-related property to a foreign person, a surrender of an interest in residential land in NSW to a foreign person, a declaration of trust over residential-related property by a person who, because of the declaration, is a foreign trustee in respect of the trust, and a foreclosure of a mortgage over residential-related property by a mortgagee who is a foreign person. In the case of a transfer, or an agreement for the sale or transfer, of residential-related property to a trustee, surcharge purchaser duty is only payable if the trustee is a foreign trustee in respect of the trust (s 104S DA97). Surcharge purchaser duty has been imposed on and from 21 June 2016.

Surcharge land tax

New South Wales surcharge land tax (currently 2%) was also introduced by the *State Revenue Legislation Amendment (Budget Measures) Act 2016*. The surcharge is payable on the taxable value of all of the residential land (see below) that a foreign person owns as at midnight of 31 December of each year, in addition to land tax (if any) that may otherwise be payable. Surcharge land tax was first payable for the 2017 land tax year (s 5A LTA56).

Residential-related property; residential land

It is important to keep in mind that a liability to NSW surcharge purchaser duty can only arise in relation to "residential-related property", and a liability to NSW surcharge land tax can only arise in relation to "residential land".

Residential-related property

"Residential-related property" is defined (s 104K DA97) as any of the following dutiable property:

1. residential land in NSW;
2. an option to purchase residential land in NSW;
3. (subject to some exceptions) an interest in any residential-related property referred to in 1 or 2 above.

Residential land

"Residential land" is defined (s 104I(1) DA97) to mean any of the following and does not include any land used for primary production (as defined in the DA97):[4]

> "(a) a parcel of land on which there are one or more dwellings, or a parcel of land on which there is a building or buildings under construction that, when completed, will constitute one or more dwellings,
>
> (b) a strata lot, if it is lawfully occupied as a separate dwelling, or suitable for lawful occupation as a separate dwelling,
>
> (c) a utility lot (within the meaning of the *Strata Schemes Management Act 2015*), if its use is restricted to the owner or occupier of a strata lot referred to in paragraph (b),
>
> (d) a land use entitlement, if it entitles the holder of the land use entitlement to occupy a building, or part of a building, as a separate dwelling,
>
> (e) a parcel of vacant land (including any land that the Chief Commissioner is satisfied is substantially vacant) that is zoned or otherwise designated for use under an environmental planning instrument (within the meaning of the *Environmental Planning and Assessment Act 1979*) for residential purposes or principally for residential purposes."

Dwelling

"Dwelling" is also defined in s 104I(1) DA97 to mean:[4]

> "a house, or a room or a suite of rooms (whether or not forming part of a building or a detached building), that is —
>
> (a) occupied or used as a separate dwelling, or
>
> (b) so constructed, designed or adapted as to be capable of being occupied or used as a separate dwelling."

However, a reference to a dwelling does not include a reference to a room or a suite of rooms determined by the Chief Commissioner not to be a dwelling (s 104I(2) DA97).[5]

Foreign person

For the purposes of NSW surcharge purchaser duty and NSW surcharge land tax, the expression "foreign person" means a person who is a foreign person within the meaning of the *Foreign Acquisitions and Takeovers Act 1975* (Cth) (FATA75), but subject to some important modifications, and the expression "foreign trustee" means a person who is a foreign person because of the person's capacity as the trustee of a trust (s 104J DA).

So far as is presently relevant, under the FATA75 definition of foreign person, an individual who is not ordinarily resident in Australia is a foreign person and an individual who is not an Australian citizen will only qualify as being ordinarily resident at a particular time if, and only if, the individual has actually been in Australia during 200 or more days in the period of 12 months immediately preceding that time (ss 4 and 5 FATA75).

Importantly, for the purposes of NSW surcharge purchaser duty and surcharge land tax, an Australian citizen is taken to be ordinarily resident in Australia, whether or not the person is ordinarily resident in Australia under the FATA75 definition (s 104J DA97; s 2A LTA56). Further, there are provisions that govern the circumstances in which a New Zealand citizen may be a foreign resident (s 104J DA97).

The FATA75 also defines the circumstances in which a corporation or the trustee of a trust will be a foreign person.[6]

Trustee

One circumstance in which the trustee of a trust will be a foreign person under the FATA75 definition is if an individual not ordinarily resident in Australia,[7] a foreign corporation or a foreign government holds a substantial interest (that is, an interest of at least 20%) in the trust (s 4 FATA75).

It is further provided that if, under the terms of a trust, a trustee has a power or discretion to distribute the income or property of the trust to one or more beneficiaries, each beneficiary is taken to hold a beneficial interest in the maximum percentage of income or property of the trust that the trustee may distribute to that beneficiary (s 18 FATA75).

In the case of the trustee of a discretionary trust, the way that the Chief Commissioner applied the surcharge purchaser duty and the surcharge land tax provisions as originally enacted is set out in Revenue Rulings G 009 and G 010 (version 2) and practice note CPN 004. These documents envisaged that, in certain circumstances, a discretionary trust deed may not have needed amendment but in others that a discretionary trust deed would need to have been amended and also foreshadowed that there would be amending legislation in this regard.

The importance of the amendments made by the amending Act is that they now define the circumstances in which the trustee of a discretionary trust will be a foreign trustee (for the purposes of surcharge purchaser duty) or will be a foreign person (for the purposes of surcharge land tax). Surcharge purchaser duty in the case of a discretionary trust is payable in respect of a transfer, or an agreement for the sale or transfer, of residential-related property if the trustee is a foreign trustee (s 104S DA97).

The definitions are similar. The relevant surcharge land tax provision in the LTA56 is as follows:

> "**5D Surcharge land tax — discretionary trusts**
>
> (1) The trustee of a discretionary trust is taken to be a foreign person in that capacity for the purposes of section 5A if the trust does not prevent a foreign person from being a beneficiary of the trust.
>
> (2) If a discretionary trust prevents a foreign person from being a beneficiary of the trust, the trustee is not in that capacity a foreign person for the purposes of section 5A.
>
> (3) A discretionary trust is considered to prevent a foreign person from being a beneficiary of the trust if (and only if) both of the following requirements are satisfied —
>
> (a) no potential beneficiary of the trust is a foreign person (the **'no foreign beneficiary requirement'**),
>
> (b) the terms of the trust are not capable of amendment in a manner that would result in there being a potential beneficiary of the trust who is a foreign person (the **'no amendment requirement'**).
>
> **Note.** Under the transitional arrangements for this section in Schedule 2 to the Principal Act, the no amendment requirement does not apply to a trust that satisfies the no foreign beneficiary requirement immediately before the commencement of this section.
>
> (4) A person is a **'potential beneficiary'** of a discretionary trust if the exercise or failure to exercise a discretion under the terms of the trust can result in any property of the trust being distributed to or applied for the benefit of the person.
>
> **Note.** A potential beneficiary is not limited to persons named in the trust instrument and extends to the members of any class of persons to whom or for whose benefit trust property can be distributed or applied pursuant to the discretions of the trust.
>
> (5) For the removal of doubt, a person is not a potential beneficiary of a discretionary trust if the terms of the trust prevent any property of the trust from being distributed to or applied for the benefit of the person.
>
> (6) In this section, **'property'** includes money, and a reference to the distribution or application of property includes a reference to the payment of money.
>
> (7) Chapter 11A (Tax avoidance schemes) of the *Duties Act 1997* applies in respect of the avoidance of surcharge land tax in connection with the operation of this section in the same way as that Chapter applies in respect of the avoidance of duty under that Act, and for that purpose —
>
> (a) a reference in that Chapter to duty is to be read as including a reference to surcharge land tax, and

(b) a reference in that Chapter to 'this Act' is to be read as a reference to the *Land Tax Act 1956* and the *Land Tax Management Act 1956*."

The corresponding provision in the DA97 is s 104JA.[8]

One important difference between this provision and the FATA75 definition of foreign person in relation to the trustee of a trust is the no amendment requirement provided for by s 5D(3)(b) LTA56.

What is a discretionary trust?

The expression "discretionary trust" is defined for the purposes of the DA97 in the Dictionary as follows:

"***'discretionary trust'*** means a trust under which the vesting of the whole or any part of the capital of the trust estate, or the whole or any part of the income from that capital, or both —

(a) is required to be determined by a person either in respect of the identity of the beneficiaries, or the quantum of interest to be taken, or both, or

(b) will occur if a discretion conferred under the trust is not exercised, or

(c) has occurred but under which the whole or any part of that capital or the whole or any part of that income, or both, will be divested from the person or persons in whom it is vested if a discretion conferred under the trust is exercised."

There does not appear to be any definition of the expression "discretionary trust" that would be relevant for the purposes of the LTA56. The ordinary meaning of the expression was considered by Hallen J in *Wright v Stevens.*[9] His Honour said:

"The Trust created was labelled, in Clause 5 of the deceased's Will, 'a discretionary trust'. That label does not dictate any particular conclusion about the nature of the Trust, the obligations it imposed on the first Defendant as the Trustee, and the entitlement it conferred on 'Beneficiaries'. However, the use of that term, by the deceased, may reveal the deceased's intention as it is considered to be a descriptive term.

…

Brereton J, in a paper delivered extra-judicially headed, 'A Trustee's Lot Is Not a Happy One', published in [2010] NSWJSchol 23, wrote:

'A "discretionary trust" is a trust coupled with a special power of appointment: the beneficiaries are not determined at the moment of creation of the trust — either as to identity or quantum of interest — and the choice of beneficiary, or determination of the extent of his or her interest, or both, is left to the trustee to decide.'

Thus, with a discretionary trust there is a class, usually described in wide terms, who, or which, are the objects of a power to appoint either income, or capital, or both, to selected members of the class. The members of the class are objects of a power, rather than beneficiaries in the strict sense."

It is clear that, if there is no relevant statutory definition, this is the meaning to be given to the expression "discretionary trust" in LTA56. If there were any question as to this, it is dispelled by the definition of "potential beneficiary" in subs (4) and the note to the subsection.

Beneficiary

It may be noted that the definition of "potential beneficiary" possibly does not add anything that would, in any event, not be conveyed by the word beneficiary. In this regard, in *Yazbek v FCT,*[10] Bennett J said:

"I accept that the common use of 'beneficiary' includes a person who is the object of a discretionary trust, including a person who has received no income or benefit from the trust in a given year."

Important transitional provisions

The amending Act contains transitional provisions that permit an amendment of a discretionary trust deed to ensure that surcharge purchaser duty and surcharge land tax that may otherwise be payable is not payable.

The transitional provisions for the purposes of surcharge land tax are contained in Pt 34 of the *Land Tax Management Act 1956*.[11] The provision of particular relevance reads as follows:

"**66 Amendments relating to discretionary trusts**

(1) Section 5D of the *Land Tax Act 1956* applies to the assessment of land tax liability in respect of the 2017 land tax year and subsequent land tax years.

(2) If the trustee of a discretionary trust is liable in that capacity as a foreign person for surcharge land tax in respect of the 2017, 2018, 2019 or 2020 land tax year —

(a) the trustee is exempt from that land tax if the terms of the trust have been amended, before payment of the land tax is due and before midnight on 31 December 2020, so that the trust prevents a foreign person from being a beneficiary, or

(b) if that land tax has been paid, the trustee is entitled to a refund of that land tax if the terms of the trust have been amended, before midnight on 31 December 2020, so that the trust prevents a foreign person from being a beneficiary.

(3) A trust that satisfies the no foreign beneficiary requirement under section 5D of the *Land Tax Act 1956* immediately before the commencement of that section is considered for the purposes of that section to prevent a foreign person from being a beneficiary of the trust (without having to satisfy the no amendment requirement under that section).

(4) Despite section 5D of the *Land Tax Act 1956*, the trustee of an Australian testamentary trust is not in that capacity a foreign person for the purposes of the application of section 5A of that Act to residential land owned by a foreign person if —

(a) liability for land tax is required (under clause 9 of Schedule 1A to this Act) to be assessed as if the deceased had not died and had continued to use and occupy the land as his or her principal place of residence, or

(b) any of the following apply (even if the trust does not prevent a foreign person from being a beneficiary of the trust) —

(i) for a trust arising from a will or codicil — the will or codicil was executed on or before 31 December 2020,

(ii) for a trust arising from the administration of an intestate estate — the deceased died before, or within 2 years after, the commencement of section 5D of the *Land Tax Act 1956*,

(iii) for a trust resulting from an order of a court varying the application of the provisions of a will or codicil or of the rules governing the distribution of an intestate estate — the order was made on or before 31 December 2020.

(5) The Chief Commissioner may in a particular case extend the date by which payment of surcharge land tax by a trustee is due so that the trustee qualifies for exemption from that surcharge land tax under this clause if the terms of the trust have been amended

before midnight on 31 December 2020 (but after the date by which payment would otherwise be due) so that the trust prevents a foreign person from being a beneficiary.

(6) In this clause —

'Australian testamentary trust' means a discretionary trust arising from a will or codicil or the administration of an intestate estate (or as a result of an order of a court varying the application of the provisions of a will or codicil or of the rules governing the distribution of an intestate estate) where the deceased was not a foreign person immediately before his or her death.

(7) Expressions in this clause have the same meanings as in section 5D of the *Land Tax Act 1956*."

The effect of s 66(1) above is that the amendments made by the amending Act are retrospective to the commencement of the surcharge land tax provisions.

The practical effect of s 66(3) above appears to be that, where the terms of a discretionary trust deed that existed immediately before the commencement of the amending Act (24 June 2020) fell within the Chief Commissioner's rulings and practice note referred to earlier, but did not contain a provision that would satisfy the no amendment requirement, the deed does not need to be amended. In any case, where this provision is to be relied on (particularly on an ongoing basis), a ruling from the Chief Commissioner should be obtained.

A further point is that, in the case of an Australian testamentary trust, it would seem that a codicil executed after 31 December 2020 may possibly preclude the transitional provision from applying, even if the will was executed on or before that date and the codicil made only a minor change to the will (such as the appointment of an executor to replace a deceased executor) and did not make any changes to the terms of a testamentary trust provided for in the will. The difficulty arises because the codicil would usually have the effect of republishing the will so that the will and codicil would be "read as one instrument speaking as at the date of the codicil" (*Hawkins v Perpetual Trustee Co Ltd*[12]). It is, of course, arguable that the use of the word "executed" overcomes any difficulty in this regard, but it is suggested that it would be useful if the Chief Commissioner issued a ruling or compliance practice note on the point.

The Chief Commissioner has now issued a revised version of practice note CPN 004 to reflect the amendments mace by the amending Act (CPN 004 version 2) to which regard should be paid.

The form of the amendments

If an amendment to a discretionary trust deed is necessary as a result of the amendments made by the amending Act, the first point to determine is whether the discretionary trust deed contains an adequate power of amendment. If it does not, advice will be needed as to how to proceed. Any amendments that are made must be irrevocable because of the no amendment requirement.

It is to be hoped that the Chief Commissioner will issue a ruling or practice note on the way in which an amendment should be drafted. Presumably, some assistance can be gained from the approach taken by the NSW Court of Appeal in *Sayden Pty Ltd v Chief Commissioner of State Revenue*[13] and the Chief Commissioner's practice note (CPN 003) in relation to the fixed trust requirements that apply for the purposes of land tax. Relevantly, the practice note states:

> "The effect of an overriding clause is that it removes the necessity to amend other clauses within the deed which would otherwise be inconsistent with the provisions of the 'relevant criteria'. It prevails over any other provision of the deed.
>
> In the decision of *Sayden Pty Ltd v CCSR* …, it was held that the phrase 'notwithstanding any other provisions of this Deed' means, to the exclusion of any other provision of this Deed or in spite of any other provisions of this Deed.
>
> Mirroring the provisions of the 'relevant criteria' prefaced with an overriding phrase is an acceptable approach in amending a unit trust deed that initially failed to satisfy the land tax fixed trust provisions."

Observations

In the light of the discussion above, the following points may be made by way of general comment:

- the limited nature of the assets that are potentially affected should be noted;
- the operations, and the constituent trust deeds, of inter vivos discretionary trusts that have a connection with NSW must be examined carefully and, if necessary, the deeds appropriately amended by 31 December 2020;
- where a new discretionary trust is being established, consideration will need to be given as to whether a standard provision that would prevent a liability to the surcharges should be included;
- there will be cases where the inclusion of a pro forma provision should be avoided, for example, where a discretionary trust will be making distributions to a foreign person but the trust will not be acquiring any asset which could attract a liability to the surcharges;
- decisions will need to be made as to the drafting of testamentary trusts;
- it is not clear whether a contingent clause in a discretionary trust deed would be effective, such as, for example, a clause along the lines that, if the trustee decides to enter into a transaction that would potentially trigger a liability for the surcharges, the deed will operate to satisfy both the no foreign beneficiary and the no amendment requirements; and
- it needs to be kept in mind that the general anti-avoidance provisions are available as a weapon for the Chief Commissioner.

As a general point, it would only be prudent for a ruling to be obtained from the Chief Commissioner as to the efficacy of any proposed provision or proposed amendment.

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References

1 Act No. 123 of 2020. This is referred to as "the amending Act" in this article.

2 It should be noted that the amendments are also relevant in relation to surcharge call option assignment duty. That surcharge duty is potentially

charged in addition to the call option assignment duty that is chargeable on the assignment of a right under a call option to purchase dutiable property, if the property is residential-related property and the person assigning the right is a foreign person (see Pt 2 of Ch 3 DA97).

3 The relevant provisions are contained in Div 2A DA97.

4 This definition is relevant for the purposes of surcharge land tax (see s 2A LTA56).

5 See Revenue Ruling G 011.

6 For the Chief Commissioner's interpretation of "foreign person" for both surcharge duty and surcharge land tax purposes, see Revenue Ruling G 009 (issued 20 December 2016, that is, before the amendments made by the amending Act).

7 The concept of "ordinarily resident" as defined in the FATA75 is modified for the purposes of the surcharge provisions.

8 That provision does not, of course, have an equivalent to s 5D(7) LTA56.

9 [2018] NSWSC 548 at [200] and [205]-[206].

10 [2013] FCA 39 at [24].

11 The transitional provisions for the purposes of surcharge purchaser duty are contained in Pt 51 of Sch 1 DA97.

12 [1960] HCA 51 at [18] per Fullagar J.

13 [2013] NSWCA 111.

Mid Market Focus

by Peter Bembrick, CTA, HLB Mann Judd

What is an affiliate, and why is it important?

The concept of affiliate is important but misunderstood, often rears its head when applying the small business CGT concessions, and impacts other grouping rules.

Introduction

The key building blocks of many of the grouping rules in the income tax legislation are the twin concepts of "connected entity" (s 328-125 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97)) and "affiliate" (s 328-130 ITAA97), and this article will focus on when an affiliate relationship will arise.

The affiliate definition is an important component of the $6m net asset value (NAV) test when applying the small business CGT concessions, and also helps to determine an entity's "aggregated turnover" (s 328-115 ITAA97) for the CGT concessions, as well as a range of other purposes within the tax legislation.

Aggregated turnover is in turn critical when determining whether an entity is a "small business entity" (s 328-110 ITAA97) for other purposes, including the reduced company tax rate, concessions for claiming prepaid expenses, immediate deductions for entity establishment costs, simplified depreciation rules, simplified trading stock rules, small business tax offset for unincorporated businesses, small business restructure roll-over and FBT car parking exemption.

The same grouping rules using the concepts of affiliate and connected entity have also applied to the various iterations of the instant asset write-off that has been available over the last few years.

What is an affiliate?

An individual or a company is an affiliate of yours (ie the subject entity) if the individual or company acts, or could reasonably be expected to act, in accordance with your directions or wishes, or in concert with you, *in relation to the affairs of the business of the individual or company* (s 328-130(1) ITAA97).

The individual or company will not, however, be an affiliate merely because of the nature of the business relationship that they share with the subject entity (s 328-130(2) ITAA97).

Breaking this down, it is therefore apparent that:

– trusts, partnerships and superannuation funds cannot be affiliates, although an individual or a company can be an affiliate of one of these entities;
– an individual or a company cannot be an affiliate if they do not carry on a business; and
– the concept of being an affiliate of another individual or entity is a one-way relationship, eg Ian can be an affiliate of Tony if Ian carries on a business and Ian acts in accordance with Tony's directions or wishes, but that alone would not make Tony an affiliate of Ian (even if Tony carries on his own business).

What is not readily apparent is that, despite what you might expect and unlike the rules that applied before 1 July 2007, a spouse or child aged under 18 will not usually be an affiliate unless they satisfy the general definition as set out above, or the extended definition discussed below.

Therefore, even where Anna is Ian's spouse, if she is not involved in his business, Ian would not be Anna's affiliate. The definition applies in the same way to spouses and non-spouses alike.

The first limb: acting "in accordance with your directions or wishes"

Acting "in accordance with your directions or wishes" is the first and easiest to understand limb of the affiliate definition, and perhaps the most common one. It provides a useful illustration of why the affiliate concept exists, as it implies a strong element of control by one entity over another, despite one party having no legal or beneficial ownership interest in the business of the other.

In this respect, the affiliate definition complements the concept of a connected entity and operates to expand the scope of the grouping rules referred to above.

Example 1. Individual qualifying as an affiliate of another individual

Will carries on a courier business as a sole trader and has no apparent connection to Izzy.

Will consults Izzy on all of his major business decisions, and Izzy frequently provides "suggestions" that Will does not, as a rule, ignore. That is, Izzy could be described as the "power behind the throne" in the conduct of Will's business.

A close and objective examination of the facts would lead a reasonable person to conclude that Will "acts in accordance with the directions or wishes" of Izzy in relation to his business, which makes Will an affiliate of Izzy.

Similarly, an individual carrying on a business can be an affiliate of a company.

Example 2. Individual qualifying as an affiliate of a company

Simon is the sole director and shareholder of Brilliant Pty Ltd, while Ian, with no apparent connection to either

Example 2. Individual qualifying as an affiliate of a company (cont)

Simon or Brilliant Pty Ltd, carries on a management consulting business as a sole trader.

Brilliant Pty Ltd (and by extension Simon) is consulted by Ian on all of his major business decisions, and frequently provides "suggestions" that Ian does not, as a rule, ignore.

A close and objective examination of the facts would lead a reasonable person to conclude that Ian "acts in accordance with the directions or wishes" of Brilliant Pty Ltd in relation to his business, which makes Ian an affiliate of Brilliant Pty Ltd.

In this example, it could equally be concluded that, because Simon is the person providing "suggestions" to Ian on behalf of Brilliant Pty Ltd, Ian is also an affiliate of Simon.

Further, applying the basic definition, a company will be an affiliate of an individual if the company acts in accordance with the directions or wishes of the individual, or in concert with the individual, in relation to the affairs of the *company's* business.

Example 3. Company qualifying as an affiliate of an individual

David is the sole director and shareholder of Village Pty Ltd which carries on a video production business that has no apparent connection to Lucy.

David consults Lucy on all of Village Pty Ltd's major business decisions, and Lucy frequently provides "suggestions" that David does not, as a rule, ignore. That is, Lucy could be described as the "power behind the throne" in the conduct of Village Pty Ltd's business.

A close and objective examination of the facts would lead a reasonable person to conclude that Village Pty Ltd "acts in accordance with the directions or wishes" of Lucy in relation to its business, which makes Village Pty Ltd an affiliate of Lucy.

David would not, however, be Lucy's affiliate because he does not himself carry on a business.

The same logic applies when testing whether a company is an affiliate of another company.

Example 4. Company qualifying as an affiliate of another company

Dan is the sole director and shareholder of Home Truth Pty Ltd which carries on a publishing business with no apparent connection to anyone in the previous examples.

NBH Pty Ltd carries on a talent agency business, and its directors are Simon, Anna, Ian, Tracey and Neil.

Dan consults NBH Pty Ltd on all of Home Truth Pty Ltd's major business decisions, and the management of NBH Pty Ltd frequently provides "suggestions" that Dan does not, as a rule, ignore. That is, NBH Pty Ltd could be described as the "power behind the throne" in the conduct of Home Truth Pty Ltd's business.

Example 4. Company qualifying as an affiliate of another company (cont)

A close and objective examination of the facts would lead a reasonable person to conclude that Home Truth Pty Ltd "acts in accordance with the directions or wishes" of NBH Pty Ltd in relation to its business, which makes Home Truth Pty Ltd an affiliate of NBH Pty Ltd.

The second limb: "acts in concert with"

As discussed in the above examples, it may often be easy to identify when one entity acts in accordance with another's directions or wishes. Where the first limb does not apply, however, the second limb of acting "in concert with" someone else in relation to the affairs of the first entity's business may provide evidence of an affiliate relationship.

The key factors to be considered include:[1]

- family or close personal relationships;
- financial relationships or dependencies;
- relationships created through links such as common directors, partners or shareholders;
- the degree to which the entities consult with each other on business matters; and
- if one entity has a formal or informal obligation to conduct business with the other.

None of these factors are considered determinative on their own, and this will in practice be a highly subjective test to apply.

Unlike the first limb, the second limb is closer to a relationship of equals or peers, although it is important to note the specific exclusion for purely business relationships between individuals and/or companies (s 328-130(2) ITAA97).

Example 5. Individuals not affiliates – purely business relationship

As noted in example 1, Will carries on a courier business as a sole trader. He has no apparent connection to Matt, although Matt sometimes refers customers needing deliveries to Will.

Will does not consult Matt at all when making major business decisions, and Matt is not in any way involved in Will's day-to-day business, operationally or financially.

A close and objective examination of the facts would lead a reasonable person to conclude that Will does not "act in concert with" Matt in relation to the affairs of Will's business.

Will should not therefore be an affiliate of Matt under the basic definition, and certainly not once the exclusion for normal business relationships is factored in.

By contrast, in other cases, the dealings between two parties will go beyond a purely business relationship and, considering the factors listed above, an affiliate relationship may exist.

Example 6. Company qualifying as an affiliate of another company – acting in concert

Tony, Tracey and Neil are the directors and shareholders of Newsnight Pty Ltd which operates a digital marketing business.

Tracey and Neil are also on the Board of NBH Pty Ltd (see example 4), and Newsnight Pty Ltd receives a significant portion of its revenue from a contract to promote the clients of NBH Pty Ltd.

While Newsnight Pty Ltd's directors do not consult NBH Pty Ltd on all of their business decisions, and an affiliate relationship should not arise under the first test, the companies work closely together in relation to the affairs of Newsnight Pty Ltd's business.

A close and objective examination of the facts would lead a reasonable person to conclude that Newsnight Pty Ltd "acts in concert with" NBH Pty Ltd in relation to the affairs of Newsnight Pty Ltd's business, which makes Newsnight Pty Ltd an affiliate of NBH Pty Ltd.

When spouses or children are taken to be affiliates

A special rule applies when one entity owns an asset that is used by another entity in carrying on its business or is inherently connected with the business of the business entity, and the business entity would not otherwise be an affiliate of, or connected with, the asset owner (s 152-47(1) ITAA97).

In such cases, when determining whether the business entity is an affiliate of, or connected with, the asset owner, the following are taken to be affiliates of an individual (s 152-47(2) ITAA97):

– the individual's spouse; and

– a child of the individual aged under 18.

One important implication of this rule is that it can allow the active asset test under the small business CGT concessions to be satisfied when the relevant asset is owned by an entity other than the business entity (s 152-40(1) ITAA97).

Example 7. Business premises owned by an individual's spouse

From examples 1 and 5, suppose that Will operates his courier business from a small office that is owned by his spouse Claire, who has no other involvement in the business.

They would not be affiliates under the basic definition but, under the special rule in s 152-47 ITAA97, Will is deemed to be an affiliate of Claire.

This means that Claire is able to treat the office as an active asset for the purposes of the small business CGT concessions in Div 152 ITAA97, and as long as the other basic criteria are satisfied, Claire should be able to apply the various CGT concessions when selling the office.

This can also apply on an indirect basis when combined with identifying connected entities.

Example 8. Company connected through a deemed affiliate

As noted in example 3, Dan is the sole shareholder of Home Truth Pty Ltd, which makes them connected entities.

Assume further that Dan is Lucy's spouse, and that Lucy owns the premises from which Home Truth Pty Ltd carries on its publishing business.

The deemed affiliate relationship between Dan and Lucy, and the connection between Dan and Home Truth Pty Ltd, allow the premises to be treated as an active asset, which would be extremely important in a future property sale by Lucy.

The special rule also has an important flow-on effect on the identification of affiliates and connected entities within a group and can significantly broaden the application of the grouping rules. This can be a double-edged sword, as it allows taxpayers to establish someone as an affiliate in order to pass the active asset test, although, on the other hand, broadening the group has the potential to push them out of qualifying for the CGT concessions based on turnover and/or net asset values.

Example 9. Broader grouping rules and breaching thresholds

Continuing example 8, when applying the small business CGT concessions to a sale of the business premises, another key consideration is satisfying the $6m net asset value test (s 152-15 ITAA97).

Because of the deemed affiliate relationship between Dan and Lucy, and the flow-on effect to grouping with other entities, there is a greater risk of the $6m limit being breached.

Assume that the net value of Home Truth Pty Ltd is $2.5m, the value of the business premises owned by Lucy is $1.5m, and Dan holds an investment portfolio valued at $1m.

At first glance, the net asset value test appears to be satisfied, as the combined net assets (excluding the family home and superannuation balances) of Home Truth Pty Ltd, Lucy and Dan are worth $5m.

Note example 3, however, where it was concluded that Village Pty Ltd is an affiliate of Lucy so its assets must also be included in the calculation. If the business of Village Pty Ltd is valued at $1.5m, this would be enough to push the combined net asset value over the $6m limit, so that Lucy would not be eligible to apply the small business CGT concessions when selling the business premises.

Conclusion

It can be seen from the above discussion and examples that the concept of affiliate is complex and far-reaching, and it is therefore important to understand its impact on particular situations to ensure that the grouping rules in the tax legislation are applied correctly.

Knowing when grouping will apply, and which individuals and entities are grouped, helps taxpayers and their advisers to make informed decisions when undertaking transactions by understanding the tax implications in advance, and to correctly account for and report transactions that have occurred to minimise the risks from ATO compliance activity.

Peter Bembrick, CTA
Tax Partner
HLB Mann Judd Sydney

Reference

1 Para 2.36 of the explanatory memorandum to the Tax Laws Amendment (Small Business) Bill 2007.

Tax Education

Remain relevant and broaden your skillset

The Tax Institute's 2019 study period 3 duxes share their views on keeping up to date with the ever-changing tax scene.

Melissa Leisavnieks, Senior Accountant, Rawson Verco Need Chartered Accountants, South Australia

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

I started working in a small accounting practice immediately after finishing year 12 and, over the years, completed an associate diploma in accounting, followed by a commerce degree, and eventually completed the Chartered Accountants program in 2006. I have worked in various tax and accounting practices for over 15 years.

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

The most valuable aspect of the Advanced Superannuation subject is that I could easily relate the practical examples in the course to real-life situations which our clients are facing every day.

What are your areas of new confidence?

The course content around strategies for building superannuation balances within the current restrictions and planning to maximise retirement benefits has given me a much deeper understanding of the options available for clients.

What was the reason for undertaking Advanced Superannuation with the Institute?

I returned to professional accounting after an extended break working in my family business and realised that there had been enormous changes in the superannuation rules over that time. Studying Advanced Superannuation was a great way to update my knowledge in this area.

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

With tax legislation changing continuously, it is so important to keep up to date, and I hope to complete further courses with The Tax Institute in the future.

What are the challenges of juggling study and work?

Finding the extra time to study is always challenging. Really make the most of the time you carve out for study by taking good summary notes as you go and work through the practical examples thoroughly. This will save time when it comes to revision at the end of the course.

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

I found the Advanced Superannuation course content to be practical and relevant and would recommend this course to anyone interested in furthering their career in tax.

Anthony Kazamias, Manager, Pitcher Partners, Queensland

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

Having started in specialist employment taxes after university, I have since made the transition into private family business advisory, now with six years' experience.

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

I am able to apply what I have learned in the CTA2B Advanced course directly into the work that we do for clients on a variety of complex tax matters.

What are your areas of new confidence?

I enjoyed understanding cross-border taxation and the complexities of Div 7A. This has already helped me in preparing structuring advice and dealing with SMEs that have a number of unrelated investors.

What was the reason for undertaking CTA2B Advanced with the Institute?

To continue learning and broadening my skill set to ensure that I remain relevant and of benefit to our clients.

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

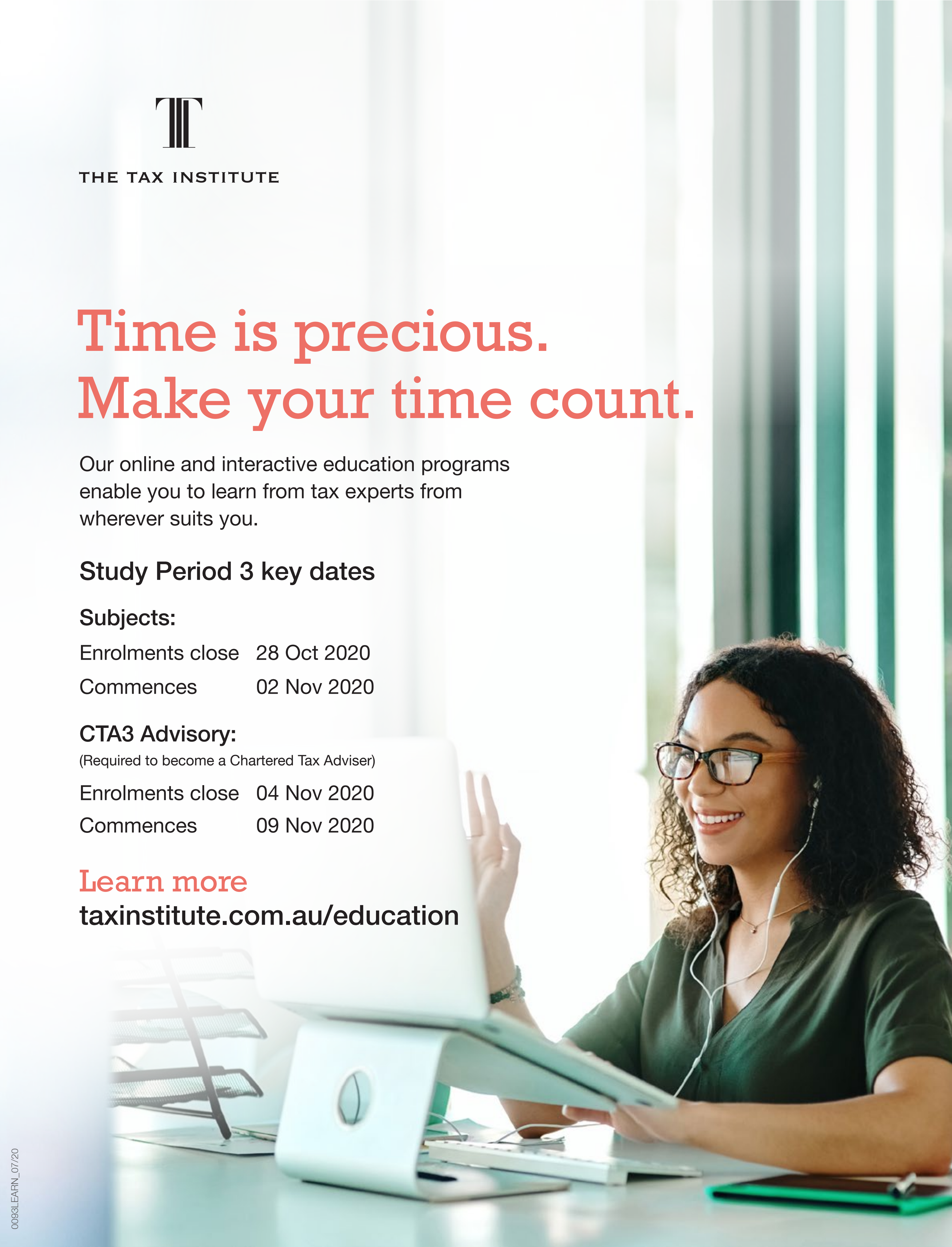
I intend to complete further subjects under the Chartered Tax Adviser Program and leverage from the resources available to members.

What are the challenges of juggling study and work?

I have always left studying to just before the exam. However, for this study period, I was more diligent throughout the course. This allowed me to give 100% to both work and study. No matter how you study and juggle work, always do what works best for you. The best result is the one that helps you retain that knowledge and allows you to apply it outside of the exam room.

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

The program is a great opportunity to refine your current skills and refresh yourself on a variety of tax disciplines.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Member Profile

This month's column features Donovan Castelyn from Curtin University and Curtin Tax Clinic.

Member since
2017

Areas of specialty
Tax pedagogy, international and comparative taxation, and Australian tax jurisprudence.

What is your personal mission statement?
Find passion and pursue it.

What do you value most about being a member of The Tax Institute?
In one word, community. The study and pursuit of taxation as a career has been a deeply rewarding experience, and to have the backing of a community as welcoming and supportive as The Tax Institute and members of the national tax profession is both encouraging and tremendously motivating.

Who has been your biggest inspiration in the tax profession and why?
Throughout my (relatively short) career, I have had the great fortune of experiencing the wonders of the tax profession from the perspective of a practitioner and, more recently, an academic and clinical professional.

During this time, I have been inspired and continue to take inspiration from many people, both professionally and personally. At the risk of failing to include each person by name, I am deeply appreciative and immensely thankful to each of my mentors, colleagues, friends and family who have made a meaningful contribution to my career in tax.

What does winning the Emerging Tax Star award mean to you?
To have received this recognition from members of the national tax profession is a tremendous honour for which I am entirely grateful.

Beyond the personal achievement, the award reflects The Tax Institute's willingness to encourage, and endorse, non-traditional pathways in tax practice and will hopefully serve to inspire other non-traditional practitioners to engage with the application process.

Advice to those considering nominating themselves or a colleague for the 2021 Tax Adviser of the Year Awards?
Take the plunge. Ultimately, there is value in the process, no matter the outcome. Whether you receive a nomination, advance to the finals or win the award is all secondary compared to the value of the reflective experience that the application process affords you.

The awards provide a great opportunity to take an introspective look into what differentiates you, what you have achieved in your career to date, and what you want to achieve moving forward.

In the current environment, how important is it to stay connected to your professional membership association?
It is imperative that we remain united during these challenging times. Staying connected with the professional community is important for two reasons: first, to stay abreast of current developments, and second, to support and be supported.

When you reflect on the past couple of months and the challenges that tax practitioners have faced, what are you most proud of?
The strength and resilience displayed by all practitioners in the face of exceptionally challenging personal and professional circumstances.

What is one thing that has helped you through the recent self-isolation period?
The ability to continue to deliver material to students online while staying physically fit and mentally well.

Foreword

by Stephanie Caredes, CTA, Tax Counsel, The Tax Institute

Reform of Australia's tax system

Members will have read in recent issues of the Institute's *TaxVine* weekly newsletter the conversation that the Institute has started on tax reform. This month's *Taxation in Australia* is a special issue on tax reform in which we are showcasing feature articles from the Institute's Senior Tax Counsel Bob Deutsch, Director of Tax Policy and Technical Andrew Mills, and Senior Advocate Robyn Jacobson.

Tax reform is one of those tricky areas — most of us who are engaged with the tax system as part of our professional pursuits want to see an Australian tax system that is functioning at its optimum. However, as we all know too well, there is substantial "room for improvement".

The last major reform, the introduction of the GST, celebrated its 20th birthday this past July. While we have seen piecemeal changes over the years, no changes have come anywhere near being the holy grail of holistic reform.

As Director of Tax Policy and Technical, Andrew Mills pointed out to members in his *TaxVine* report on 10 July 2020 that tax reform is a job for The Tax Institute. Andrew set out the parameters of the Institute's tax reform project that will position the Institute as the leader of the tax reform debate, being *the* independent, rational and objective voice.

Some of the key parameters include:

– that everything is on the table, that is, all taxes federal, state/territory and local;

– that consideration has to be given to the overall tax mix, how comprehensive each head of tax should be, and how taxes should be designed and administered; and

– that the objectives of a good tax system are clearly expressed.

So, together with the extensive expertise within its membership, we believe it falls to The Tax Institute, a natural thought leader in tax reform, to pave the way forward. This is where the Institute's technical leaders come to the fore.

In his article, Bob Deutsch puts forward some tax reform ideas for The Tax Institute to consider from the "roaring 20s" of the 21st century. He takes us back to 2015, when the *Re:think* tax discussion paper was released as part of the 2015 reform of Australia's tax system. This review ran alongside the *Reform of Federation* white paper, with the two reviews intended to be coordinated. The Tax Institute had high hopes at the time of seeing real tax reform occur, though ensuing political machinations prevented the tax system review from getting past stage one.

Andrew Mill's article takes us through a history of attempts at tax reform, some more successful than others, casting our minds back to the heady "80s" and the substantive reforms from the 1985 *Reform of the Australian tax system*. I'm sure many members will have fond memories of this time. Andrew also refers to the original "roaring 20s", the one from the 20th century, mentioning the Kerr Royal Commission which began in 1920. Andrew goes on to explore taxes like the GST and business taxation, and tackles one of the most difficult aspects of the current Australian tax system — the sheer complexity of it all.

Robyn Jacobson's article brings us back to present times and considers tax reform with 2020 vision. It is a detailed look at the lessons we can learn from the recent decade, namely, the Henry review. Robyn discusses taxes such as FBT (should fringe benefits be folded back into the income tax system?), our two-tiered corporate tax rate, CGT discount, trusts, small business tax concessions and Div 7A — issues so close to many of our members' hearts. Only a handful of the 138 recommendations in the Henry review were ever taken up by the then Rudd Government. Surely that leaves us with a solid 130 recommendations to start with for a current tax review, doesn't it?

We are just at the beginning of tax reform in the 21st century's roaring 20s. The Tax Institute invites members to engage with us and each other in the tax reform discussion. The next three articles written by Bob, Andrew and Robyn are intended to prompt your thinking and start the conversation on tax reform. We, your Institute, want to hear your thoughts and ideas, however big or small, on how we can shape our position on tax reform. In the coming months, you will read and hear more about this through articles, interviews, events, issues and discussion papers. Our collective thinking will culminate with The Tax Summit: Reform Edition, a virtual event to be held in November where all of the issues on the table with be shared, discussed and debated. We look forward to hearing from you.

Tax reform in the roaring 20s: some ideas from The Tax Institute

by Robert Deutsch, CTA,
Senior Tax Counsel,
The Tax Institute

In this brief introductory note, some key issues around tax reform are raised, with more detailed consideration to follow in the articles by Andrew Mills and Robyn Jacobson.

The right tax system for Australia's future is one that is most likely to stimulate productivity and economic growth. To achieve this, complexity and impediments to growth need to be removed and a simpler, fairer and more efficient tax system needs to be designed.

The current tax system is very complex, with a variety of taxes applying to a range of different bases. Fixing one part only will not of itself give rise to the reform needed for real, structural change. As such, a package of reforms is required.

Particularly now in light of the dreadful consequences that flow from the pandemic that has gripped the world, we urge the federal government to undertake a thorough, considered review of the federal tax system and, in doing so, determine what should be the appropriate tax mix for Australia to provide a sustainable source of revenue to meet ongoing government spending requirements.

We urge the government to consider adopting a policy of shifting Australia's dependence on income tax for the bulk of revenue collections towards more simple and efficient consumption taxes (such as the GST). Such a shift will ease the heavy dependence that Australia's current tax system has on individual income tax, will create a simpler tax system to implement and regulate, and will provide the government with more sustainable revenue collections.

The Tax Institute endorses the pursuit of a tax system with "lower, simpler and fairer" taxes. We endorse both simplicity and fairness as objectives, though in practice a variety of ideas about "fairness" exist, not all of which are easy to accommodate with simplicity. The Tax Institute also supports in principle the aspiration for "lower" taxes.

Inevitably though, views on how low or high the total tax burden should be depend largely on views as to how much money governments should spend.

The Tax Institute does not comment on how much money is desirable for governments to take out of private ownership to fund government spending. However, if all levels of government are to continue to spend at anywhere near the levels to which we have become accustomed, and which the pandemic now necessitates, the tax system will have to deliver a large, reliable and sustainable flow of revenue for the foreseeable future.

In this context, we seek to identify ways in which the system can be improved as a vehicle for raising revenue in a simpler, fairer way, while recognising that achieving equity in the tax system can at times be at odds with the goal of simplicity. It will also be necessary to address the deadweight costs of compliance and enforcement, and distortions and disincentives in the system, all of which are inherently detrimental to our system. Less tax distortions mean higher productivity to fund higher living standards involving more private consumption of goods and services.

In 2015, The Tax Institute put a submission to the then federal government advocating for wide-ranging tax reform, the essential elements of which included the following key elements:

- shifting away from a disproportionate reliance on direct income taxation to a more balanced mix, with heavier reliance on fairer and simpler consumption taxes and with a reasonable compensation package for lower paid workers, pensioners etc. This would necessitate a comprehensive review of the present exemptions and special rules in the current GST law to determine their ongoing appropriateness and to ensure that the simplicity and efficiency that is sacrificed by the presence of these exceptions is still justified;
- adopting a transparent marginal tax rate system for individual taxpayers. Currently, tax rates do not reveal the full picture, with a separate Medicare levy, FBT regime and a myriad of income tax offsets all distorting the real picture. Consideration needs to be given to addressing these matters so as to make the system more transparent;
- adopting a standard deduction for work-related expenses, together with the option to claim actual expenses properly substantiated for employees with expenses above the standard deduction threshold. This would make it much simpler for employees to comply with their individual tax obligations;
- assess any change to negative gearing in light of any complexity likely to be created;
- address the inequity in the FBT system caused by the application of tax at a rate equivalent to the highest marginal tax rate and address the significant administration costs in the current system;
- make changes to the taxation of superannuation only with bipartisan support;
- maintain a single-tier system for the corporate tax rate and reduce the corporate tax rate for all corporate tax entities;

- evaluate the dividend imputation system against the backdrop that it encourages the payment of corporate tax and preserves integrity in the system. Any change to the dividend imputation system should not be at the expense of these benefits;
- introduce a simpler set of loss rules for companies and trusts;
- review and simplify the small business CGT concessions;
- address the significant regulatory burden for entities in the not-for-profit sector due to a lack of harmonisation between state/territory and federal administrative requirements, and review the policy settings for the provision of tax concessions for not-for-profits. The Tax Institute recommends that uniformity in state and territory legislation should be pursued, as well as simplification of the administrative burden from complying with these taxes by introducing a centralised collection agency;
- reduce the complexity in the Australian tax system by implementing improved processes around policy development and law design, including the development of an agreed procedure for tax law;
- seek opportunities to develop and adopt new technologies for use in improving administration; and
- complete the rewrite of the *Income Tax Assessment Act 1936* (Cth).

In the following two articles in this issue of the journal, my colleagues Andrew Mills and Robyn Jacobson will consider the extent to which any or all of these aspirations are still appropriate and the extent to which they have been achieved. They might also consider what other measures could be considered as part of the tax reform of the roaring 20s.

Robert Deutsch, CTA
Senior Tax Counsel
The Tax Institute

Tax reform: selected issues

by Andrew Mills, CTA (Life), Director, Tax Policy and Technical, The Tax Institute

This article builds on the introductory piece authored by Bob Deutsch and is complementary to the article authored by Robyn Jacobson, both of which are published in this issue of the journal.

The article reminds readers of some history, addresses some selected issues in tax, including the problems in the current system, the design of those selected areas and some options to improve the system overall. The areas covered include GST, general business tax issues, tax administration and governance, and complexity. Notably, in these current articles, state taxes have not been addressed. That will be the subject of a separate article soon.

Some history

Many readers will be aware of the tax reform proposals in their own lifetime or working career, the most obvious of which are *Reform of the Australian tax system* (Hawke–Keating) in 1985,[1] *Tax reform: not a new tax, a new tax system*[2] and *Review of business taxation* (Howard–Costello) in 1998 to 2000,[3] and *Australia's future tax system* (Henry review) in 2009.[4] Many readers may even remember the Asprey report[5] which formed the basis of some of the changes that followed in the 1980s and 1990s.

However, readers may not be so familiar with the *Royal Commission on taxation* (the Kerr Commission),[6] the *Royal Commission on taxation* (the Ferguson Commission),[7] the Spooner Committee of Inquiry,[8] and the Commonwealth Committee on taxation (the Ligertwood Committee).[9]

Taking the two lists together, one can observe that there have been enquiries of some sort into taxation almost every decade since Federation. Perhaps the early years can be excused from such an omission on the basis that those in charge were too busy establishing some type of tax system in the first place, and the 1940s were taken up with the Commonwealth effectively taking control of most taxation and the ensuing fights that followed.

In his significant paper "Tax reform: a Tower of Babel; Distinguishing tax reform from tax change",[10] Justice Graham Hill posited that:

> "Reform of the system as a whole will involve a change of one or more of the following kinds:
>
> – Tax mix — existing taxes
> – Tax mix — the imposition of new taxes
> – Existing taxes — tax rates including deductions and rebates having regard to the tax mix and to promote an equitable distribution of tax burdens
> – Existing taxes — change in tax rates including deductions and rebates to promote an equitable distribution of tax burdens
> – Existing taxes — change in the tax base (for example extension of income tax to include capital gains).
> – Existing taxes — promoting neutrality of the tax system, eg, entity taxation
> – Existing taxes — substantive amendments such as plugging loopholes or removing anomalies, inconsistencies or complexities
> – Existing taxes — procedural or administrative changes to promote simplicity in compliance or administration
> – Existing taxes — simplifying language to improve intelligibility
> – Existing taxes — tax expenditure elimination (or introduction of new concessions designed to promote government economic policy)."

While presented differently, Hill's list covers most of the principles typically identified in approaching tax reform.

As Robyn Jacobson points out in her article, the Henry review identifies both fundamentally efficient taxes, as well as detailing recommendations for specific reforms that are consistent with the principles in Hill's list.

How does this translate to specific issues and areas of the current tax law? In the particular areas covered by this article, the principle behind each area, the design (or scope) and the issues that need to be addressed are discussed.

Goods and services tax

As a proportion of total tax collections

As the Henry review pointed out, consumption taxes are one of the more efficient taxes. It has also been pointed out that, compared to most other jurisdictions, Australia collects a relatively smaller proportion of total tax from taxes on consumption than other countries do. There are two main reasons for this — one is the rate, but the other is the base.

This is not a place to debate the rate. Suffice to say that, whatever the base and rate, careful consideration needs to be given to the impact of the GST on different socio-economic groups and how the social security system needs to be engaged to ensure that those most vulnerable are taken care of.

However, when it comes to the base, it is clear that, in recent years, parts of the economy that are growing (as a share of GDP) more than other parts of the economy are those that are either not subject to GST or not fully so.

Scope/base

What follows are some observation on particular areas that are not at all or not fully subject to GST.

Education

Educational services are GST-free. This was part of the ultimate (negotiated) design of the GST in 2000. The underlying reason is noble — why tax something so fundamental as education? It is a social good. While those reasons are fair and valid, closer scrutiny is warranted. Most education is government-funded, either directly or indirectly, by one or both levels of government. Accordingly, for many people, the amount paid out of pocket (or perhaps, more correctly, the amount charged by educational institutions) for primary and secondary education is relatively modest. In some states and territories, there is little or no charge by state/territory schools and the systemic Catholic schools charge relatively modest amounts. The high fees of $20,000 per annum and more are charged by private schools (whether or not denominational).

Accordingly, at least insofar as school education is concerned, the imposition of a GST on school fees would impact most on those paying private school fees and very little on those attending state or systemic Catholic schools. The preliminary conclusion, therefore, is that, given those paying private school fees tend to be better off, is it not progressive to impose GST on school fees. In fact, is the lack of GST on those fees regressive?

Naturally, tertiary and pre-school fees give rise to different consideration because of the direct cost imposed, even though in many cases there are other government benefits (eg child-care subsidies) that ameliorate that cost. Further investigation into the impact that a GST would have in such cases is required.

Finally, given the growth in foreign students in Australia, consideration will need to be given to the current regime and whether it is able to adequately address these services which are economically understood as exports.

Health

Similar to the reasons expressed above, there is a need to closely examine the incidence of health costs on different socio-economic groups. There may be variations depending on the nature of the services (be they hospital, specialist medical, para-medical or pharmaceutical) that give rise to certain outcomes, as well as the natural public/private issues that arise in the same way as education.

Additionally, consideration needs to be given to the way that private health insurance engages with the rest of the health system and how that might need to be addressed, both in terms of the incidence and the impact on the level of private health insurance and the potential impact on the public system.

Food

In the current system, there are distinctions between fresh food and restaurant and prepared meals. While fresh food is generally GST-free, restaurant meals (including takeaway) are not. Similarly, pre-prepared meals from supermarkets are also subject to GST.

Consideration of the current impact of these differences needs to be given to understand the impact of any changes. To borrow a concept from another field of law, should the "wagyu and shiraz" of one consumer be taxed more concessionally than the McDonalds takeaway and beer of another?

Financial services

Like most countries, Australia does not impose GST on financial services but rather treats those services as "input-taxed" (or "exempt" in other regimes). The effect is that GST is imposed on the inputs but there is no GST on the services themselves. In other regimes, that might be the end of it. However, in Australia, there is a regime of reduced input tax credits (RITCs) on certain acquisitions by financial services providers.

Whether technology has moved on sufficiently to allow for the application of GST to such services or whether the RITC regime is still appropriate should be part of any review of the scope of GST.

Business tax issues

While there are specific issues relating to small and medium businesses (which will be addressed in Robyn Jacobson's article), there are issues that traverse large and small business and those that tend to relate only to larger businesses.

Company (and trust) losses

The current structure of the company and trust loss rules is unnecessarily complicated and often hard to apply — even if there is a clear intention that the losses should be available.

Allowing losses to be offset against future years' income overcomes the artificial construct of a company's liability being calculated on a single income year when it is in fact an ongoing business. This would be unnecessary had there been a "negative income tax" that would have seen Treasury pay a company in those years when it made a loss (often the argument in favour of the carry back of losses as well). Put another way, Treasury provides the tax credit for the loss sustained in the same way it would otherwise collect (and had been collecting) tax on the profits of that enterprise.

Prior to the existence of any loss limitation rules, the situation would be that an entity made a loss. That loss was available to offset future income and thereby reduce future tax. The loss was treated in this way because of an absence of negative income tax. If the loss continued to be available to the company despite a change in control, the purchasers would have paid the loss-incurring shareholders for the tax value of that loss. That is, the purchasers take the place of Treasury in providing the benefit of the loss offset to the vendor/loss-incurring shareholders. It is unsurprising that the purchaser-shareholders might then expect Treasury to reimburse them for having outlaid that tax value on Treasury's behalf.

The logic for the current loss limitation regime can be found in the Ligertwood Commission's report in the 1960s. The argument was that there had been "trading" (a pejorative term) in company losses. This gave rise to the continuity of ownership test, a concession for "genuine" cases through first, the same business test, and more recently, the similar business test, as well as the income injection rules. Originally, the rules only applied to prior year losses, but later rules were introduced to address current year losses. Of course, similar rules were introduced for trusts, but they have been problematic from the start because of definitional issues around what is a fixed trust or a family trust.

However, seen in the context described above, there is no real "trading" but rather a substitution or agency going on. Given that light, it would be reasonable to completely remove the loss rules.

Perhaps one can determine from the existence of the rules for more than 50 years that the real reason for the introduction of the loss rules was (much like the 1988 superannuation rules) to plug a gap in revenue. If there is a revenue reason to maintain some limitation on losses (and it should be seen as an aberration to good, principled taxation), it would be far easier to have a simple rule that, for example, losses could be recouped over a set number of years only or they could be recouped on a straight-line basis, without the need for the complex continuity of ownership and similar business tests. No doubt, other options could be explored.

Consolidation

Many countries have introduced corporate consolidation tax rules. For most countries, this follows the accounting approach of recognising the separate identity of each entity in the defined group but, like accounting, eliminating intra-group transactions. As a result, the legislation enacting those regimes tends to be relatively direct and easily understood.

Naturally, Australia decided to take a different and unique path. This resulted in detailed and complex rules running to hundreds of pages, the fundamental design of which is to treat the head entity of the defined group as effectively having all of the assets and liabilities, and all of the income and expenses of every entity in the group. Those rules were accompanied by voluminous explanatory memoranda and over 1,000 pages of ATO issued guidance.

Those rules deal with how to address the formation of a group in the first place, entities joining the group, and entities leaving the group. The rules deal with the cost setting of assets that "become" those of the head entity and with the cost of an entity as it leaves the group. Unsurprisingly, the rules are both complicated and give rise to anomalies. For example, in order to determine the cost of assets that "become" those of the head entity, it is necessary to take into account liabilities assumed. Some of those liabilities may be deductible. How then to maintain the fundamental approach that applies across the tax law of only allowing a cost to be taken into account once — either as a deduction or part of a cost base? Again, unsurprisingly, there are even more complicated rules to address this that were further refined after a Board of Taxation Review.[11]

Some of the problems in the regime that have been identified are those arising from the concept in the legislation of multiple entry consolidated (MEC) groups. This is a regime designed to deal with foreign groups that do not have a single head entity in Australia but have a single head entity in a foreign jurisdiction.[12]

The design of the consolidation regime led groups of companies to examine their structures and caused some groups to tidy up ownership structures before electing into the regime. It also caused groups, when setting cost bases of assets of the group, to carefully identify all relevant assets, including those not necessarily recorded on the balance sheet, such as goodwill. This gave rise to the identification of goodwill-like assets that were described as "rights to future income" (RTFI). The allocation of cost base to such assets meant that, rather than significant cost being allocated to goodwill, some cost base would be allocated to an asset (the RFTI) that would expire in time and therefore give rise to a deduction or loss for that amount of cost base. This was seen as a potential significant loss to revenue and was the cause of another Board of Taxation Review.[13]

The cost setting rules (sometimes combined with the MEC rules) have given rise to concern around inappropriate uplifts in cost bases of assets, as well as what are sometimes referred to as "phantom" gains. In the latter case, this is where a "gain" is taxable today because cost base has been allocated to an asset which will be available at a later time but for which there was no identifiable cost (ie outgoing or liability assumed).

The conclusion must be drawn that the consolidation regime as enacted in Australia is a failed experiment, and the rules should be repealed and replaced with a more conventional and simpler approach that does not give rise to so many anomalies.

The challenge, as always, will be how to transition from the existing regime to a newly designed regime.

CGT scope

When designing any tax system, the starting point is to ask whether a particular tax should be comprehensive or whether there should be some exception to comprehensiveness — usually by way of concession to one or more sections of the community or a type of activity.

When it comes to the design of CGT, there is living proof that overly detailed rules can not only give rise to many anomalies (see later in this article), but also that detailed rules can unintentionally move away from a comprehensive base and provide concessions where they were never meant to apply. Thus it is with CGT. The design of, and approach to, the CGT rules are such that they completely miss gains and losses on half of the balance sheet. This is because the fundamental design of CGT was around "assets". The rewrite of the CGT rules into the *Income Tax Assessment Act 1997* (Cth) (ITAA97) added a further unintentionally limiting concept, that of "CGT events".[14] The problem is plugged by many more provisions, including the foreign exchange gains and losses rules (another overengineered set of provisions), the commercial debt forgiveness rules, the limited recourse debt rules, the taxation of financial arrangements, and many more.

That so many rules are needed to address a fundamental design flaw of the principal tax reflects the paucity of thinking about the basic design and the way to address shortcomings. Rather than ask why there is a shortcoming in the first place, the parliamentary kneejerk reaction is to add another set of rules to deal with the single observed issue.

CGT concessions

While the nature of the small business CGT concessions is raised in Robyn Jacobson's article, a few issues remain that require addressing around CGT.

CGT discount

First, the 50% discount for individuals.[15] In the context of business activities (as distinct from passive investment), there is clearly an anomaly between incorporated businesses and those operating through partnerships and trusts and as sole traders. The fact that the CGT discount is available (mostly) in the unincorporated cases and not in the incorporated one gives rise to questions about the integrity of the discount and, naturally, gives rise to costs and time spent on tax planning.

Although not an original design feature of the CGT rules when introduced in September 1985, there was a concept of CPI indexation of the costs of an asset such that only the "real" (after inflation) gain was taxed. The 50% discount was introduced in September 1999 on the basis that it would simplify the CPI indexation approach and that it was a reasonable approximation of inflation at the time. Inflation has subsequently reduced to the point where that reason for such a large discount no longer holds true.

The change to the discount also coincided with a period when there was a growing view that it was necessary to do things to attract capital. That capital was "mobile" and that tax regimes could be used in attracting and retaining that capital. This view was also manifested in some of the recommendations in the Henry review for the reduced taxation of income from capital.[16] However, if the concession was intended to encourage investment in productive assets, it is fair to say that it was poorly targeted. In fact, one might ask whether the concession encourages the wrong kinds of investment and behaviours.

Accordingly, it will be important to look at the CGT discount in any review. Consideration should be given to options for reform, including (but not limited to) reverting to a cost base indexation approach (or none), providing particular incentives for certain types of asset investments, and even the interaction of CGT with other features of a reformed tax system (including how to treat other taxes associated with holding assets).

Taxation of superannuation funds

While Robyn Jacobson's article raises issues around the unnecessarily complicated taxation of superannuation from the individual/member point of view, this section of the present article raises the question about the design of the taxation of superannuation funds.

Readers of a certain age may recall that, to understand the taxation of superannuation funds prior to 1988, it was necessary merely to understand a small number of sections of the ITAA36 mostly dealing with how to ensure that the exempt status of the superannuation fund was maintained. That is, like many countries, the pre-1988 tax treatment of superannuation was an "exempt – exempt – taxed" approach. That is, contributions were exempt (and were effectively "gross" by virtue of the deduction available to the employer), earnings were exempt while ever the relevant conditions were maintained, and the benefits were taxed in the hands of the superannuant.

Without covering the position of the member, the taxation of all funds at the rate of 15% was introduced in the 1988 May Economic Statement as a means to bring forward revenue, offset in part by a more concessionary taxation of end benefits for fund members. However, that taxation was not to apply to the extent that the fund's assets were being used to fund pension obligations. Effectively, an "exempt – taxed – taxed" model was introduced.

Subsequent changes have meant that the taxation of the end benefit has, in most cases, been effectively reduced to zero for those over 60 years of age. Accordingly, we now have a system that is "exempt – taxed – exempt". Although some point to "tax expenditures" published by Treasury as reflecting a very large concession to superannuation, such analysis often incorrectly adds separate items together and therefore overstates the level of that tax expenditure. Nonetheless, one must query whether this is the right setting or a sustainable long-term setting.

The current model is somewhat unique (a recurring theme here?) and clashes with models that operate in other jurisdictions. This can give rise to potential double taxation for both funds and members. Tax treaties are seldom able to address this. Additionally, certain jurisdictions give concessions not just in tax, but also in reporting, where the treatment of the fund or member is consistent with that applying in that jurisdiction (think of the Foreign Account Tax Compliance Act in the United States). This means either an enormous amount of work to explain the nature of the Australian regime and/or seeking a special exemption or treatment. Another compliance cost for no net benefit.

Are the concessions for superannuation funds still appropriate in the context of the whole of the tax system? Should there be a reversion to a simpler regime? There is ample opportunity for high quality reform in this area.

Taxation of financial arrangements

The taxation of financial arrangements (TOFA) regime consists of a set of rules developed over a period of some 20 years that is designed to bring to account gains and losses on financial transactions earlier than might otherwise be the case. Previously, there was a limited attempt to address accruing gains and losses on certain instruments through Div 16E of Pt III of the *Income Tax Assessment Act 1936* (Cth) (ITAA36).

The TOFA regime consists of a number of components the first of which attempts to classify various "financial" instruments as being either debt or equity — not by reference to their form but by reference to the economic substance of the arrangement. This might be a noble venture, given that the taxation of debt and equity differs in Australia. However, that begs the question of whether such a difference in taxation treatment should exist.

Thus, Div 974 ITAA97 was born. This Division operates on the basis of finding certain features of the relevant instrument and then determining, according to a set of rules, whether the instrument should be treated as "tax debt" or "tax equity".

This was designed to overcome the prior position that issuers of debt or equity could choose the outcome they wanted by picking the legal form that suited them best. Thus, if they wanted the instrument to be debt-like but be treated like equity, they might choose redeemable preference shares (ignoring any special rules). If they wanted the instrument to be essentially deductible debt but wanted the form to be equity for other reasons (eg capital management and balance sheet presentation), they might choose a participating debt instrument or a convertible note.

Under Div 974, of course, the issuer simply needs to determine what outcome they want and choose the features in Div 974 to achieve that outcome. Is that all that different from the previous position when using legal form to determine the outcome?

Similarly, Div 775 ITAA97 was introduced as a rewrite to Div 3B ITAA36, each dealing with foreign exchange gains and losses. While gains and losses on revenue account were dealt with adequately under the general income and deduction provision of the tax law, and foreign exchange gains and losses on assets were ultimately dealt with under the CGT rules (from 1985), gains and losses on foreign exchange liabilities were not. To solve a minor gap, a regime was developed to take such gains and losses out of the general income and capital rules in the Tax Acts and create a special rule treating all such gains and losses on revenue account.

Of course, this failed to recognise that the reason for foreign exchange contracts was, in many cases, a hedge against an investment denominated in a foreign currency.

As can be seen, this is a regime that, on one view, is completely unnecessary if the CGT rules were properly addressed. However, to give some credit, when designing the overarching TOFA rules in Div 230 ITAA97, there was an attempt to overcome the potential mismatch that the Div 775 rules could give rise to — but it was very narrowly drafted, with the result that, for most taxpayers, it was completely useless.

Division 230 itself is so detailed and complicated, so full of exceptions and special rules, that the end result seems to be an enormous amount of work to bring to account an amount that, in many cases, would have been brought to account anyway in the same income year. To the extent that there was a real timing difference (the reason for the regime in the first place), it is often minor or no more than one year's difference — in some cases, in favour of the Revenue, in others, in favour of the taxpayer. This represents an enormous burden on the economy for very little benefit and needs to be addressed.

Insurance tax

The tax regimes applying to general and life insurance (Divs 320 and 321 ITAA97 and Div 15 ITAA36) have particular complications and peculiarities that are in need of reform.

In the case of Div 321, applying to general insurance activities, the Division represents a codification of the general principles that previously existed. Those principles followed accounting and business principles that underlay the operation of the insurance industry and borrowed from longstanding principles of returning income and claiming expenses. By writing those principles into Div 321, little has been added other than the constrictions of legislated rules that become unwieldy as soon as the accounting principles or general business approaches change. This then requires the industry or the tax administration to try to reconcile those differences which would not really have arisen had the regime been left to the broad accounting and business principles that existed previously.

In the case of Div 320, applying to life insurance companies, the rewrite of special rules from the ITAA36 was originally built on suspicion of earlier practices, which resulted in a regime that still sought to create multiple taxation regimes in the one taxpayer. This gave rise to theoretical legislated divisions which had to then be replicated by business to accord with the tax regime. This is known as the tax tail wagging the business dog.

Again, such an approach has given rise to anomalies and, when added to other theoretical regimes (like consolidation), gives rise to even more anomalies, all of which demand further amendments. This ongoing tinkering with the regime means that it also becomes unwieldy and is proof of the adage that the greater the number of words that are written the more problems that arise.

Division 15 is a specific regime designed to deal with non-resident insurers. It is a relic of a time when large (usually United Kingdom) foreign insurers would compete but, not having a presence in Australia, would not be subject to tax in Australia (one might call it a pre-BEPS (base erosion and profit shifting), BEPS issue). Australia's right to tax has been preserved in double tax agreements (DTAs). It would appear to be contrary to our free trade principles and should be reconsidered in light of subsequent developments.

> *"... proof of the adage that the greater the number of words that are written the more problems that arise."*

International tax

The international tax regime adopted in Australia in somewhat contradictory. While there are concessions that are designed to encourage inward investment (as one might expect from a net capital-important country), those rules collide with regimes that attempt to prevent the shifting of income to foreign jurisdictions via non-fixed trusts.

Recent judicial decisions confirm the limitation of the concession for foreign investors when those flow through non-fixed trusts.[17] Many have argued that this is an anomaly and should be addressed. It raises broader issues about the extent of concessions drafted to encourage investment and the appropriateness of discretionary trusts as a vehicle for such investment. Other jurisdictions would restrict what trusts could be used. Of course, other jurisdictions provide appropriate flow-through vehicles for small business and family investors, such as limited partnerships.

Similarly, the foreign income tax offset rules, designed to reduce double taxation for residents, has recently thrown up anomalies. This occurs where the way in which Australia seeks to tax certain kinds of income differs from the way another country in which an Australian invests chooses to tax that same amount. Most recently, *Burton's* case[18] resulted in a capital gain that was subject to concessional *rates* of tax in the US also being subject to taxation in Australia, with credit for only half of the US tax paid because the method in Australia meant that half of the gain was subject to tax at full tax rates. This contrasted with all of the gain being subject to lower rates of tax in the US. The net tax paid in each jurisdiction may have even been the same, but the difference in methods gave rise to an anomaly when it came to granting the credit.

Australia's thin capitalisation rules are not only unnecessarily complex and overly prescriptive, but they are also somewhat out of step with the trend in the rest of the world in terms of methodologies applied. This can give rise to mismatches when having to deal cross border. The other feature of the Australian regime that is presently absent are anti-debt creation rules. These once existed in Div 16G ITAA36 but were thought unnecessary to replicate when thin capitalisation was rewritten into the ITAA97.

Tax administration and governance

The Henry review proposed a number of changes designed to improve the governance of the tax system and the "client experience". Those recommendations included:

- a "principles-based approach to tax law design as a way of addressing the growing volume and complexity of tax legislation, and as a way of helping those laws to be interpreted consistently with their policy objectives";[19]
- better oversight of the effectiveness of and costs of compliance with the system,[20] that "[t]he government should, every five years, publish a Tax and Transfer Analysis Statement that analyses and reports on the overall performance and impact of the system, including estimates of efficiency costs and distributional impacts";[21] and
- making better use of data and technology to make it simpler to engage with the tax system, leveraging off existing (and then emerging) systems to allow direct reporting and, in addition, support small business.[22]

While many of these recommendations have been progressed, there is still further work that could be done to minimise the compliance cost for taxpayers. For example, even if the strict technical basis for the final determination of tax liability does not essentially change, it would be possible to develop simpler methods for calculating quarterly instalments of tax.

Further, and hinted at in the Henry review, better integration of the Commonwealth and state/territory revenue agencies could see a significant reduction in compliance and administration costs. Why have multiple reporting of information — especially where taxes are based off the same data?

Commissioner's remedial power

The fact that the Commissioner's remedial power (CRP) exists at all is perhaps an indictment on the system. It was put in place to address the underlying problems that politicians do not really want to address. Thus, it is easier to get the ATO to fix things than for parliament to take responsibility for fixing up the mess it has created. However, the design of the CRP has been hampered from the start. In a departure from the recommended design, parliament decided to handcuff the power to prevent the true original policy intent from being implemented if it were to cost the government of the day any revenue. This must be addressed. However, even more important is the need to address the underlying design of law that gives rise to anomalies that then require the exercise of the CRP.

Complexity

Codified general rules add to confusion

A number of provisions of the Tax Acts essentially codify general taxation principles that were both well understood and followed general business and accounting rules; some of these have been referred to above. It is interesting that, at different times, various studies and bodies (including the Board of Taxation[23]) have looked at how the tax law and accounting could be better aligned. The converse of this is that the law has developed in a way that works in the opposite direction. By codifying particular general principles — sometimes for the avoidance of doubt, other times because the government of the day has determined that the timing of assessability or deductibility should be different to the general principals explained by the courts — there has been added numerous "clarifications" and detailed rules that one suspects adds little to either understanding or consolidated revenue. Thus, we have particular rules in law around:

- royalties;
- return-to-work payments;
- insurance or indemnity amounts;
- profits and losses from profit-making undertakings or schemes; and
- others,

which, for the most part, are designed to only slightly modify (or, in some cases, just restate) what the courts have already given guidance on.

Additionally, there has been a tendency to implement overly detailed legislated rules where ATO guidance would have been sufficient. These include items such as car expenses, substantiation, depreciation rules (there is a whole Subdivision on what is the cost of the asset!), and one of my favourites, non-compulsory uniform rules (or the "make work for the Department of Industry" by requiring registration and approval of uniform designs).

Ironically, in the case of the substantiation rules, it has had the opposite effect of what was originally intended, with a significant growth in the amount of work-related expense claims over the years.

Finally, there seems to be a tendency to be so prescriptive that what was once a single section in the ITAA36 becomes a whole Subdivision in the ITAA97, for example, Subdiv 32-A on entertainment expenses.

Other complexity

While this heading could cover a large number of issues, I note that one has been addressed in Robyn Jacobson's article on the differential corporate tax rates and the complexity that a superficially simple difference can cause. The second example which deserves some attention is FBT.

The high cost of compliance associated with FBT can be found in two features of the law that emerged during the late 1980s:

1. very broad drafting to capture absolutely everything, then providing limited exemptions; and
2. incorporating highly detailed rules with a view to limiting planning opportunities.

Experience has shown that both techniques are flawed. Drafting so overly-broadly means capturing things that were never intended. Thus, the availability of toilet facilities to an employee would be a taxable fringe benefit but for the specific exemption provided. Accordingly, the FBT law is replete with the most mundane exemptions. Additionally, experience shows that more prescriptive drafting often creates planning opportunities rather than limiting them.

The main issue with FBT is, as referred to in the Henry review (and quoted in the accompanying article), that it taxes the wrong person, more often than not at the wrong rate. I would add that it also taxes things that were never intended to be taxed and impacts on the social security benefits of an employee (think reportable fringe benefits) when they were merely undertaking their normal duties (which could include manning a desk at a client seminar).

Conclusion

There are many opportunities to improve the tax system in Australia, from the significant system design issues to the way in which practitioners have to assist clients to comply with the laws. All aspects need to be addressed, but it is necessary to start with the highest principles and agree on a process to implement the agreed principles and the way in which administration can continue to make the system accessible.

As Albert Einstein is reported as saying, “Everything should be made as simple as possible, but no simpler”.

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11 Board of Taxation, *Post-implementation review of certain aspects of the consolidation tax cost setting process*, April 2013.

12 Interestingly, the same treatment is not afforded to commonly owned entities in Australia, particularly SME groups that are owned by the same individuals in the same proportions but not with a common head entity.

13 Board of Taxation, *Review of the consolidation rights to future income and residual tax cost setting rules*, 31 May 2011.

14 For a fuller exposé of the limitations of that approach, see AV Mills, “CGT events — the case for: The current list of 54 CGT events should be removed and replaced with a more coherent conceptually based system”, from The Tax Institute and the Australian Tax Research Foundation Great Australian Tax Debate, 16 August 2017.

15 One could add the one-third discount for complying superannuation funds to this discussion, at least in relation to the indexation substitution point. Nonetheless, there are productive investment considerations for superannuation funds as well (even given the context of managing members’ money for the purposes of providing for retirement or death).

16 See, for example, Australia’s Future Tax System Review Panel, *Australia’s future tax system: final report* (Henry review), 23 December 2009, recommendation 14.

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

18 *Burton v FCT* [2019] FCAFC 141.

19 Australia’s Future Tax System Review Panel, *Australia’s future tax system: final report* (Henry review), 23 December 2009, recommendation 112.

20 Ibid, recommendation 133.

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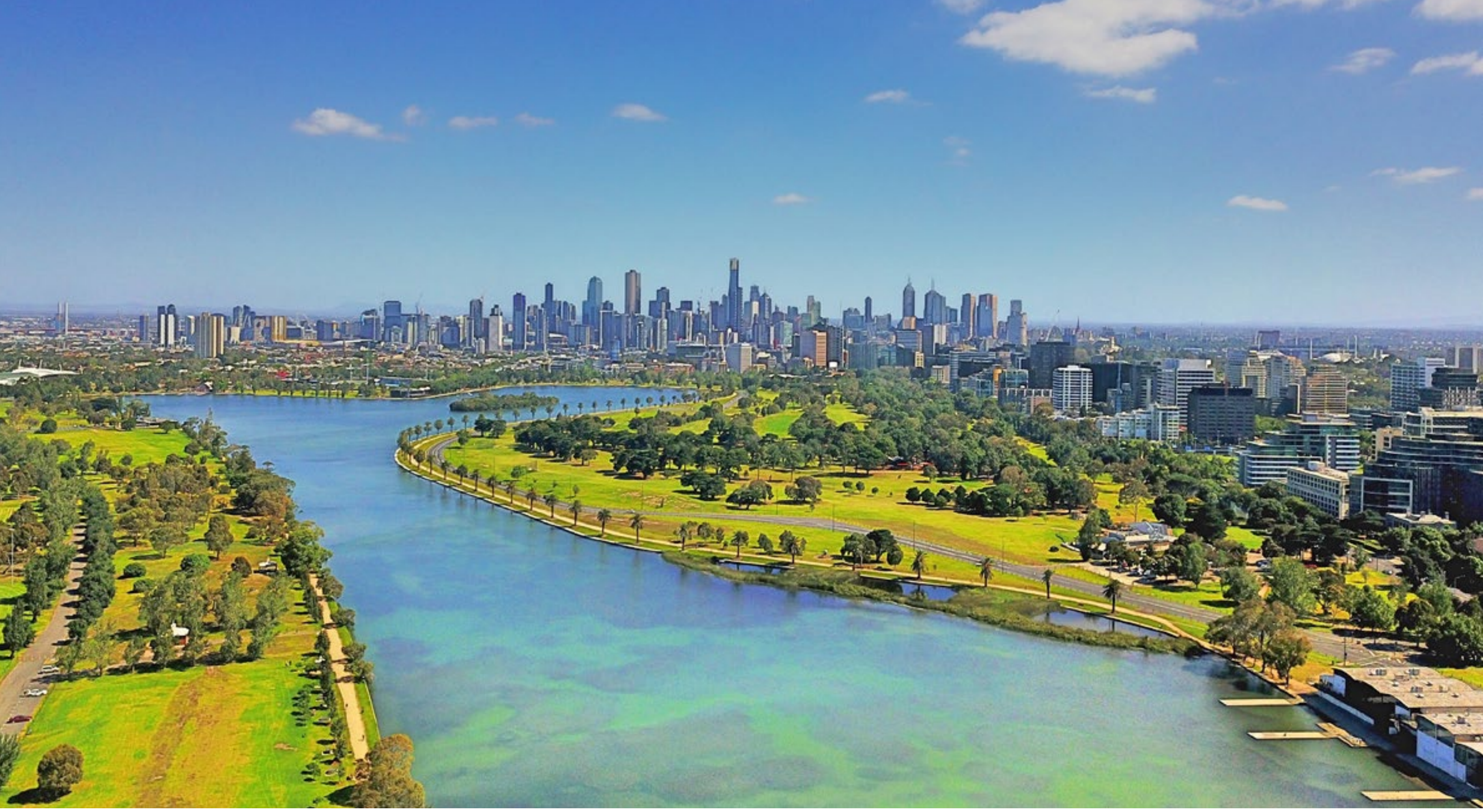
23 Board of Taxation, *Greater alignment between tax and accounting systems in Australia*. Available at http://taxboard.gov.au/consultation/tax-accounting-systems-in-aus.



Tax reform: with 2020 vision

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It is universally agreed that tax reform in Australia is necessary but obtaining agreement from all stakeholders on the design of an improved system, and implementing those improvements, seems an impossible task. Previous tax reform made some inroads, but our tax system has been creaking under its own weight for far too long. The COVID-19 pandemic may provide the impetus for reform. The Henry review remains a blueprint for the reform of Australia's tax system and many of the recommendations contained in the report are worthy of consideration, even 10 years on. Against this backdrop, this article considers issues with the taxation of fringe benefits, the corporate tax rate, the top marginal tax rate and the CGT discount, the taxation of trusts, small business tax concessions, Div 7A, individual tax residency, the personal services income rules, the superannuation guarantee regime, and the state of consultation on legislative amendments.

While it is universally agreed that tax reform in Australia is necessary, our political leaders have lacked the courage, foresight and will to make genuine and substantive reforms. Some business and community leaders lack the vision to suggest changes beyond their own sectoral interests. The majority of the legislative amendments made to the tax law just tinker around the edges and adjusting the personal income tax thresholds and rates does not constitute "reform".

1 July 2020 marked the 20th anniversary of the introduction of the GST in Australia. Its introduction was the centrepiece of the Howard Government's tax reform package. You may recall the slogan, "Tax reform: not a new tax, a new tax system". This was abridged to "A new tax system" or "ANTS", which became the prefix for the titles of all tax-related Bills at the time.

The Howard Government described its policy framework for securing Australia's economic future in 1998 in the following terms:[1]

> "It is a framework designed to achieve stronger sustainable growth, higher productivity, more jobs and rising living standards.
>
> Tax reform is not an end in itself. It is an indispensable part of a broader co-ordinated policy approach that has as its goals greater incentive, security, consistency and simplicity. It also provides for fairer outcomes, greater choice and greater opportunity.
>
> As part of that broader co-ordinated policy approach, tax reform is essential if Australia is to be able to achieve its full potential as a nation in the twenty-first century.
>
> The tax reform which is necessary for Australia — and to which the Coalition Government is committed — is not reform narrowly focussed on establishing a new tax, but reform which delivers a new tax system: a system which is built on a lower tax burden and which is fairer, more internationally competitive, more effective, and less complex.
>
> It is a new tax system that has as its central priorities not only the efficiency and effectiveness of our national economic policy framework but also the sense of equity and fairness that has always been part of the Australian way."

Reading back those words, it is striking that these aspirations are as relevant today as they were 22 years ago. However, the sad truth is that little has been done by those on either side of the political divide to achieve them.

In the last two decades, the chorus of voices championing improvements to our tax system has only amplified. Our tax system has been creaking under its own weight for far too long.

Continual legislative amendments by successive governments over more than four decades have resulted in a set of rules, regulations and necessary binding and non-binding ATO guidance that all agree is unwieldy, inefficient and in desperate need of reform. Our tax system must be robust so that it can adapt to changing conditions and challenges, including:

– digital and technological changes;
– the globalisation of business, investment and labour — this has increased the mobility of capital which was historically fixed in physical, geographical locations but is now borderless;
– an ageing demographic; and
– an increased consumption of services across our economy that falls outside the GST.

The COVID-19 pandemic may turn out to be both the straw that breaks the camel's back and the impetus for change. The crisis has inevitably caused a rethink of virtually everything we do and how we do it.

Significant parts of the economy are hurting badly, and we are seeing many business closures. However, there are also some sectors that are still managing okay or have even not been significantly impacted. Regardless, our economic future is uncertain. Unprecedented levels of debt to fund the stimulus packages have presented the government with an enormous challenge in balancing financial recovery of the economy with the fiscal impost. Getting its policies right over the next few months will be crucial to the recovery of the economy but, longer term, getting its policies right will be crucial to the future of our nation.

Our current taxation system is simply not robust enough to sustain us well into the 21st century. If there was ever a time for necessary and genuine reform, it is now.

Lessons from the Henry review

The Henry review[2] remains a blueprint for the reform of Australia's tax system. The December 2009 report (the report) famously stated that:

> "Around 90 per cent of Australian tax revenue is raised through only 10 out of some 125 different taxes that are currently levied on businesses and individuals."

According to the report, the 10 taxes (ranked in order from highest to lowest) that generate around 90% of the Australian tax revenue are:

1. personal tax;
2. company tax;
3. GST;
4. payroll tax;
5. fuel excise;
6. local government rates;
7. conveyance stamp duty;
8. superannuation;
9. tobacco excise; and
10. land taxes.

The 115 other taxes include FBT, gambling taxes, insurance taxes, beer and spirits excise, customs duties, motor vehicle taxes, crude oil excise and agricultural levies.

Many of the 138 recommendations contained in the report are worthy of consideration, even 10 years on. Some of the notable recommendations include:

- recommendation 2: a high tax-free threshold with a constant marginal rate for most people should be introduced to provide greater transparency and simplicity;
- recommendation 5: the Medicare levy and structural tax offsets — the low income, senior Australians, pensioner and beneficiary tax offsets — should be removed as separate components of the system and incorporated into the personal income tax rates scale;
- recommendation 6: to remove complexity and ensure that government assistance is properly targeted, concessional tax offsets should be removed, rationalised or replaced by outlays;
- recommendation 9: fringe benefits that are readily valued and attributable to individual employees should be taxed in the hands of employees through the PAYG system. Other fringe benefits, including those incidental to an individual's employment, should remain taxed to employers at the top marginal rate (and non-reportable for employees);
- recommendation 11: a standard deduction should be introduced to cover work-related expenses and the cost of managing tax affairs to simplify personal tax for most taxpayers. Taxpayers should be able to choose either to take a standard deduction or to claim actual expenses where they are above the claims threshold, with full substantiation;
- recommendation 17: the CGT regime should be simplified (see the report for further details);
- recommendation 18: the tax on superannuation contributions in the fund should be abolished. Employer superannuation contributions should be treated as income in the hands of the individual, taxed at marginal personal income tax rates, and receive a flat-rate refundable tax offset;
- recommendation 20: the restriction on people aged 75 and over from making contributions should be removed. However, a work test should still apply for people aged 65 and over;
- recommendation 23: superannuation guarantee contributions should be paid at the same time as wages;
- recommendation 27: the company income tax rate should be reduced to 25% over the short to medium term, with the timing subject to economic and fiscal circumstances;
- recommendation 36: the current trust rules should be updated and rewritten to reduce complexity and uncertainty around their application; and
- recommendation 51: ideally, there would be no role for any stamp duties, including conveyancing stamp duties, in a modern Australian tax system. Recognising the revenue needs of the states, the removal of stamp duty should be achieved through a switch to more efficient taxes, such as those levied on broad consumption or land bases.

What can we take from these and the other 126 recommendations? Reflecting on the Henry review recommendations, a number of issues with our tax system become apparent. These are discussed below.

Taxation of fringe benefits

In 2018-19, the FBT revenue contributed \$3.794b[3] out of total revenue of \$425.980b, just 0.89% of all revenue. The system is complex and burdensome for employers and it generates comparatively minimal revenue for the government.

There are recurring compliance concerns relating to:

- valuing benefits;
- record-keeping and employee declarations;
- misalignment of the FBT year (ending 31 March) with the income tax year (ending generally 30 June);
- allocation of shared benefits to employees;
- misunderstanding by employers of the various exemptions;
- interpretation of terms such as "minor, infrequent and irregular";
- complexity with the provision of benefits relating to meal entertainment and Christmas parties; and
- recent judicial and resulting ATO guidance on "car parking" benefits.

The antiquated provisions of the *Fringe Benefits Tax Assessment Act 1986* (Cth) is further impetus for an overhaul of the regime. Occasional amendments[4] are made to the Act to reflect changes in our society, but expressions such as "briefcase" and "panel van" are hopelessly showing their age.

The notion of taxing benefits to employees has been a perennial recommendation in tax reviews.[5] Taxing fringe benefits to employees would depart from collecting tax from a relatively small number of employers versus a significantly larger number of employees. But this could be overcome by applying a reporting and withholding tax regime, effectively extending PAYG withholding that currently applies to most other types of payments made by employers.

Corporate tax rate

Between 1940 and 1973, the tax rate for public companies was higher than that for private companies. The two-rate system was removed in 1973 when the rates for both types of companies were aligned. In 1986, the rate was increased to align with the top marginal tax rate (49% at the time). The rate was then reduced to 30% between 1988 and 2000, where it remained for 14 years, before a two-rate system was once again introduced from 2015-16.

The government's vain attempt to reduce the corporate tax rate for all companies to 25% has resulted in non-resident shareholders faring better than Australian resident shareholders. The lower corporate tax rate is advantageous for non-resident shareholders who benefit from larger dividends, but is disadvantageous for resident shareholders who may face additional top-up tax due to trapped franking credits.

The legislative amendments made in 2018 have resulted in an unnecessarily complex and nuanced regime for companies which must navigate their way through the complicated aggregated turnover test and the base rate entity passive income test to determine their tax rate and franking rate.

Unnecessary complexity exists due to the potential misalignment of a company's tax rate and its maximum franking rate, resulting in top-up tax or trapped franking credits where dividends flow between companies that are base rate entities and those that are not. The misalignment is compounded by companies being required to use current year data to determine their tax rate but prior year data to determine their franking rate. Further complexities arise where distributions flow through trusts, as illustrated below.

Numerous anomalies arise such as where, assuming the aggregated turnover is less than $50m and there is no significant passive income:

- business income derived by a company that is distributed to another company via a trust is taxed at the higher rate, but income distributed directly to another company is taxed at the lower rate;
- a company carrying on a business of equipment hire is taxed at the higher rate, yet a dormant company must frank its distributions at the lower rate; and
- a company that derives both business income and rent suffers a massive decline in its turnover due to the COVID-19 pandemic — it may extraordinarily find itself being taxed at the higher rate as a result.

Top marginal tax rate and CGT discount

It would be a bold move, but reducing the highest marginal tax rate to align it with the corporate tax rate would eliminate:

- the personal services income (PSI) rules;
- Div 7A of Pt III of the *Income Tax Assessment Act 1936* (Cth) (ITAA36); and
- the need for proposed amendments to include all remuneration (including payments and non-cash benefits) provided for the commercial exploitation of a person's fame or image in their assessable income from 1 July 2019.

Such an alignment would remove the incentive for individual taxpayers to divert their taxable income to companies and trusts to minimise their tax. This would have the consequential effect of reducing the benefit of the CGT discount, but perhaps there is merit in a redesigned CGT discount which becomes more generous the longer the asset is held.

It is notable that a discount capital gain made by an individual on the highest marginal tax rate is now taxed at a rate that is very similar to that which applies to a non-discount gain made by a company that is a base rate entity, although the gain must still be extracted from the company by the shareholder.

> *"The exclusion in s 100A(13) for 'an … ordinary family or commercial dealing' is screaming out for judicial clarification."*

Taxation of trusts

Copious articles have been written over the decades by the best minds in the judiciary and legal and accounting practitioners who have identified, dissected and debated the problems inherent in Div 6 of Pt III ITAA36 (Div 6). Vain attempts to reform Div 6 have been largely unsuccessful, notably in 2010 following the High Court's decision in *FCT v Bamford*[6] which finally provided some certainty in relation to some long-debated issues regarding the taxation of trusts.

There was a flurry of activity following the *Bamford* decision, including a consultation paper[7] in 2011 and a policy options paper[8] in 2012 which set out proposed reforms to the taxation of trust income. However, only some limited trust streaming provisions relating to capital gains and franked distributions emerged from the extensive and earnest efforts to reform Div 6.

"Be careful what you ask for"

The adage, "be careful what you ask for", rings true here. The profession asked for the ability for trusts to continue to stream capital gains and franked distributions in the wake of concerns arising from the *Bamford* decision. Had the profession maintained its insistence on the ability to stream foreign income, interest income or rental income, maybe the provisions would have included those classes of income.

It is a similar situation with s 100A which deals with reimbursement agreements. This obscure provision in Div 6 has been in the law since 1981 and treats a beneficiary as not being presently entitled where the present entitlement arose out of a reimbursement agreement. The exclusion in s 100A(13) for "an agreement, arrangement or understanding entered into in the course of ordinary family or commercial dealing" is screaming out for judicial clarification.

In the meantime, the profession sought interpretive guidance from the ATO, which was first provided in the form of a non-binding document[9] on 2 July 2014. Since then, the profession has continued to seek binding guidance from the ATO. The ATO's advice under development program[10] advises that a draft ruling will set out the Commissioner's preliminary views on the exclusions from a "reimbursement agreement" for:

– agreements not entered into with a purpose of eliminating or reducing someone's income tax; and
– agreements entered into in the course of ordinary family or commercial dealings.

The expected completion is yet to be advised but targeted consultation on this issue has commenced.

The provisions affecting trusts

More than 30 separate set of rules affect trusts (many of which contain dozens more rules):

– Div 6 of Pt III ITAA36: incorporating the key provisions of ss 97, 98, 99, 99A, 99B and 101;
– s 100A ITAA36: reimbursement agreements;
– Div 6C of Pt III ITAA36: public trading trusts;
– Div 6D of Pt III ITAA36: closely held trust rules;
– Div 7A of Pt III ITAA36: loans by private companies to trusts;
– Subdivs EA and EB of Div 7A of Pt III ITAA36: private companies with trust entitlements;
– Pt IVA ITAA36: the general anti-avoidance rules;
– Sch 2F ITAA36: trust loss provisions;
– Sch 2F ITAA36: family trust elections;
– s 106-50 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97): absolute entitlement;
– Div 115 ITAA97: discount capital gains;
– Subdiv 115-C ITAA97: streaming capital gains;
– s 118-180 ITAA97: CGT main residence exemption rule on marriage or relationship breakdown;
– Divs 122 and 124 ITAA97: CGT roll-overs;
– s 126-15 ITAA97: CGT roll-over involving trustee on marriage or relationship breakdown;
– Subdiv 130-D ITAA97: employee share trusts;
– s 152-70 ITAA97: "significant individual" modifications (small business CGT concessions);
– Subdiv 165-F ITAA97: company losses — non-fixed trust ownership;
– Subdiv 207-B ITAA97: streaming franked distributions;
– Subdiv 235-I ITAA97: instalment trusts;
– Div 275 ITAA9: managed investment trusts;
– Div 276 ITAA97: attributed managed investment trusts;
– s 328-125 ITAA97: "connected with" modifications for trusts;
– ss 12-175 and 12-180 of Sch 1 to the *Taxation Administration Act 1953* (Cth): TFN reporting for closely held trusts;
– CGT events E1 to E8;
– deceased estates;
– holding period rule (when distributing franking credits attached to dividends);
– special disability trusts;
– superannuation funds;
– testamentary trusts; and
– transferor trust provisions.

A cursory glance of the above list shows that the interplay and application of the legislative provisions affecting trusts is unworkable, and almost impossible to fully comply with.

An obvious area of reform is the sets of provisions applying to closely held trusts. There is both an overlap of and mutual exclusivity between:

– the trustee beneficiary reporting rules in Div 6D of Pt III ITAA36;
– the TFN reporting rules for closely held trusts in ss 12-175 and 12-180 of Sch 1 of the *Taxation Administration Act 1953*; and
– the trust loss provisions in Sch 2F ITAA36, which includes the rules governing family trust elections, interposed entity elections and family trust distributions tax.

Surely it is time for the trustee beneficiary statement, which can result in the imposition of trustee beneficiary non-disclosure tax, to be repealed. The rules are poorly understood, complied with, and enforced. The family trust election rules and TFN reporting rules (which emerged subsequent to the trustee beneficiary reporting rules), together with the information reported in the distribution statement in the trust's tax return, should be sufficient to warrant the repeal of the rules in Div 6D.

Reform s 99A tax rate

While reasons of asset protection, family succession and control of assets are frequently offered as the basis of distributing from a trust to a corporate beneficiary, arguably, one of the main drivers is ensuring that the trust income that is not being used for personal or non-income producing purposes is taxed at the corporate rate rather than at the penal rate which applies under s 99A ITAA36.

If the rate imposed under s 99A were reduced to be aligned with the corporate tax rate, whether the headline rate of 30% or the lower rate that applies to base rate entities, this would simplify structures by removing some of the motivation to distribute to corporate beneficiaries.

In most cases, the funds are retained for working capital and are not used for a personal or non-income producing purpose. The tax law should acknowledge the widespread use of companies and trusts for business and asset-holding purposes and recognise that, where the funds are used for a taxable or working capital purpose, penal rates of tax should not be imposed and Div 7A implications should not arise.

Small business tax concessions

The raft of tax concessions available to small business entities were recently reviewed by the Board of Taxation.[11] In response, the government announced on 12 December 2019 that it will continue to consider the implications of the Board's findings as this report constitutes a valuable contribution to public debate on important tax issues.[12]

There is scope for concessions applying to small business entities, including the small business CGT concessions in Div 152 ITAA97, to be simplified, streamlined and better targeted. The February 2018 amendments affecting CGT events that happen to shares in companies and interests in trusts were designed to close a loophole. However, they were dreadfully overengineered and greatly increased the complexity of the eligibility rules, making this a specialist area for advisers. The fact that the commencement of the amendments was delayed by nearly eight months reflected the chasm that existed between what was foreshadowed in the Budget announcement and the eventual form of the rules when the exposure draft legislation was released. They were poles apart, and the Senate's insistence on a delay to the start date was appropriate.

Division 7A

The recent announcement on 30 June 2020 to further defer the commencement of the proposed reforms to Div 7A extended the uncertainty which has existed since 2012 when the review by the Board of Taxation was commissioned, but sensibly links the start of the new rules to the timing of enacted legislation.[13]

A detailed analysis of the proposed reforms is beyond the scope of this article, but the following key areas remain of utmost concern to SME practitioners:

- equitable transitional rules for existing loans and unpaid present entitlements, including those that are quarantined;
- minimum yearly repayments under the proposed 10-year loan model;
- the proposed removal of the distributable surplus;
- the treatment of unpaid present entitlements and sub-trusts under the new rules;
- the operation of a much-needed self-correction mechanism, which could be accompanied by a limited-period amnesty to address existing loans that do not comply with Div 7A; and
- the proposed excessive 14-year amendment period.

It will be essential for the profession to constructively engage with the various stakeholders to ensure that the policy objective is reasonable and the enacted provisions are workable, sensible and equitable.

Individual tax residency

There have been 29 cases on individual tax residency before the courts and tribunal since 2011. Unsurprisingly, the overwhelming majority were initiated by Australian taxpayers working overseas who sought to have their foreign earnings treated as exempt income following the 2009 changes which greatly restricted the availability of the exemption for foreign employment earnings in s 23AG ITAA36. The removal of s 23AG in fact was the catalyst for the change in behaviour that led to a number of taxpayers attempting to argue that they were non-residents for tax purposes. Separately, some foreign backpackers unsuccessfully attempted to argue that they were residents in order to claim the tax-free threshold.

The individual tax residency rules were recently reviewed by the Board of Taxation.[14] In response, the government announced on 12 December 2019 that it will continue to consider the implications of the Board's findings as this report constitutes a valuable contribution to public debate on important tax issues.[12]

The residency rules are a fundamental part of the income tax system, yet individual taxpayers have to navigate at least 18 different sets of tax rules, including the differing marginal tax rates, the temporary resident and working holiday-maker rules, non-resident withholding taxes, implications for CGT assets when becoming or ceasing to be a resident, double tax agreements, the CGT discount and the main residence exemption changes. The complexity associated with the interplay of the relevant provisions, coupled with the fundamental threshold question of whether an individual is a resident or a non-resident for tax purposes, makes it increasingly difficult to comply with the law and costly to litigate in the event of a dispute with the Commissioner (as was illustrated by the taxpayer in *Harding v FCT*[15]).

Improved certainty, reduced compliance costs and making Australia more attractive as a destination for inbound taxpayers should be a priority in reforming the residency rules. We should be encouraging Australians to gain valuable experience overseas with the aim of benefitting from these skills on their return, so the tax system should also provide a smooth transition for Australian expatriates returning home.

Superannuation guarantee regime

Introduced on 1 July 1992, the superannuation guarantee (SG) law has not been substantially reviewed or overhauled in its 28-year history.

The following considerations support long-overdue reform of the SG regime:

- the ATO estimates that the SG gap for 2016-17 is $2.3 billion;[16]
- an Industry Super report from May 2017 suggests that 2.85 million Australians did not receive their full SG entitlements in 2016-17, missing out on $5.94 billion.[17] The number of workers who were short-changed increased by 90,000 in three years (up from 2.76 million) and now affects 31.3% of workers;
- the design of the superannuation guarantee charge (SGC) dissuades employers who want to avoid penalties or losing deductions for late or unpaid superannuation;
- the notional interest component ends on lodgment of the SG statement with the ATO, not the payment of the late contribution;
- company directors can be personally liable for unpaid SGC liabilities;
- single touch payroll reporting provides greater transparency over non-compliant employers;
- some employers wrongly treat late contributions as being non-deductible (without also paying the SGC and lodging an SG statement);
- the rate of the SG is legislated to increase to 12% by 2025;
- employers are often confused as to the meaning of "ordinary times earnings";

- there are perennial issues with correctly classifying workers as contractors versus employees;
- due to annual indexation, the maximum contributions base is within uncomfortable reach of the $25,000 concessional contributions cap;
- due to the COVID-19 pandemic, many employers in lockdown or with greatly diminished cash flow will not be in a position to avail themselves of the SG amnesty which ends on 7 September 2020; and
- redesigned rules could:
  - makes it easier for employers to comply;
  - be less draconian if an employer pays the contribution one day late — they are currently treated the same as an employer who never makes the contribution; and
  - more adequately support a modern and sustainable retirement system.

PSI

Introduced in 2000 to ensure that individuals could not alienate their personal services income (PSI), the PSI rules are a frequent source of confusion for taxpayers and practitioners.

The Board of Taxation reviewed the PSI regime in 2009.[18] In releasing the Board of Taxation's review into whether the tax rules on the alienation of PSI are proving effective, the then Assistant Treasurer, Nick Sherry, announced on 16 December 2009 that:[19]

> "The Board has concluded that while the current rules have gone some way in achieving their intention of improving integrity and equity in the tax system, the extent of this improvement is inadequate.
>
> The Board has found evidence of a low level of compliance and a degree of uncertainty or 'greyness' around the rules, such that it has found the alienation of [PSI] rules in their current form do not provide acceptable levels of integrity and equity."

In its review, the Board suggested a range of possible reform options:

- introduce a reporting obligation;
- extend the attribution rules to personal services businesses;
- clarify and simplify the deduction provisions;
- implement a test of "employee-like" manner to clarify who is affected by the rules; and/or
- introduce a deemed labour income approach.

The Assistant Treasurer also stated:

> "… these findings are of concern so we have passed the Board's report to the Australia's Future Tax System review. The Government will wait for the final report of the Henry Review before determining the appropriate action in this area."

Recommendation 10 of the Henry review stated:

> "Consideration should be given to a revised regime to prevent the alienation of [PSI] that would extend to all entities earning a significant proportion of their business income from the personal services of their owner-managers, whether in employee-like or non-employee-like cases. This regime may also apply an arm's length rule to deductions arising from payments to associates to ensure deductions reflect the value of services provided."

No reforms to the PSI rules arose from the Henry review, and the concerns raised by the Board of Taxation in 2009 are still valid today. Evidence remains of a low level of compliance and uncertainty around the rules, for example:

- whether income is correctly characterised as PSI;
- incorrect claims that the results test is satisfied, or that the entity conducts a personal services business;
- failure to remit PAYG withholding on attributed income (some mistakenly apply the PAYG instalment rules in the belief that the ATO is still collecting the right amount of tax);
- a lack of understanding of the interaction of the PSI rules with the SG regime; and
- failure to understand that alienating personal exertion income, even where the entity conducts a personal services business, remains subject to Pt IVA ITAA36.

State of consultation on legislative amendments

A robust, consultation process exists as part of tax law design. This allows the professional bodies and the profession opportunities to provide feedback to Treasury through private focus groups and submissions on draft legislative measures. Senate committees also play a vital role in scrutinising bills.

These processes are designed to iron out any technical problems with newly drafted provisions. However, notwithstanding the efforts of the professional bodies and the profession in regularly raising technical issues with Treasury throughout the consultation process, there are numerous instances of technical deficiencies, illustrated by the recently enacted vacant land measures and the changes to the main residence exemption, both of which have interpretation issues and unintended outcomes.

The Tax Institute's submission to Treasury in November 2019 observed a decrease in the quality of explanatory memoranda (EMs) being produced by Treasury.

The following concerns were raised in the submission:

- misalignments between statements of parliament's intent captured in EMs and the actual drafting of the legislation. A misalignment between the legislation and the EM causes uncertainty for taxpayers;
- a trend towards leaving pertinent examples, explanations and interpretative guidance out of EMs which should not merely repeat or paraphrase the legislation. They should provide practical and interpretive guidance that illustrates how the legislation is intended to apply, and clearly articulate and explain the underlying tax policy of the legislation; and
- a trend towards putting interpretive material into ATO guidance including law companion rulings that should be in EMs.

Conclusion

The issues covered in this article are far from an exhaustive list of the areas in need of reform. The preceding discussion does, however, highlight the importance of approaching tax reform in a holistic manner. Amending elements of the law to simplify and improve it is commendable, but only with courage, collaboration and a willingness to change our collective mindset can we truly reform our tax law.

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5 See, for example, Commonwealth Taxation Review Committee and Justice K Asprey (Chairman), *Asprey Taxation Review Committee report* (Asprey report), 31 January 1975.

6 [2010] HCA 10.

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A Matter of Trusts

by Edward Skilton, Sladen Legal

Court variations to the appointor identity and powers

Where the trustee is unable or unwilling to vary the identity and/or powers of the appointor, the court may intervene.

Many modern discretionary trust deeds provide that trustees can be removed and appointed by an "appointor". The appointor may have additional powers, for example, the trustee may not have the power to distribute capital or vary the trust instrument without the consent in writing of the appointor. There are also some asset protection considerations which relate to the appointor. If a party to a relationship is the appointor of a trust, the trust assets could be held to be property or a resource of that party in a family law matter.[1]

The *Richstar*[2] case caused some concern among professional advisers regarding whether trust assets could be considered property for the purposes of bankruptcy proceedings. The *Richstar* case was brought by ASIC seeking the appointment of receivers under the *Corporations Act 2001* (Cth) (as distinct from under the *Bankruptcy Act 1966* (Cth)) to the property of officers and former officers of companies in the Westpoint Property and Finance Group. In the Federal Court, French J stated that:[3]

> "At least by analogy it may be observed that a beneficiary who effectively controls the trustee of a discretionary trust may have what approaches a general power and thus a proprietary interest in the income and corpus of the trust."

In *Fordyce v Ryan*,[4] in finding that the interests of the bankrupt beneficiary were not altered because of his actions or influence in causing the trustee to make distributions of income to himself, Jackson J distinguished *Richstar*, stating:[5]

> "At the outset, it is to be noted that *Richstar* concerned the meaning of what is property for the purposes of the *Corporations Act* 2001 (Cth). That reasoning did not engage upon the reasoning of earlier cases in the bankruptcy context …"

Given the current economic climate, clients (appointors, trustees and/or beneficiaries) may seek guidance from advisers regarding the appropriate powers of the appointor and who should hold those powers.

For a variety of reasons, clients may wish to vary the provisions of a trust deed which relate to the appointor. Reasons include succession issues (such as ensuring that the appointor can nominate successors) and asset protection concerns (such as including restrictions on the powers of the trustees unless the appointor consents in writing or to add appointors so that no single person can be argued to have effective control of the trust). If the variation power in the trust deed is not broad enough, or if the trustee (or other parties) is unwilling to use the power, a court application to vary the deed may be considered.

The various state and territory Trustee Acts[6] provide courts with a statutory power to vary trust instruments. By way of example, the wording in s 63 of the *Trustee Act 1958* (Vic) is as follows:

> "**Power of Court to authorize dealings with trust property**
>
> (1) Where in the *management or administration* of any property vested in trustees, any sale, lease, mortgage, surrender, release or other disposition, or any purchase, investment, acquisition, expenditure or other transaction, *is in the opinion of the Court expedient*, but the same cannot be effected by reason of the absence of any power for that purpose vested in the trustees by the trust instrument (if any) or by law, *the Court may by order confer upon the trustees, either generally or in any particular instance, the necessary power for the purpose on such terms and subject to such provisions and conditions (if any) as the Court thinks fit* and may direct in what manner any money authorized to be expended, and the costs of any transaction are to be paid or borne as between capital and income.
>
> (2) The Court may from time to time rescind or vary any order made under this section, or may make any new or further order.
>
> (3) An application to the Court under this section may be made by the trustees, or by any of them, or by any person beneficially interested under the trust." (emphasis added)

Some states also provide the courts with a statutory power to, for example, vary or revoke trusts for the benefit of beneficiaries who cannot consent (for example, persons unborn or incapacitated).[7]

In *WE Pickering Nominees Pty Ltd v Pickering*,[8] the trustee, with the consent of the adult beneficiaries and two minor beneficiaries, sought a variation of the deed such that the directors of the trustee company be appointed by the court as appointors and that the appointors be empowered to nominate successors. The court noted that there were potential unborn beneficiaries. The court also noted that the Trustee Act contained powers to appoint and remove trustees. McMillan J was not persuaded to vary the deed:[9]

> "I am similarly unconvinced that the other orders sought, namely the power to amend and the power to appoint an appointor ought be approved under s 63A. There is no authority for the proposition that s 63A confers on the Court the ability to grant a general power of to [sic] amend or to a power to appoint an appointor …
>
> In regard to the power to appoint an appointor, the provisions of the SA Act have sufficient breadth to address any issues that might arise concerning the appointment and removal of the trustee to the trust."

On appeal,[10] it was decided that the matter should be remitted to the trial division for hearing before a different judge as the judge took into account the potential impact on unborn beneficiaries, which was an issue not raised with the parties. The current position appears to be that the court will not vary a trust instrument to appoint an appointor and provide such persons with powers to nominate successors where there is no appointor role in the trust instrument.

There are many cases where beneficiaries seek the removal of trustees, where there is no appointor or where the appointor is unwilling to remove the trustee. A recent example is *McNee v Lachlan McNee Family Maintenance Pty Ltd*,[11] in which a beneficiary (who was a minor and would, pursuant to the terms of the trust, become appointor on attaining the age of 18 years) sought the removal of the trustee pursuant to s 48 of the *Trustee Act 1958* (Vic). In addition to removing the trustee, Moore J, distinguishing the decision in *WE Pickering Nominees*,[12] also varied the deed to remove the appointor, who was also the sole director and shareholder of the removed trustee company. In place of the removed trustee company and removed appointor, an independent person (a trustee company) was appointed as trustee and appointor. The trust held a property. The beneficiary applicant was the only named beneficiary, but terms of the trust provided a right of occupation to the removed appointor (the beneficiary's mother).

Moore J noted that the removed appointor was the controlling mind of the removed trustee and that there could be circumstances where there was a vacancy in the trustee and/or where the trustee was unable to vary the trust deed as the appointor withheld consent. Moore J distinguished *WE Pickering Nominees*:[13]

> "In circumstances where, as in the present case, the trust instrument already contains an express power of appointment, I am satisfied that s 63A of the *Trustee Act 1958* is a source of power for the order sought by [the beneficiary]."

Where there are grounds to remove the trustee, clients might consider seeking a court ordered variation to the trust instrument to remove the appointor. Where the trust instrument names an appointor but does not include desirable provisions such as the power to appoint joint, replacement or successor appointors (and the deed does not contain a broad enough variation power for the matter to be addressed without a court application), clients may be able to persuade the court to vary the deed to include appropriate changes to the appointor position and powers, if it is in the best interests of the beneficiaries of the trust.

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3 [2006] FCA 814 at [19].

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5 [2016] QSC 307 at [33].

6 S 63 of the *Trustee Act 1958* (Vic); s 47 of the *Trustee Act 1898* (Tas); s 81 of the *Trustee Act 1925* (NSW); s 89 of the *Trustees Act 1962* (WA); s 59B of the *Trustee Act 1936* (SA); s 81 of the *Trustee Act 1925* (ACT); s 50A of the *Trustee Act 2007* (NT); s 94 of the *Trusts Act 1973* (Qld).

7 S 63A of the *Trustee Act* 1958 (Vic); ss 13 and 14 of the *Variation of Trusts Act* 1994 (Tas); s 90 of the *Trustees Act* 1962 (WA); s 59C of the *Trustee Act* 1936 (SA); s 95 of the *Trusts Act* 1973 (Qld).

8 [2016] VSC 71.

9 [2016] VSC 71 at [60] and [62]. The reference to the South Australian Trustee Act was due to the deed stating it is subject to the law of South Australia.

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13 [2020] VSC 273 at [105].

Superannuation

by William Fettes and Daniel Butler, CTA, DBA Lawyers

A guide to family law superannuation splitting in an SMSF

The most appropriate splitting method for a couple sharing an SMSF in relation to a relationship breakdown depends on a range of factors.

Over the last century, we have seen significant changes in the way relationships form and dissolve, with marriages often occurring later in life and de facto co-habitation arrangements becoming more prevalent. Unfortunately, relationship breakdowns are also a relatively common occurrence in the modern era.

Due to the COVID-19 global pandemic, there may be many additional stress points affecting married and de facto couples, including employment pressures (eg where one or both individuals have lost their job or are experiencing reduced working hours), financial problems caused by investments losing value, and other lifestyle issues associated with social isolation (eg where there is a "cabin fever" effect from being stuck at home).

Thus, it is important that advisers remain alert to the possibility of their clients suffering relationship difficulties, particularly during COVID-19, so that expert advice can be sought where required in the context of a relationship that is about to, or has already, broken down irretrievably.

Where a relationship breakdown has occurred, there will be numerous issues for the parties to consider, including how superannuation (which is broadly considered to be "property" for the purposes of the *Family Law Act 1975* (Cth) (FLA)) is to be divided.

Due to the complexity of the superannuation splitting rules, it is recommended that expert advice be obtained regarding what options are feasible under the rules and how best to structure a proposed split from a superannuation law and tax perspective.

This article discusses some key considerations regarding how the splitting rules operate. (Note that this article focuses on splitting superannuation interests in an SMSF and not large public offer funds, or defined benefit funds.)

Splitting orders

The starting point is that a division of superannuation entitlements can only occur pursuant to a prescribed split recorded via:

– minutes of consent (as endorsed by a court) or a court order under the FLA; or
– a financial agreement covering superannuation (made by the parties, with each side receiving independent legal advice).

For convenience and ease of expression, we refer to the term "splitting order" below to include a split pursuant to a court order (whether a contested order or a consent order arrived at by the parties to a court action) and to a split in accordance with a financial agreement.

As discussed below, once there is a splitting order in place, additional documents are required to implement the splitting order. However, we pause now to consider some technical aspects of how splitting orders operate.

Member and non-member spouse

This article refers to a "member spouse" and a "non-member spouse" when explaining key features of the splitting rules. This terminology comes from s 90XD FLA and Pt 7A of the *Superannuation Industry (Supervision) Regulations 1994* (Cth) (SISR).

These terms can broadly be explained as follows:

– a member spouse (MS) is a spouse or former spouse who is a member of the fund and whose superannuation interest is subject to a split which reduces their superannuation benefits; and
– the non-member spouse (NMS) is a spouse or former spouse who is obtaining the benefit of a split which increases their superannuation benefits.

Thus, the label NMS does not necessarily mean that the person is not a member of the fund — it simply means that there is a split operating in that person's favour. Indeed, in a typical two-member SMSF with a former couple, each spouse would be considered to be an NMS in respect of a split from the other's interest in the fund, notwithstanding that they are both members of the fund. That is, the NMS will typically have their own interest (ie based on them being a fund member with an account balance in the fund), as well as the split interest to be transferred or rolled over. However, in the context of a single member SMSF where the member's interest is subject to a split, the NMS will not be a member of the fund.

It should be borne in mind that, for multi-stage splits or cross-splits, it is possible for the parties to alternate between being an MS and an NMS at different stages of the split. For example, a common strategy is for one spouse to give up 100% of their superannuation to the other spouse as a preliminary split before they can receive a base amount (discussed below) in their favour as part of an agreed property settlement. In this scenario, the spouse is an MS for the first stage of the split and an NMS for the second stage of the split.

Accordingly, it is best not to confuse MS/NMS status with SMSF membership.

Types of splits

Base amount order

A splitting order can specify an amount (or a formula for determining such an amount) that is payable to the NMS.

A base amount can be determined in advance and interest accrues and is payable on this amount up to the time of payment, transfer or roll-over.

Interest is based on a rate that is 2.5% above the percentage change in the original estimate of full-time adult ordinary time earnings (AOTE) for all persons in Australia, as published by the Australian Bureau of Statistics during the year ending with the February quarter immediately before the beginning of the adjustment period (ie AOTE + 2.5%). The rate for the financial year ending 30 June 2020 is 4.8% per annum.

Using a base amount approach can be useful from a practical perspective because the parties may find it easier to make progress on broader property negotiations where a fixed number (or an ascertainable number) is used for the purpose of the superannuation split.

Percentage split order

As an alternative to the base amount approach discussed above, splitting orders can also provide for a "percentage interest split". Under this approach, the superannuation interest is generally divided by specifying a percentage of the member's splittable interest that is to be paid to the NMS.

The percentage specified in the order is generally applied to the splittable payment at the time the payment is required to take place. This means that valuations and updated financial statements or management accounts are broadly required to ascertain and divide the member balances at that time, including earnings (or negative earnings) and any capital appreciation (or capital devaluation).

Thus, under a percentage split approach, the actual amount that is split is not fully determined until the time the payment, transfer or roll-over is made.

Base amount versus percentage split

The most appropriate splitting method for a couple sharing an SMSF in relation to a relationship breakdown depends on a range of factors. What may be good for one party may be adverse for the other party. Thus, each party should ensure that they obtain expert advice from their family lawyer and other experts before deciding on what method best suits their particular needs.

Table 1 provides a general guide of some important factors to consider.

When are superannuation splitting documents required?

It should be noted that splitting orders do not actually implement a split of superannuation. At the risk of oversimplifying, the reason for this is that the SMSF trustee (as a third party to the spousal relationship) is not bound by splitting orders.

Thus, splitting orders are only the first step in the process. The parties will also need to put in place documents to enliven the relevant provisions of the SISR to implement the split.

Table 1. Factors to consider: base amount versus a percentage split

Factor	Base amount order	Percentage split order
How to quantify?	By a specified amount or formula having regard to the MS's interest	By a percentage split of the MS's interest
When is the amount valued?	The base amount (or formula) has regard to the value of the couple's superannuation interests at the time the base amount is settled via the splitting order (ie via the court system or financial agreement). The base amount can be valued well before the split actually occurs as a subsequent change in the spouse's superannuation interests will generally not impact the base amount (especially if that balance decreases).	The percentage split has regard to the value of the couple's assets and superannuation interests at the time the split is settled. A valuation of assets to effect the split is required at the time the split actually occurs. The valuation must be carefully managed to accurately reflect the value of the assets and percentage at that time supporting the relevant superannuation interests.
Is interest payable for the period from the splitting order to the time of the payment split (or transfer)?	Yes.	The valuation at the time of the split should reflect earnings up to the time of the actual payment/transfer/roll-over.
Other factors	May prove simpler for parties who want to split a specified amount plus interest. An NMS may prefer where asset values are likely to decrease. Conversely, an MS may prefer where asset values are likely to increase.	May prove simpler for parties who cannot agree on a specified base amount. An NMS may prefer where asset values are likely to increase. Conversely, an MS may prefer where asset values are likely to decrease.

In broad terms, this requires a four-step process:

- step 1: the NMS serves the splitting order on the SMSF trustee together with a notice under reg 72 of the *Family Law (Superannuation) Regulations 2001* (Cth);
- step 2: the SMSF trustee gives each party a notice, called a "payment split notice". This notice is the formal notification to each of the parties that the MS's superannuation interest is to be split under the terms of the splitting order;
- step 3: the NMS makes a choice regarding how the split is to be implemented (eg to create a new interest, roll over the amount, or pay a lump sum) and notifies the SMSF trustee of this choice. (A modified process under reg 7A.10 SISR applies if the NMS does not make a choice.); and
- step 4: the SMSF trustee must then give each party a notice that the split has been implemented.

Many advisers and SMSF trustees overlook these requirements and assume that splitting orders are broadly self-executing. However, it must be emphasised that the above steps are absolutely critical to ensure a legally effective split.

A purported split that is implemented without enlivening the relevant provisions of the SISR will be open to legal challenge and could result in contravention of superannuation law (eg due to the minimum benefits of the MS being illegally forfeited).

Conclusion

There are numerous variables to consider when making the critical decision of what type of split works best depending on which party you are acting for. Moreover, multiple splits are often made for the same couple which may involve a mix of base amount and percentage splits.

There are also a range of commercial, tax, superannuation and legal issues to consider, and expert advice should be obtained by all parties to ensure that an optimal outcome can be achieved. In particular, each party should obtain their own advice from their own family lawyer. The *Family Law Rules 2004* (Cth) also provide for the appointment of a joint expert, including a superannuation expert, to provide advice and assistance.

This article provides a general guide only and is no replacement for expert advice, given the complexity of the superannuation, taxation, family law and other factors that relate to an effective superannuation split.

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Alternative Assets Insights

by Peter Collins, FTI, Lynda Brumm, CTA, and Patricia Muscat, CTA, PwC

Expansion of the definition of significant global entity

New rules mean that some taxpayers will need to reassess whether they are classified as a significant global entity.

In the 2018-19 federal Budget, the government announced its intention to broaden the definition of "significant global entity" (SGE) to include a broader range of entities beyond groups headed by listed companies and by private companies required to prepare consolidated financial statements. The measures have now been enacted and are applicable to income years commencing on or after 1 July 2019 (a welcome deferral to the start date from that initially announced).

The concept of an SGE was introduced in 2015 as part of a package of reporting and integrity measures targeted at large Australian and multinational groups. As originally enacted, an SGE is broadly an entity that has annual global income of A$1b or more, or is a member of a group of entities, consolidated for accounting purposes, that has annual global income of A$1b or more. Under the new expanded definition, the concept of an SGE will now include a broader range of entities that did not fall within the original definition of SGE because they are not included in consolidated financial statements.

The new rules mean that it will be necessary for some taxpayers to reassess whether they are classified as an SGE under the new definition as the consequences for SGEs that fail to meet certain tax lodgment obligations can be as high as A$555,000 per missed obligation.

In detail

The *Treasury Laws Amendment (2020 Measures No. 1) Act 2020* (the Act) received royal assent on 20 May 2020. Among other things, this Act expands the scope of what an SGE is such that it now also applies to groups of entities that would be required to consolidate for accounting purposes as a single group if the members of the group were assumed to be listed companies and were not affected by the accounting exceptions for consolidation or materiality.

These amendments broadly apply to income years commencing on or after 1 July 2019.

The Act also amends the country-by-country (CbC) reporting requirements and the requirement for corporate tax entities to lodge general purpose financial statements with the Australian Taxation Office (if not lodged with ASIC) such that these measures now apply to a subset of SGEs that are referred to as country-by-country reporting entities (CbCREs).

The expanded definition of "significant global entity"

The original definition of SGE applies to an entity which is either:

– a global parent entity (that is, an entity that, according to accounting concepts, is not controlled by any other entity) with an annual global income of at least A$1b; or

– a member of a group of entities, consolidated for accounting purposes, that has annual global income of at least A$1b.

Central to the second limb of this definition is the requirement for the entity to be included in a set of consolidated financial statements. As a consequence of this, many entities that the government considered should have been classified as SGEs were not because they were not included in consolidated financial statements. For example, this may have been the case because the parent entity is not required to prepare consolidated accounts in its home jurisdiction (for example, trusts and partnerships are often not required to prepare consolidated financial accounts), the parent entity is an investment entity that applies a specific consolidation exemption when preparing its financial statements, or the parent entity excludes certain entities from its consolidated accounts due to materiality.

The amendments made by the Act are aimed at addressing a perceived deficiency in the SGE definition by introducing the concept of a "notional (fictional) listed company" so that more entities are caught within its scope. Under the expanded definition, an entity will also be an SGE if it would be part of a consolidated group for accounting purposes if the following critical assumptions were made:

– the group members are listed companies (ie a "notional listed company group"); and

– any exceptions to consolidation for accounting purposes, and materiality principles, are disregarded.

This means that entities that were previously not classified as SGEs because they were not consolidated in the financial statements of a larger group due to, for example, materiality or the investment entity exception in AASB 10 *Consolidated financial statements* (or its foreign equivalent), will now be classified as SGEs as a result of these amendments.

The amendments introduce new complications for entities trying to determine whether they are SGEs as they depart from the actual financial statements that are prepared by a group, and require entities to construct consolidated accounts that do not otherwise exist to assess whether or not the A$1b annual global income threshold is exceeded. To do this, taxpayers may need to disapply the accounting exception applicable to investment entities and apply the accounting concept of control to entities where they have not previously been required to consider this issue.

The expanded definition of SGE applies to income years commencing on or after 1 July 2019 for the purposes of:

- the multinational anti-avoidance law;
- the diverted profits tax; and
- increased administrative penalties for failing to meet tax obligations, making false or misleading statements and entering into tax avoidance and profit-shifting schemes.

To ensure that the penalty provisions do not apply retrospectively to an entity that is only an SGE under the expanded definition, a transitional provision has been included so that the higher penalties that would otherwise apply to an SGE cannot apply any earlier than 1 July 2020.

Country-by-country reporting entity

Prior to the amendments made by the Act, SGEs were required to comply with Australia's CbC reporting requirements. In most cases, these require the annual lodgment of a master file and an Australian-specific XML format local file with the ATO. Significant global entities with an Australian global parent entity must also lodge an annual CbC report.

The concept of a CbCRE has been introduced to more closely align Australian CbC reporting requirements to those provided by the Organisation of Economic Cooperation and Development under its base erosion and profit-shifting action plan. Under these amendments, there is now a narrower group of entities subject to Australia's CbC reporting requirements (so-called CbCREs) as compared to the expanded definition of SGE. The key difference between the new definitions of SGE and CbCRE is that, when determining which entities would be consolidated in the financial accounts of the "notional listed company group", a CbCRE can take into account exceptions to consolidation provided by the relevant accounting principles (other than materiality).

This means that, if an entity would not be consolidated in its parent's financial statements because the parent has applied, for example, the investment entity exemption in AASB 10, that entity could be an SGE (if the A$1b annual global income threshold is met) but would not be a CbCRE, and hence would remain outside the scope of Australia's CbC reporting requirements.

It should be noted that, even if an entity is not consolidated with its ultimate parent due to an exemption such as the investment entity exemption in AASB 10, it could still be a CbCRE in its own right if it (by itself, with its subsidiaries and/or with its immediate parent that is *not* an investment entity) meets the A$1b annual global income threshold.

By contrast, where an entity is not included in consolidated financial statements (for example, because the parent entity is not required to prepare consolidated accounts in its home jurisdiction, or due to materiality), the new concept of notional listed company would mean that the entity is now a CbCRE, and becomes subject to Australia's CbC reporting requirements.

Table 1 summarises the main categories of entities that are likely to be impacted by the new SGE and CbCRE definitions.

Table 1. Main categories of entities likely to be impacted by the new SGE and CbCRE definitions

Category	Original SGE rules?	New rules	
		SGE?	CbCRE?
Entity is a subsidiary excluded from global parent entity's financial accounts based on materiality	✗	✓	✓
Entity is a member of a group for which consolidated financial statements are not prepared	✗	✓	✓
Entity is controlled by, but not consolidated into the financial statements of, another entity	✗	✓	✓
Entity is excluded from consolidated accounts because investment entity accounting exception applied	✗	✓	✗
Entities are controlled by an individual, where the income of those entities would exceed A$1b if they were consolidated, but no single entity and its subsidiaries have income > A$1b	✗	✓	✗

Note that this list is not exhaustive and does not cover all possible scenarios. In all cases, assume that, if the entity were consolidated with its parent, the A$1b annual global income threshold would be exceeded.

The concept of a CbCRE will also be used going forward to determine which corporate tax entities are required to lodge general purpose financial statements with the ATO where they are not already lodged with ASIC. The government has also taken the opportunity to introduce an exemption from the requirement to lodge general purpose financial statements with the ATO for certain government-related entities.

Consistent with the expanded definition of SGE, these amendments apply in relation to income years commencing on or after 1 July 2019.

Conclusion

The consequences of an entity becoming an SGE or a CbCRE are significant in terms of the additional compliance burdens and the cost of failing to determine status as an SGE correctly. The amendments bring with them additional complexity to an already complex set of provisions, which many taxpayers have grappled with over the last few years.

There is also new complexity in applying the accounting concepts of control to the notional listed entity. Entities with ultimate investment from private equity, funds management, superannuation and pension funds, sovereign wealth funds, and state-owned enterprises may find it difficult to ascertain the profile of their investors and obtain the requisite information to assess SGE status. It is therefore critical for potentially impacted taxpayers to understand these changes and, where necessary, seek guidance from the ATO. While ATO guidance may take some time to be developed, the authors' previous experience with the ATO on matters relating to SGEs has shown that it is keen to work with taxpayers to resolve uncertainties.

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Successful Succession

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

Fraudulent calumny: recognition of a growing reality?

Readers will likely be familiar with the common types of disputes that arise with respect to wills and deceased estates. A less common cause of action grounded in fraud may be gaining increasing recognition.

With an ageing population and the consequent increase in cognitively impaired clients, the potential for misinformation to "poison" the mind of a vulnerable testator would seem to be on the rise. The concept of fraud in a probate sense is an area expected to receive more legal attention in the future.

A calumny is defined as "a false statement about a person that is made to damage their reputation".[1]

In an estate planning context (involving not only wills, but also other powers, nominations, asset ownership structures, and instruments such as trust deeds and powers of attorney), the concept of "calumny" has been considered in some jurisdictions in recent years.

Historically, challenges to the validity of a will have typically been based on a lack of due execution, testamentary capacity, a lack of knowledge and approval of the will or undue influence. Statutes in all Australian states and territories have provided relief against a failure to meet all of the formalities for execution of a will where it can be demonstrated that a document expresses the testamentary intentions of a person and that the deceased intended it to constitute their will.[2]

Undue influence requires "an overbearing of the mind of the testator" to the point where a will does not reflect their true wishes. It is difficult to prove and the number of cases where a will has been set aside in Australia on that basis is small.

The notion of "fraudulent calumny" reflects a lesser utilised but emerging doctrine — the features of which will be familiar to many practitioners working in the area of succession law.

In the United Kingdom, there has been an increase in cases alleging fraudulent calumny. Prior to 2007, there had been little mention of the concept in legal challenges to wills.

In 2007, in the leading modern UK authority *Re Edwards*,[3] Lewison J (as he then was) expressed the concept as follows:

> "The basic idea is that if A poisons the testator's mind against B, who would otherwise be a natural beneficiary of the testator's bounty, by casting dishonest aspersions on his character then the will is liable to be set aside."

Since that judicial statement, there has been an increase in High Court cases in England and Wales where fraudulent calumny has been alleged against an executor seeking to prove a will.[4]

The concept has only been touched on in judicial commentary in Australia.[5] In the authors' opinion, it is only a matter of time before calumny is more regularly specifically alleged and argued in courts in Australia.

In *Re Edwards*, the court set aside inter vivos dispositions of properties made by an elderly testator in favour of her daughter and son-in-law during her lifetime. The properties had been the object of gifts made in the testator's will in favour of her son who, not surprisingly, challenged the validity of the inter vivos dispositions of the properties on the basis of fraud and undue influence. In recognising the merit in the son's allegations of fraudulent calumny, the court stated:[3]

> "… the essence of fraudulent calumny is that the person alleged to have been poisoning the testator's mind must either know that the aspersions are false or not care whether they are true or false. In my judgment if a person believes that he is telling the truth about a potential beneficiary then even if what he tells the testator is objectively untrue, the will is not liable to be set aside on that ground alone."

Since *Re Edwards* in 2007, the elements required to successfully invalidate a will by fraudulent calumny were expanded in *Re Hayward*.[4] In that case, the court summarised the requirements set out in *Re Edwards*, but effectively introduced further requirements that:

1. A made a false representation;
2. to the testator;
3. about B's character;
4. *for the purpose* of inducing the testator to alter his testamentary dispositions;
5. A made such a representation knowing it to be true or being reckless as to its truth; and
6. the will was made *only* because of the fraudulent calumny.

The elements introduced in items 4 and 6 were new requirements not previously laid out in *Re Edwards* and arguably (unnecessarily) served to restrict the applicability of the doctrine.

There would seem to be no logical basis to suggest that a fraudulent calumny that adversely affected a willmaker's testamentary dispositions regarding a beneficiary or potential beneficiary (or even a class of beneficiaries) resulting in a change of provision from a prior will (or the making of a will in different terms to what the willmaker might otherwise have made), regardless of the representor's intention, should not be caught within the doctrine. Indeed, the fraudulent calumny can effectively remain in the consciousness of a testator, not only in terms of a will, but also in terms of their perceptions and the nature of a person's ongoing relationship with the victim.

There has also been discussion among writers as to whether the representor A must benefit from the change in a willmaker's testamentary disposition.[6] While, in most cases, it will be likely that the "poisoner" will benefit from the making of the adverse aspersion against another, in any consequent new or amended will, there seems no reason why that should be a requirement.

Practitioner's will be familiar with family vitriol extending to a common mindset expressed in contested estate proceedings whereby a party make take the approach, "If I am to get nothing from the estate, I will see to it that they will get nothing either".

While such an approach may have adverse cost consequences in probate and family provision proceedings, it is not difficult to imagine an ill-intentioned party seeking to poison the testator's view of another party simply to reduce any benefit to be left to that affected party by a willmaker, and without any other direct benefit to themself.

There appears to be no reason for a requirement that a beneficiary who has been the victim of a calumny cannot receive any benefit *at all* under the affected will.[7] An argument that calumny could not have been committed if the victim still receives any benefit in a will has been rejected.[7] Probate of a will can still be denied on the basis of calumny if an individual receives *less* than they otherwise would have as result of the calumny of another.[4]

The expansion of the defence of fraudulent calumny, both in the UK and its applicability in Australia, is unsettled and yet to be fully explored. While many practitioners will "know it when they see it", the burden of proof is a heavy one.

In *Christodoulides v Markou*,[8] a sister successfully alleged that a will should not be admitted to probate on the basis that one sister had poisoned the mind of the mother against her. The "poisoner" had alleged to the mother that the other daughter had stolen significant sums of money from her, and that she was also very well off financially and not in need of any inheritance. That case was assisted by the clear evidence in writing of the sister's poisonous and wrongly based claims to the mother who was elderly and not in good health.

It further emphasises the importance of practitioners, particularly solicitors, who are taking instructions for wills and testamentary dispositions to "test" the evidence of the willmaker's testamentary capacity (including their ability to asses and reason information) and to record the willmaker's reasons for their dispositions, especially where there are changes to prior wills.

There appears to be no reason why concepts of fraudulent calumny could not carry over into other areas, such as trust distributions of income and capital where a vulnerable trustee or director of a trustee is influenced by the actions of one party to reduce a benefit to another. It could also indirectly affect wealth distribution through the changing of appointments of attorneys and trust appointors as a result of poisoned relationships.

In *Rea v Rea*,[9] the court held that the subject will was valid, and that allegations of fraudulent calumny committed by the deceased testator's daughter were not made out. The evidence supported the fact that the deceased "knew and understood the effect and implications of the 2015 will and that its terms represented her genuine testamentary intentions".

In that case, the testator was 84 years old and in relatively poor health at the time of making a will in 2015. She died in 2016. The court relied heavily on the evidence of the solicitor who had made the will, commenting:

> "If this level of care and competence was applied in every case there would doubtless be fewer disputes about wills coming before the courts."

The solicitor had made detailed and extensive notes of all conversations with the deceased and she had been particularly cautious to have the testator demonstrate her understanding and reasoning for the changes to her earlier will when taking instructions.

In *Ryan v Dalton*,[10] a case regarding the testamentary capacity of an elderly testator, Kunc J provided some best practice guidelines to be undertaken in the case of a willmaker who is over 70, being cared for by someone, who resides in a nursing home or similar facility, or about whom for any other reason the solicitor might have concern about capacity. He reinforced the requirement for an interview with the testator without other people being present, using open rather than leading questioning and taking comprehensive file notes. His Honour's commentary also provides guidance for medical experts in the assessment process.

Diligence from practitioners in not only recording the reasons provided by vulnerable willmakers for particular dispositions, but also in considering the veracity of those reasons and the potential for poisoned information, is of increasing importance when dealing with vulnerable clients. As Kunk J stated, the efforts made by practitioners in dispensing their duties "pales into insignificance with the expense, delay and anxiety caused by litigation after the testator's death".

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References

1 *Oxford Advanced American Dictionary.*

2 S 12 of the *Wills Act 1936* (SA); s 9 of the *Wills Act 1997* (Vic); s 32 of the *Wills Act 1970* (WA); s 18 of the *Succession Act 1981* (Qld); s 8 of the *Succession Act 2006* (NSW); s 10 of the *Wills Act 2008* (Tas); s 11A of the *Wills Act 1968* (ACT); and s 10 of the *Wills Act 2000* (NT).

3 [2007] EWHC 1119 (Ch).

4 *Re Hayward* [2016] EWHC 3199 (Ch); *Nesbitt v Nicholson; Re Boyes* [2013] EWHC 4027 (Ch); *Christodoulides v Marcou* [2017] EWHC 2636 (Ch); and *Rea v Rea* [2019] EWHC 2434 (Ch).

5 *Trustee for the Salvation Army (NSW) Property Trust v Becker* [2007] NSWCA 136; *Robertson v Smith* [1998] 4 VR 165; and *Public Trustee v Mullane*, unreported, Supreme Court of New South Wales, Powell J, 12 June 1992.

6 See, for example, DE Grant, "A poisoned mind", *STEP Trust Quarterly Review*, 25 March 2020.

7 *Allen v McPherson* (1847) 9 ER 727.

8 [2017] EWHC 2636 (Ch).

9 [2019] EWHC 2434 (Ch).

10 [2017] NSWCA 1007.

Events Calendar

August/September 2020

STATE / EVENT	DATE	CPD
Northern Territory		
2020 Darwin Tax Convention	28/8/20	6.25
Online		
JobKeeper 2.0: What's Changing?	7/8/20	1.5
Tax Notes Series – Part 3: Mussalli v Commissioner of Taxation [2020] FCA 544	7/8/20	1
Corporate Tax Series – Part 3: BHP High Court decision	10/8/20	1
Superannuation Guarantee Charge Refresher Series – Part 2: Understanding the SG amnesty and the interaction of the SG regime with other rules	11/8/20	2
Private Business Online – Part 8: Dancing with Division 7A	12/8/20	1
States' Taxation Online Series – Part 4: Employment agents – the state of play	13/8/20	1
Tax Notes Series – Part 4: Commissioner of Taxation v Sharpcan Pty Ltd [2019] HCA 36	14/8/20	1
Corporate Tax Series – Part 4: Topical issues affecting cross-border capital management	17/8/20	1
Taxing Times Webinar Series – Part 5: Maximising deductions for capital allowances	18/8/20	1.5
Private Business Online – Part 9: Lock down, stimulus and temporary measures – the impact of COVID-19 on the 2020 insolvency landscape	19/8/20	1
States' Taxation Online Series – Part 5: Partnerships	20/8/20	1
2020 Breakfast Club Online Series – State taxes: a review and observations on recent trends	21/8/20	1.5
Tax Notes Series – Part 5: Watson as trustee for the Murrindindi Bushfire Class Action …	21/8/20	1
2020 National GST Intensive Online | Full webinar and live Q&A series	24/8/20	11.25
2020 National GST Intensive Online: Part 1 | Webinar and live Q&A	24/8/20	3.75
2020 National GST Intensive Online: GST, tax and economic reform in a post-COVID-19 world | Session 1 webinar	24/8/20	1
2020 National GST Intensive Online: Hot topics, issues and tips | Session 2 webinar	24/8/20	1
2020 National GST Intensive Online: Indirect tax in the digital space: a domestic and international perspective | Session 3 webinar	24/8/20	1
Private Business Online – Part 10: Thought leadership – tomorrow's tax practice	26/8/20	1
Tax Disputes Online Series – Part 1: Topical tax disputes: transfer pricing and GST	26/8/20	1
States' Taxation Online Series – Part 6A: Duties cases – "the big ones"	27/8/20	1
Tax Notes Series – Part 6: Panel discussion – recent capital versus revenue decisions	28/8/20	1
2020 National GST Intensive Online: Part 2 | Webinar and live Q&A	31/8/20	3.75
2020 National GST Intensive Online: GST and financial supplies – topical issues | Session 4 webinar	31/8/20	1
2020 National GST Intensive Online: Travelex case | Session 5 webinar	31/8/20	1
2020 National GST Intensive Online: "All that glitters is not gold": GST and missing trader fraud | Session 6 webinar	31/8/20	1
Morning Tax Club 2020 – General superannuation update	1/9/20	1.5
Tax Disputes Online Series – Part 2: ATO private wealth compliance activity	2/9/20	1
States' Taxation Online Series – Part 6B: Payroll tax cases – "the big ones"	3/9/20	1

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

Cumulative Index

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Giving back to the profession

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

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