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SG amnesty unpacked

Robyn Jacobson, CTA

Residency in a global pandemic: advising the returning Australian

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THE TAX INSTITUTE

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Invitation to write

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

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

Tax News – at a glance

by TaxCounsel Pty Ltd

August – what happened in tax?

The following points highlight important federal tax developments that occurred during August 2020. A selection of the developments is considered in more detail in the "Tax News – the details" column on page 105 (at the item number indicated).

SMSFs: in-house assets and COVID-19

A draft legislative instrument has been released which details the situation where the trustee(s) of a self-managed superannuation fund acquires an in-house asset from a deferral of rental income under a lease (on arm's length terms) (SPR 2020/D2). **See item 1.**

CGT demerger relief

The Commissioner has issued a final determination which considers what constitutes a "restructuring" for the purposes of the CGT demerger relief provisions in Div 125 ITAA97 (TD 2020/6). **See item 2.**

Remission of additional superannuation guarantee charge

The Commissioner has released a draft practice statement that sets out what ATO officers need to consider when making a decision on the remission, in whole or part, of the additional superannuation guarantee charge imposed under s 59(1) of the *Superannuation Guarantee (Administration) Act 1992* (referred to as the "Part 7 penalty") where an employer fails to lodge a superannuation guarantee statement by the lodgment due date (PS LA 2020/D1). **See item 3.**

R&D and JobKeeper

The Commissioner has released a draft determination that sets out how the "at-risk rule" (s 355-405 ITAA97) applies to JobKeeper payments received by a research and development entity under the *Coronavirus Economic Response Package (Payments and Benefits) Rules 2020* (the Payments and Benefits Rules) (TD 2020/D1). **See item 4.**

Environmental protection activities expenditure

The Commissioner has released a final ruling in relation to the operation of s 40-755(1) ITAA97 which allows an immediate deduction for expenditure that is incurred for the sole or dominant purpose of carrying on environmental protection activities (TR 2020/2). **See item 5.**

Amount paid for release capital

The AAT has held that a lump sum paid by a former director/employee of a group of companies that had failed financially for a release from all legal actions was of a capital nature and, so, not allowable as a general deduction (*Duncan and FCT* [2020] AATA 2540). **See item 6.**

Beneficiary's interest on borrowings used by the trust

The AAT has rejected a claim by a beneficiary of a discretionary trust for a deduction for interest incurred on borrowings that were used to facilitate the trust's acquisition of assets that were potentially income-producing (*Chadbourne and FCT* [2020] AATA 2441). **See item 7.**

Unregistered entity providing tax agent services

The Federal Court (Rangiah J) has held that an individual and two companies with which he was closely associated had contravened the prohibition in s 50-5 of the *Tax Agent Services Act 2009* on unregistered entities providing tax agent services or BAS agent services for a fee or other reward (*Tax Practitioners Board v Hacker* [2020] FCA 1047). **See item 8.**

President's Report

by Peter Godber, CTA

Accepting and embracing change

The Institute has an appetite for positive change and growth, writes president Peter Godber.

Thoughts have been going out to our Victorian-based members as we reflect on the struggles they have faced with the COVID-19 lockdowns. We all know the extra pressure that lockdown measures have on practitioners and everyone at the Institute (including members in communities less affected by the pandemic outbreaks), and we wish for a speedy return to some sort of normality for those in difficult circumstances.

Life goes on for tax professionals. As we have recently noted many times, tax professionals are needed like never before to assist clients who need to be compliant, especially for accessing JobKeeper and government support to keep their businesses going.

Thanks to all members who have recently renewed their membership with the Institute. It has been pleasing to hear positive feedback about the support members have felt they are receiving from Institute events, publications and knowledge-sharing. For example, we have read, and we keep reading, some very pertinent and relevant articles on JobKeeper provided by our Senior Advocate, Robyn Jacobson, CTA. It is an area that continues to evolve, and we all need to be confident with knowledge on the changing eligibility rules and be aware of all oncoming deadlines for reporting in order to maximise JobKeeper support.

TaxVine continues to be a valuable source of knowledge, and from that and other communications, you will be aware that The Tax Institute's events continue to roll out in their unique formats. The online registrations for many of our events have been quite staggering, so it is pleasing to see so many members taking advantage of our virtual professional development and learning platforms.

You will also be aware of the enormity of our tax reform project, culminating in *The Tax Summit: Project Reform*, which is being led by our Director of Tax Policy and Technical, Andrew Mills, CTA (Life). This project will deliver tangible recommendations by the end of this year, and it is intended to reflect the input of our members. Lead-up events, roundtable discussions, keynote addresses and other forums will all be part of the project. All members will get an opportunity to contribute to and learn from this initiative. So, stay tuned and get involved in supporting the extensive work that is being undertaken.

Once again, I make reference to the wonderful work that our Tax Policy and Advocacy team is doing this year. Sadly, though, we have recently farewelled Stephanie Caredes after many, many years working tirelessly for the Institute. Stephanie dedicated herself to helping our volunteers, committees and members, and significantly contributed to the Institute's consultancy, submissions and advocacy on a wide range of topics. We wish Stephanie all the best in her new endeavours.

However, we have now welcomed Julie Abdalla as our new Tax Counsel. Julie is no stranger to The Tax Institute, having served as a co-chair of the Young Tax Professionals Committee and having been part of the organising committee for the National Women in Tax Congress. Julie has expertise in corporate and individual tax matters, with a strong international tax focus.

She has been awarded a number of scholarships and awards, including the International Bar Association Taxes Committee Scholarship. She was educated at the University of Sydney, the University of Melbourne and the University of Oxford.

Julie brings to The Tax Institute a strong passion for tax policy and reform, and the enthusiasm and depth of knowledge required to advocate for members. There has never been a better time for that.

So, there's plenty of change in our immediate and wider environments. There is more and more for us to accept, but we are getting used to it. The Tax Institute is not stopping in the face of uncertain times. In fact, we are showing a great appetite to embrace challenges and advocate more actively for change — change for the better. The next few months will be an interesting time for us all, and I hope that you can share in it with us.

CEO's Report

by Giles Hurst

Our membership: a force to be reckoned with

With an army of dedicated volunteers, the Institute is set for growth, writes CEO Giles Hurst.

Reflecting on the current reality for The Tax Institute, no image springs to mind quite so vividly as the army of terracotta warriors unearthed in 1975 in China. 8,000 strong, crafted with care and purpose, it was one of the single most impressive discoveries of our time.

The Institute is over 11,000 strong and built on the shoulders of an army of highly competent experts who generously make their immense talents available to our cause. With all that is happening in the current environment, especially in Victoria, and amid the ongoing effects of COVID-19, the skill and the determination of our volunteers are more important than ever.

Our Victorian members are dealing with numerous challenges, from managing tax time in challenging circumstances, to a reliance on sometimes unfamiliar technology, and restrictions that mean they can't reach their offices to collect important documents and mail.

The Tax Institute has stepped up to advocate for measures to ease the burden on Victorian practitioners. We have joined forces with the joint bodies to make a number of submissions to Treasury and the ATO on behalf of our members and the profession. These joint efforts with other leading professional bodies in accounting and tax allow us to present the strongest possible case as a united front across the profession.

Importantly, this advocacy is not just for our Victorian members, though they are necessarily at the top of our priority list right now. Our work in this area is vital for anyone with suppliers, clients, friends and family in the state of Victoria, as well as being important for our profession as a whole.

Case in point: one of the submissions made to federal Treasurer Josh Frydenberg sought for flexibility in the new decline in turnover test for the modified JobKeeper program. JobKeeper, in all its iterations, is a new frontier that we are facing together. Our Tax Policy and Advocacy team, supported by our incredible volunteer committee members, have been working tirelessly to make sure members are fully supported in interpreting and applying modified rules.

I sincerely hope our efforts in this area have been helpful to you in your practice and that we can continue to support you.

The forward march to meaningful tax reform

The terracotta army was a feat of expertise and skill that belongs to humanity's history. Our Tax Institute army of committee members, speakers, authors and other volunteers is turning its expertise towards our future. And we have the very sharpest minds in tax.

One of our core objectives at the Institute has long been to facilitate research into tax reform. Well, no longer can that mantra be considered a mere intellectual pursuit. The immediacy of the issue is abundantly clear.

Working with our Director, Tax Policy and Technical, Andrew Mills, CTA (Life), the heads of our technical committees have recently come together to start mapping out a major undertaking, *The Tax Summit: Project Reform*.

In recent weeks, these technical committees have been generously giving their time to identify the options for improvement in our tax system, with the explicit directive to "think big". The Tax Institute's case for change will span all levels of the profession, and it will delve into the core issues that will place our tax system on a footing to make the changes necessary to strengthen our economy and make our future brighter. No issue too big or too small; no stone left unturned.

With our veritable army of voices, from academics to sole traders, lawyers and corporates, the Institute is in a unique position to drive forward the national tax reform agenda. We are in the enviable situation of being able to amplify the voices of those tax practitioners who work with the system every day to make it a better, stronger and higher performing system.

Come November, many hundreds of people will have contributed to this initiative, helping to make meaningful tax reform a reality. I am both humbled by the generosity of, and energised by the tremendous potential in, such a force.

You may have seen the "Project Reform" logo in last month's issue of *Taxation in Australia*. I urge you to engage with the thought leadership emerging in this area, and to contribute your voice when a topic falls into your area of expertise or interest. It is a once-in-a-lifetime opportunity to make our tax system fit for purpose for the years to come.

There has never been a better time to be involved with tax, and no Institute can claim to have the same depth and credibility in this most complex of area of finance as ours.

Tax Counsel's Report

by Angie Ananda, CTA

Let logic prevail – extend the amnesty

At the time of writing, hopes for an extension of the SG amnesty are fading. However, we are still hoping that logic might prevail and an extension will be granted.

Background

The government introduced a superannuation guarantee (SG) amnesty in March 2020. The SG amnesty allows employers to disclose and pay previously unpaid SG charges for the period from 1 July 1992 to 31 March 2018 without certain penalties being applied.

At the time of writing this column, the SG amnesty deadline is fast approaching and hope for an extension of the amnesty is fading.

Amnesty should be extended

The Tax Institute has strongly advocated for an extension of the SG amnesty.

The Institute is disappointed that its calls for a six-month extension of the deadline appear to have been ignored. Given the adverse impacts caused by COVID-19, it seems illogical and unreasonable to maintain the 7 September 2020 deadline.

In submissions, The Tax Institute has highlighted the point that many businesses are under significant pressure due to managing JobKeeper payments, restructuring working arrangements, dealing with staff downsizing, and other issues arising as a result of COVID-19. Given these pressures, the amnesty should be extended.

Further, determining SG shortfalls is a complex and time-consuming task. Qualified personnel are needed to make assessments, and access to historical documents, which may not be available remotely, is required. One has to question whether the complexity of preparing an amnesty application has truly been considered.

In our submission requesting an extension of the amnesty, we outlined what each application will require to demonstrate the complexity of applying for the SG amnesty. As noted in our submission, applications will generally require:

- a separate calculation of SG shortfall for every affected employee for every quarter;
- for some employers, the calculations will be made over longer periods of time, meaning that there are more than 40 separate calculations for the same employee (and past employee);
- the SG laws have been regularly amended over the last 30 years and it is necessary to test compliance with the law applying for each relevant quarter;
- in many cases, the shortfall amount is only a fraction of the SG charge, which makes the shortfall percentage potentially different for every employee;
- once a relevant shortfall percentage is determined for an employee, the SG shortfall is calculated based on the employee's "salary and wages" and not simply ordinary time earnings. As a consequence, the employer must determine overtime paid to the employee for the relevant quarter because it forms part of "salary and wages"; and
- payroll and human resources records will need to be checked to determine various components of remuneration for each employee for each relevant quarter.

These points demonstrate the complexity and time-consuming nature of making SG amnesty applications.

The amnesty was only introduced in March 2020 — that is, during the pandemic. To expect businesses to be able to prepare amnesty applications by next month is not reasonable given the impact and additional pressures faced by businesses as a result of COVID-19.

Penalties should be reconsidered

The Tax Institute has also strongly advocated for changes to the penalty regime in relation to the SG system.

The Part 7 penalty contained in the *Superannuation Guarantee (Administration) Act 1992* (Cth) is 200% of an employer's SG liability. Currently, the Commissioner has the power to reduce this penalty to nil. After the expiry of the amnesty, other than in "exceptional circumstances", the Commissioner will only have discretion to reduce the Part 7 penalty to 100%.

The minimum 100% penalty is harsh in circumstances where there may be reasonable grounds for an employer to fail to pay SG contributions or to apply for the SG amnesty that may not qualify as "exceptional circumstances". For example, the uncertainty in relation to correctly classifying contractors and employees.

The Institute, together with other professional bodies, made a submission requesting a legislative amendment to remove the current limit so that the Commissioner will continue to have broad discretion to waive the entire Part 7 penalty for liabilities that would have qualified for the SG amnesty (had an eligible application been made by the deadline).

Such an amendment would mean that the Commissioner would retain discretion to apply anything from a zero to 200% penalty.

Conclusion

The fact that penalties in relation to the SG system are so onerous that they can place an employer in an insolvent position forcing a liquidation, administration or bankruptcy is reason enough to allow more time to apply for the amnesty. We should be assisting businesses to get back on their feet rather than pushing them towards collapse.

Note: The article by Robyn Jacobson at page 122 of this issue of the journal provides an in-depth analysis of the SG amnesty.

Tax News – the details

by TaxCounsel Pty Ltd

August – what happened in tax?

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

The Commissioner's perspective

1. SMSFs: in-house assets and COVID-19

A draft legislative instrument has been released which details the situation where the trustee(s) of a self-managed superannuation fund (SMSF) acquires an in-house asset from a deferral of rental income under a lease (on arm's length terms) described in the situations explained below (SPR 2020/D2).

More particularly, the draft instrument will (when made) ensure that an SMSF asset will not be considered an in-house asset where the SMSF, during the 2019-20 and 2020-21 financial years, either:

- allows a related party tenant a deferral of rental income under a lease (on arm's length terms) due to the financial impacts of COVID-19; or
- holds an interest in a related party (a company or unit trust) which is exempt from being an in-house asset due to the operation of reg 13.22B or 13.22C of the *Superannuation Industry (Supervision) Regulations 1994* (Cth) (SISR), and that related party allows a tenant a deferral of rental income under a lease (on arm's length terms) due to the financial impacts of COVID-19.

Where an SMSF trustee(s) offers a deferral of rental income under a lease (on arm's length terms) directly to a related party tenant, the deferral can constitute a loan to the related party within the meaning of that term as defined in the *Superannuation Industry (Supervision) Act 1993* (Cth) (SISA). The definition of "loan" in s 10(1) SISA includes the provision of credit or any other form of financial accommodation, whether or not enforceable or intended to be enforceable by legal proceedings. This definition includes arrangements that are in substance financing arrangements deferring the payment of an amount. Such arrangements would include, but are not limited to, deferring the payment of debts such as rental payments due to the SMSF trustee under a lease.

This means that, when an SMSF trustee accepts a request for a deferral of rental income under a lease (on arm's length terms) directly from a related party, the deferral results in the trustee acquiring an in-house asset that is not covered by any of the exemptions in s 71(1) SISA. When the value of an SMSF's in-house asset investments exceeds 5% of the total value of its assets, the SMSF trustee is required to prepare and implement a written plan to dispose of the excess by the end of the following income year pursuant to s 82 SISA. It also means that the SMSF trustee cannot acquire any further in-house assets under s 83 SISA. There are penalties for not complying with the in-house asset provisions.

The restrictions on an SMSF trustee having an in-house asset do not apply to an investment in a related party of the SMSF if it is an asset specified in the regulations not to be an in-house asset pursuant to s 71(1)(j) SISA. An investment in a company or unit trust specified in reg 13.22B or 13.22C SISR is not an in-house asset. These entities are often referred to as a non-geared company or unit trust. However, reg 13.22B or 13.22C will cease to apply to the SMSF's investment in the company or unit trust if any of the events in reg 13.22D occur, including the company or unit trust providing a loan to another entity.

Where a company or unit trust covered by reg 13.22B or 13.22C (that is a related party of the SMSF) allows a tenant a deferral of rental income under a lease (on arm's length terms) due to the financial impacts of COVID-19, the company or unit trust will have provided a loan to another entity. Accordingly, the SMSF investment in the company or unit trust will become an in-house asset for the current and all future financial years. This will mean that the SMSF will need to dispose of the investment where the value exceeds the 5% threshold.

Given the context of the COVID-19 pandemic and the long-term effects of triggering an event in reg 13.22D, the Commissioner believes that it is appropriate to exercise his powers as regulator to exclude the SMSF's investment from being an in-house asset where the deferral of rental income is provided during the 2019-20 and 2020-21 financial years. This also means that SMSF auditors will not be required to report a contravention to the ATO or to advise trustees of the contraventions which would otherwise result in relation to the 2019-20, 2020-21 or future financial years.

The exclusion will only apply to situations where the SMSF trustee or interposed entity has acted in good faith and, as a result of the financial impacts of COVID-19, has offered the tenant a deferral of rental income under a lease (on arm's length terms) during the 2019-20 and 2020-21 financial years in order to ease the financial hardship caused by COVID-19. There should be contemporaneous documentation drafted reflecting the revised rental terms agreed to by the SMSF trustee or company or unit trust covered by reg 13.22B or 13.22C and the tenant to ensure that the parties continue to deal with each other at arm's length and the lease remains enforceable.

The exclusion will only apply to the deferral of rental income under a lease (on arm's length terms) made in the 2019-20 and 2020-21 financial years, being the income years during which tenants are likely to be impacted financially by the coronavirus known as COVID-19.

2. CGT demerger relief

The Commissioner has issued a final determination which considers what constitutes a "restructuring" for the purposes of the CGT demerger relief provisions in Div 125 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) (TD 2020/6).

For demerger relief to be available, there must be a "demerger" (as defined in s 125-70(1) ITAA97). The first element of that definition is that there is a "restructuring" of the demerger group. A restructuring of the demerger group has its ordinary business meaning. It refers to the reorganisation of a group of companies or trusts.

What constitutes a particular restructuring is essentially a question of fact. However, all of the steps which occur under a single plan of reorganisation will usually constitute the restructuring. The restructuring of a demerger group is not necessarily confined to the steps or transactions under s 125-70(1)(b) ITAA97 that deliver the ownership interests in an entity to the owners of the head entity of the demerger group, but may include previous and/or subsequent transactions in a sequence of transactions. Commercial understanding and the objectively inferred plan for reorganisation will determine which steps or transactions form part of the restructuring of the demerger group.

Points made in the determination include:

- transactions which are to occur under a plan for the reorganisation of the demerger group may constitute parts of the restructuring of the demerger group even though those transactions are legally independent of each other, contingent on different events, or may not all occur;
- conversely, a transaction is not necessarily part of the restructuring of the group merely because it is enabled by the restructuring of the group or is a consequence of the restructuring of the group;
- when determining the scope of the plan (and hence the restructuring), the Commissioner will look at all of the facts and circumstances, including contracts and deeds executed by or affecting the relevant entities (including contracts and deeds that are given legal effect by a court decision, for example, pursuant to a scheme of arrangement under Pt 5.1 of the *Corporations Act 2001* (Cth)), statements in documents filed with regulators, commercial factors, internal deliberations by a company's directors or the directors of a trustee company, statements by directors or influential owners, and announcements to any relevant securities exchange;
- a key factor in determining what transactions or steps form part of a single plan will be the proposal that is presented to the affected owners of original interests in the head entity of the demerger group (shareholders or unitholders);
- if a step or transaction forms part of the restructuring of the demerger group, the particular step or transaction may affect whether or not the conditions to qualify as a demerger in s 125-70(1) ITAA97 can be satisfied;
- the fact that transactions or steps are separated by several months does not automatically mean that they cannot form part of the same restructuring;
- the fact that steps or transactions are included in the scope of a restructuring does not automatically mean that any of the conditions in s 125-70(1) and (2) will be failed; and
- if any steps or transactions happen within the demerger group that have the effect of causing a change in the economic position of the owners of ownership interests in the head entity of the demerger group before, at or after the time of the separation of the subsidiary from the demerger group (such as the variation of the rights attached to any shares, or entering into arrangements that affect or create ownership interests), those steps or transactions may affect, and cause a failure of, some of the conditions in s 125-70(1) and (2).

3. Remission of additional superannuation guarantee charge

The Commissioner has released a draft practice statement that sets out what ATO officers need to consider when making a decision on the remission, in whole or part, of the additional superannuation guarantee charge (SGC) imposed under s 59(1) of the *Superannuation Guarantee (Administration) Act 1992* (Cth) (SGAA92) (referred to as the "Part 7 penalty") where an employer fails to lodge a superannuation guarantee (SG) statement by the lodgment due date (PS LA 2020/D1).

The draft practice statement also sets out when it is appropriate to apply penalty relief.

When making a decision concerning SG matters, ATO officers should have regard to the overarching principles of the SG regime. In summary, these are:

- the SG regime is designed to encourage employers to provide their employees with a minimum level of superannuation. This compulsory superannuation is a fundamental pillar in Australia's retirement income system;
- where an employer does not provide this minimum level of superannuation, the employer is liable to pay a tax, the SGC;
- the SGC is collected from employers and is distributed primarily to the superannuation interests of employees. For that reason, the SGC is unlike other taxes; and
- non-payment of SG contributions has severe impacts on several groups. Employees are deprived of superannuation support, impairing their ability to save for retirement. Employers who meet their SG obligations may be disadvantaged in competing with others who do not comply.

When is it appropriate to provide penalty relief?

An employer should only be considered for a penalty relief arrangement where the employer has a turnover of less than $10m and:

- took voluntary action to comply with their obligation to lodge SG statements;
- does not have a history of lodging SG statements late;
- has lodged no more than four SG statements after the lodgment due date in the present case;
- has no previous SG audits where they were found to have not met their SG obligations; and
- has not previously been provided with penalty relief.

Penalty relief would not be appropriate where the employer has:

- been issued with an SG default assessment;
- lodged more than four SG statements after the lodgment due date in the present case; or
- has previously been issued with an SG education direction.

The draft practice statement also considers the interaction of the SG penalty regime with the penalties that may apply in some cases under the *Taxation Administration Act 1953* (Cth).

The effect of the amnesty

The draft practice statement refers to the fact that, between 24 May 2018 and 7 September 2020, employers were offered a one-off amnesty to disclose unpaid SG contributions without Part 7 penalties. The ATO will take a very strict approach to penalties where an employer could have come forward voluntarily to disclose an SG shortfall and failed to do so.

4. R&D and JobKeeper

The Commissioner has released a draft determination that sets out how the "at-risk rule" (s 355-405 ITAA97) applies to JobKeeper payments received by a research and development (R&D) entity under the *Coronavirus Economic Response Package (Payments and Benefits) Rules 2020* (the Payments and Benefits Rules) (TD 2020/D1).

If an R&D entity receives a JobKeeper payment:

- for its paid employees (under Div 2 of the Payments and Benefits Rules), the entity triggers the at-risk rule. The entity cannot notionally deduct the portion of its wage expenditure incurred on R&D activities that has attracted the JobKeeper payment; and
- based on business participation (under Div 3 of the Payments and Benefits Rules), the entity does not trigger the at-risk rule. The entity is, therefore, not prevented from notionally deducting expenditure for having received a JobKeeper payment.

If the R&D entity receives a JobKeeper payment for an eligible employee who is wholly engaged in R&D activities during a fortnight, the entity cannot notionally deduct so much of its wage expenditure paid to that employee as is equal to the $1,500 JobKeeper payment.

If the R&D entity receives a JobKeeper payment for an eligible employee who is partially engaged in R&D activities during a fortnight, the entity's notional deduction is partially reduced. The notional deduction is reduced by that portion of the JobKeeper payment as is in proportion with the time the employee spends on R&D activities during that fortnight.

Expenditure that the R&D entity incurs on R&D activities that cannot be notionally deducted does not give rise to a tax offset under s 355-100 ITAA97. Therefore, for the portion of JobKeeper payments the R&D entity receives that triggers the at-risk rule, no extra income tax is payable under the R&D clawback rules.

5. Environmental protection activities expenditure

The Commissioner has released a final ruling in relation to the operation of s 40-755(1) ITAA97 which allows an immediate deduction for expenditure that is incurred for the sole or dominant purpose of carrying on environmental protection activities (TR 2020/2).

The ruling explains:

- what "environmental protection activities" are;
- when expenditure is incurred for the "sole or dominant purpose" of carrying on those activities;
- the limits on the amount that can be deducted; and
- the assessability of recouped expenditure on environmental protection activities.

Recent case decisions

6. Amount paid for release capital

The AAT has held that a lump sum paid by a former director/employee of a group of companies that had failed financially for a release from all legal actions was of a capital nature and, so, not allowable as a general deduction (*Duncan and FCT*[1]).

Keystone Australia Holdings Pty Ltd (KAH) operated as a holding company of 41 subsidiaries, including Keystone Group Holdings Pty Ltd (KGH). The Keystone Group owned restaurants, bars and hotels in various capital cities around Australia. The taxpayer was employed by entities in the Keystone Group from at least 16 September 2000 and was a director of various entities in the Keystone Group since 1999. On 15 April 2011, the taxpayer became a director and secretary of KGH when it was incorporated, and from 2014, was a director of all of the companies in the Keystone Group except KAH. KGH acted as the Keystone Group's employer and treasury company.

On or about 15 August 2014, the taxpayer commenced as an employee of KGH pursuant to an executive employment agreement dated 30 July 2014 (the EEA). His position was Chief Property and Corporate Development Officer. In about June 2015, the taxpayer was appointed managing director of the Keystone Group.

On 28 June 2016, creditors of the Keystone Group appointed receivers and managers of the Keystone Group. Also on that day, joint and several administrators of the Keystone Group were appointed by resolution of directors for each company in the Keystone Group. Shortly after their appointment, the administrators reached agreement with the receivers which enabled the Keystone Group's businesses to continue to trade at the direction of the receivers.

In a letter dated 30 August 2016, the receivers referred to a meeting held with the taxpayer on 26 August 2016, specifically with respect to discussions regarding the sale process being undertaken by the receivers and their requirements for the assistance of the directors in that process. It referred to the obligations of directors under the *Corporations Act 2001* (Cth) to provide assistance to the receivers in that context.

In a letter to the taxpayer dated 9 September 2016, the receivers set out incentive arrangements and requested the taxpayer to sign the enclosed copy to indicate his acceptance, which he did. Conditions included that the taxpayer remain an employee of the Keystone Group and comply with his duties under ss 180 to 184 of the

Corporations Act 2001. Each of those provisions applies to a director or other officer of a corporation. The incentives were to include two payments.

On 30 January 2017, the administrators issued a report to creditors pursuant to s 439A(4) of the *Corporations Act 2001.* Part 10 of the report was entitled "Administrators' Investigations" and stated (inter alia) that, in the administrators' view, the Keystone Group demonstrated many indicia of insolvency from at least 31 December 2015.

By a letter dated 28 April 2017, the receivers notified the taxpayer that his employment with KGH would be terminated by reason of redundancy. Creditors voted to wind up the Keystone Group, and on 5 May 2017, the administrators were appointed liquidators.

On 30 June 2017, the liquidators executed an agreement with a Hong Kong registered company (DEM Aspirion Ltd) to assign the right to sue various directors, including the taxpayer, under s 100-5 of Sch 2 of the *Corporations Act 2001*. On that day, the taxpayer entered into a deed of release of settlement with DEM Aspirion Ltd pursuant to which the taxpayer paid DEM Aspirion Ltd $100,000 in "full and final settlement of all or (sic) legal actions against [the taxpayer] in his role as a director of the relevant entities in the Keystone Group of Companies for trading while insolvent".

The taxpayer's claim for a deduction under s 8-1 ITAA97 for the amount paid by him pursuant to the deed of release was disallowed by the Commissioner and, on review, the AAT affirmed the Commissioner's decision.

The AAT, when addressing the positive limbs of s 8-1 ITAA97, said that the taxpayer did not incur the outgoing in order to preserve his employment which had already ended (on 19 May 2017). The advantage that the taxpayer sought by incurring the outgoing was unrelated to the maintenance of his employment.

In rejecting an argument of the taxpayer based on the decision of the High Court in *FCT v Day*,[2] the AAT said that the taxpayer in that case was seeking to maintain his employment by defending the charges. In the present case, the taxpayer was not. He incurred the expenditure after his employment ended.

Although not necessary to do so, the AAT also considered the exclusion from deductibility under s 8-1 ITAA97 of expenditure of capital or of a capital nature. The AAT said that the advantage sought by the taxpayer was to avoid litigation in which the taxpayer would be accused of being a director of a company or companies which traded while insolvent. It was to protect and preserve the taxpayer's reputation as a director of a company and an employee, and his capacity to earn income as such in the future. While not decisive, the lasting nature of an advantage is a relevant factor to consider. In this case, it pointed to the capital nature of the outgoing.

Also, the means adopted to secure the advantage was a one-off payment. Again, while not decisive, recurrence is relevant to whether an outgoing is of a revenue nature. This consideration also pointed to the outgoing being of a capital nature.

7. Beneficiary's interest on borrowings used by the trust

The AAT has rejected a claim by a beneficiary of a discretionary trust for a deduction for interest incurred on borrowings that were used to facilitate the trust's acquisition of assets that were potentially income-producing (*Chadbourne and FCT*[3]).

The AAT said that the taxpayer chose to use a discretionary trust as the vehicle for investments in real estate and shares. He borrowed money which was then used by the trustee of the discretionary trust to invest and trade in the real estate and share markets. The investments and trading were conducted in the name of the trustee, who acted in its capacity as trustee of the discretionary trust. This structure meant that it was not the taxpayer who owned the real estate or traded in the shares, but rather a separate legal entity, namely, a corporate trustee. It is a fundamental aspect of a trust that the trustee holds the legal interest in the trust property. Consequently, it was the trustee of the trust which derived income from its investments and trading. This income was recorded in the tax returns lodged by the trust. Those tax returns recorded the rent and expenses associated with the apartments and the trades and profits or losses associated with the share trading.

The assessable income of the trust must be distinguished from the assessable income of the taxpayer because the required nexus is between losses or outgoings and the assessable income of the taxpayer (not the trust).

The taxpayer contended that any income derived from the trust would be included in his assessable income because it had always been his intention that any net income of the trust would be returned to him. Because of his control over the corporate trustee, the taxpayer considered that he had a reasonable expectation of sharing in these profits by way of distributions from the trust. In rejecting this contention, the AAT pointed out that the trust was a discretionary trust the terms of which required the trustee to exercise a discretion as to whom a distribution of net income was to be made. It is an inherent requirement of the exercise of that discretion that it be given real and genuine consideration. There must be "the exercise of an active discretion". There were numerous beneficiaries in the trust and there was no certainty provided by the terms of the trust that the trustee would exercise its discretionary power of appointment in favour of the taxpayer.

8. Unregistered entity providing tax agent services

The Federal Court (Rangiah J) has held that an individual and two companies with which he was closely associated had contravened the prohibition in s 50-5 of the *Tax Agent Services Act 2009* (Cth) (TASA) on unregistered entities providing tax agent services or BAS agent services for a fee or other reward (*Tax Practitioners Board v Hacker*[4]).

Rangiah J rejected several arguments advanced on behalf of the defendants. One argument was that both the individual and the company could not contravene the prohibition in respect of the same taxation service. His Honour said that the language and legislative scheme of s 50-5(1) TASA demonstrated that, when an unregistered individual employee, agent or director of a company provides a tax agent service for a fee or reward for or on behalf of an unregistered company which also charges a fee or receives a reward for that service, both the individual and the company may contravene the provision. It would not be the same offence because the individual and the company will have each breached their separate obligations to be registered.

It may be noted that Rangiah J refused an application made by the applicant Board after the close of evidence to file an amended statement of claim. His Honour said that the applicant had provided an explanation for seeking the amendments and its delay in doing so, namely, that a simple mistake was made and was not picked up earlier. But, in his Honour's view, this was not an adequate explanation. The applicant had been represented by lawyers throughout the proceeding and, even if the making of the original mistake was understandable, it should have been discovered well before the close of evidence in the trial.

While the refusal of leave to amend would mean that the applicant could not pursue all of the allegations it wished to pursue, the effect of the amendments would be to allow the applicant to make hundreds of new substantive allegations of contraventions of s 50-5(1) TASA. The application had been made, not just at a late stage, but after the close of evidence. The explanation for the applicant's delay was inadequate and, further, there may be prejudice to the respondents by reason of their inability to investigate the new allegations.

The question of the penalties to be imposed is to be the subject of a further hearing.

In a separate judgment handed down on the same day, Rangiah J held that the defendants were guilty of contempt of court by breeching undertakings that had been given by them to the court (*Tax Practitioners Board v Hacker (No. 2)*[5]).

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References

1 [2020] AATA 2540.

2 [2008] HCA 53.

3 [2020] AATA 2441.

4 [2020] FCA 1047.

5 [2020] FCA 1048.

Tax Tips

by TaxCounsel Pty Ltd

Division 7A and COVID-19

A procedure is in place to obtain an extension of time where the minimum 2019-20 annual repayment under a complying Div 7A loan agreement was not made because of COVID-19.

Background

The Commissioner has instigated several relief measures in relation to the effects of COVID-19.

Most recently, the Commissioner addressed the issue of the implications for the self-managed superannuation fund in-house asset rules where, as a consequence of COVID-19, there is a deferral of rental income under a lease to a related party made on arm's length terms.[1]

Another significant issue that has been addressed are the consequences of a failure by a borrower to pay all or part of the minimum annual repayment in respect of an amalgamated loan for the 2019-20 income year under a complying Div 7A loan agreement. The relief offered is by way of a streamlined application for the exercise by the Commissioner of the discretion he has under s 109RD of the *Income Tax Assessment Act 1936* (Cth) (ITAA36) to defer the time for making the repayment of the required minimum annual repayment for the 2019-20 income year.[2] The deferral that is provided by the streamlined application process is for 12 months. For convenience, the deferral is referred to as the Commissioner's Div 7A loan COVID-19 initiative.

The reason for the Commissioner's Div 7A loan COVID-19 initiative is explained in the ATO Div 7A COVID-19 document as follows:[2]

> "As a result of the COVID-19 situation, we understand that some borrowers are facing circumstances beyond their control. To offer more support, we'll allow an extension of the repayment period for those borrowers who are unable to make their MYR [minimum yearly repayment] by the end of the lender's 2019-20 income year (generally 30 June) under section 109RD."

This article considers aspects of the operation of s 109RD and the way the Commissioner's deferral discretion will operate under the streamlined application procedure.

The text of s 109RD

As noted, the Div 7A loan repayment deferral discretion is conferred on the Commissioner by s 109RD. That section reads as follows:

> **"109RD Commissioner may extend period for repayments of amalgamated loan**
>
> (1) The Commissioner may make a decision under subsection (2) if:
>
> (a) section 109E operates with the result that a private company is taken to pay a particular dividend to a particular entity (the ***recipient***); and
>
> (b) the shortfall mentioned in paragraph 109E(1)(c) arises because the recipient is unable to pay the private company the minimum yearly repayment mentioned in that paragraph because of circumstances beyond the recipient's control.
>
> (2) The Commissioner may decide in writing that the result mentioned in paragraph (1)(a) should be disregarded (see subsection (4)) if the recipient pays the private company the amount of the shortfall within a specified time.
>
> (3) In making a decision under subsection (2) (or refusing to make such a decision), the Commissioner must have regard to the following:
>
> (a) the nature of the circumstances mentioned in paragraph (1)(b);
>
> (b) any other matters that the Commissioner considers relevant.
>
> (4) This Division is taken not to operate with the result mentioned in paragraph (1)(a) if:
>
> (a) the Commissioner makes a decision under subsection (2); and
>
> (b) the recipient pays the private company the amount of the shortfall within the specified time.
>
> (5) Despite subsection 33(3A) of the *Acts Interpretation Act 1901*, each decision made under subsection (2) must relate only to one amount that would be taken to be a dividend paid by the private company (disregarding this section)."

Some comments on s 109RD

Before considering the terms of the Commissioner's Div 7A loan COVID-19 initiative, there are several general observations that should be made in relation to the construction and operation of s 109RD.

It must be remembered that the operation of the section is expressed to be dependent on the Commissioner's exercise of a discretionary power or discretionary powers conferred on him ("[t]he Commissioner may make a decision …";[3] "[t]he Commissioner may decide in writing …"[4]), and in exercising the discretion, the Commissioner is directed to have regard to "any other matters that the Commissioner considers relevant".[5]

A basic point is that the potential for the exercise by the Commissioner of the discretionary power only arises after the end of the income year in question. This is because the discretion can only be exercised once Div 7A has operated to deem the private company to have paid a dividend (s 109RD(1)(a)).

Also, if there is more than one amalgamated loan by a private company to a particular entity, the discretion conferred by s 109RD must be exercised separately in relation to each amalgamated loan.[6]

But, importantly, it is only open for the Commissioner to exercise the discretion in a given situation if the condition specified in s 109RD(1)(b) is met. Whether this condition is met in a given case does not depend in any way on the Commissioner's satisfaction or opinion. Rather, whether the condition is met will depend on the particular facts and the correct construction of para (1)(b). However, if the terms of paras (1)(a) and (b) are met, this does not mean that the Commissioner must exercise the discretion in favour of the recipient; in the exercise of the discretion, the Commissioner must, by reason of subs (3), have regard to the nature of the circumstances mentioned in para (1)(b) and any other matters that the Commissioner considers relevant.[7]

A further point is that s 109RD does not deal directly with the consequences that may follow if the Commissioner exercises the discretion but only a part (and not the whole) of the amount to which the deferral relates is paid within the specified time. It would seem arguable, however, that, in such a case, the exercise of the deferral discretion would be ineffective to confer any benefit; para (4)(b) requires that the recipient pays "*the amount of the shortfall* within the specified time".

It will be seen that, in practical terms, the fundamental issue that determines whether the discretion is potentially available to be exercised by the Commissioner in a given case depends on the proper construction of para (1)(b). Issues of construction that are raised by this paragraph include what meaning is to be ascribed to the following expressions in the context of the paragraph:

– "unable to pay";
– "because of"; and
– "circumstances beyond the recipient's control".

None of these issues of construction have been addressed by the Commissioner in any binding document. As explained below, the concept of "unable to pay" is considered in the ATO Div 7A COVID-19 document.

Because of

A fundamental issue is whether the expression "because of" in para (1)(b) requires that the inability of the borrower to pay the minimum yearly repayment is solely because of circumstances beyond the entity's control.

The relevant meaning given to "because" in the *Macquarie Dictionary* is "for the reason that; due to the fact that".

However, in some contexts, the view has been taken that the expression "because of" used without any qualifying word does not have the force of "solely because of". For example, in *Trust Co of Australia Ltd v Commissioner of State Revenue*,[8] which was concerned with the construction of a provision of the *Duties Act 2000* (Vic), Hansen J said:

> "44 … I accept the appellant's submission … that even if the underlying purpose of the transactions was to effect a change in the beneficial ownership of the properties, absent the word 'solely' in s 33(2), it did not matter that the transfers were 'because of' other factors, provided that the transfers were also 'because of' the retirement or appointment of a trustee, in the sense that the retirement or appointment of trustees was a cause of the transfers."

It may be noted that the application form that is to be used to make a deferral request under the Commissioner's Div 7A loan COVID-19 initiative has these questions:

> "14. Have you (or for a partnership, one or more of the partners) experienced adverse effects from the COVID-19 situation?
>
> ☐ Yes ☐ No
>
> 15. Are you unable to pay the MYR in full for the 2019-20 income year as a result of these adverse effects?
>
> ☐ Yes ☐ No
>
> 16. Are there other transactions or events that contribute to the reason that you have been unable to pay the MYR?
>
> ☐ Yes. If you answer yes, we may contact you to understand the additional circumstances.
>
> ☐ No."

And the instructions in the ATO Div 7A COVID-19 document state:[2]

> "You'll need to confirm that your inability to pay is a result of the COVID-19 situation. This could be because the COVID-19 situation has directly affected you, or because it has affected another person and there has been a flow-on effect for you. You'll also need to confirm that your inability to pay has not been caused by something else."

It would seem from the last sentence quoted that the Commissioner's view is that the words "because of" in s 109RD(1) effectively mean solely because of. However, it is suggested that, in the absence of a qualifying word such as "solely", this is not the correct construction of s 109RD(1). Rather, the words "because of" should be interpreted as allowing some flexibility to ensure that s 109RD can operate in a pragmatic way. Question 16 in the application form may perhaps suggest that, contrary to what seems to follow from the last sentence in the above quotation, this may in fact be the view of the Commissioner.

Circumstances beyond the recipient's control

It is suggested that some assistance as to the meaning of the expression "circumstances beyond the recipient's control" in s 109RD(1)(b) may be gained from the decision of Jenkinson J in *Atomic Skifabrik Alois Rohrmoser v Registrar of Trade Marks*[9] where his Honour considered the expression "circumstances beyond the control of the person concerned" in s 131 of the *Trade Marks Act 1995* (Cth). Jenkinson J said:

> "18. In the context in which it is found, the expression 'circumstances beyond the control of the person concerned' does in my opinion designate — and designates only — occurrences which neither the person concerned nor any person acting on his behalf to do the act or take the step could prevent. The operations of nature and the activities of strangers may result in such occurrences. So, too, may the acts and omissions of certain independent contractors engaged by the person concerned or by his agent, as for example the carrier of mail or the office cleaner, either of whom causes the loss or destruction of a document to be filed. But the acts or omissions of the agent who on behalf of the person concerned is to do the act or take the step are not occurrences of the description specified in paragraph 131(1)(a), in my opinion. Nor, in my opinion, are the acts or omissions of that agent's servants. The section is, I think, correctly described as a force majeure provision."

It would seem to be clear that the effects of COVID-19 would constitute "circumstances beyond the recipient's control" for the purposes of s 109RD(1)(b).[10]

Unable to pay

The ATO Div 7A COVID-19 document makes several comments on the "unable to pay" concept which should be noted.

It is stated that the "unable to pay" concept is about cash-flow, not whether there is an excess of assets over liabilities. Considerations that need to be considered are:

- the entity's cash resources; and
- money that the entity can readily obtain by realising assets or using those assets as security to obtain finance.

For a business, an important question to ask is whether the relevant entity can pay its way in carrying on the business. For example, a business is unable to pay if it needs to sell its trading stock outside the course of its business to obtain the funds.

Other points made in the ATO Div 7A COVID-19 document are:

- an individual is unable to pay where they need to use the assets necessary to maintain an adequate living standard for themselves and their family to make a payment;
- a partnership is unable to pay if each of the partners is unable to pay; and
- a trust is unable to pay if the trustee is unable to pay. This includes by recourse to the trust assets under the right of indemnity.

Whether an entity is unable to pay is a question of fact that must be determined in a practical business environment. It is a matter of commercial reality taking into account all of the circumstances.

It is also stated that the practical business environment includes the economic effects and degree of uncertainty that has resulted from the COVID-19 situation. Allowing for these effects, the Commissioner accepts that a borrower can make a practical commercial assessment of factors, including market conditions, relevant to their ability to pay an amount.

Realising assets or using assets as security

It is further stated that an entity is able to pay an amount if assets can be readily sold or used as security to obtain finance. Whether assets can be readily realised within the time required to make a payment depends on factors, including:

- the availability of a market for sale;
- the commercial costs of realisation in a short time;
- the time required to sell the asset or use it as security; and
- the interest of joint owners.

For example, an entity would have been able to make a minimum yearly repayment of $30,000 by 30 June 2020 if the entity owned ASX-listed shares with a market value of $150,000 and could have readily sold them, while having other means to maintain an adequate living standard. The position would be different if the asset was a commercial property. In this case, it would be unlikely that the entity could have completed a sale before that date.

Money for business or living expenses

It is also stated that a borrower is unable to pay an amount if the borrower has to use the money and assets needed to run the borrower's existing business or other regular activities. This extends to things which are reasonably necessary to maintain existing activities, including maintaining a portfolio of assets that will sustain the borrower's income both during and after the COVID-19 situation. However, it would not extend to other expenses, such as for the future expansion of those activities.

For an individual, it extends to the activities of others for whom the individual is responsible for. For example, paying school fees for children.

The ATO Div 7A COVID-19 document gives a number of examples of the operation of the unable to pay concept for the purposes of the streamlined application. These examples are headed:

- recovering unpaid debts;
- accessible redraw facility;
- money for business continuity;
- responsibility for family maintenance; and
- funds for discretionary costs.

Unable to pay due to COVID-19

The application form requires confirmation that the borrower's inability to pay is a result of the COVID-19 situation (see the questions quoted above from the application form).

The ATO Div 7A COVID-19 document gives a number of examples under these headings:

- business affected by COVID-19;
- sales affected by COVID-19;
- guarantor affected by COVID-19;
- tests positive for COVID-19; and
- inability to pay for reasons other than COVID-19.

Making the application

As already noted, borrowers can request the extension by completing a streamlined online application form.

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.

The streamlined process only applies to applications for an extension of up to 12 months (that is, to 30 June 2021). 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).

The loan agreement

It will be the case that the loan agreement will be in writing and the deferral of the time for making the minimum repayment for the 2019-20 income year would usually cause a breach of the agreement. Accordingly, the parties to the loan agreement would usually need to amend the agreement to cover the late payment of the minimum yearly repayment. It may be prudent to not only cover the 2019-20 repayment but to make the agreement more flexible to cover any other repayment extensions that may occur in the future. The terms of any amendment will, of course, depend on how the Div 7A loan agreement is drafted.

Records etc

An important point is that, where the Commissioner's Div 7A loan COVID-19 initiative is availed of, adequate records that underpin the application must be kept.

As with any document that is lodged with the ATO, care must be taken to ensure that the statements made are correct to avoid the possibility of penalties.

Example: calculating minimum yearly repayments where s 109RD applies

The following example of how the deferral of a minimum yearly repayment operates is adapted from an example in the ATO Div 7A COVID-19 document.

Wonderland Pty Ltd lent its shareholder Alice $1,000 under a s 109N ITAA36 complying loan agreement during its income year that ended on 30 June 2018. The term of the loan is seven years and the loan agreement does not provide for the capitalisation of interest (at the benchmark interest rate) that is not paid by the due date.

Assuming:

- the benchmark interest rate remains at 5.37% for the remaining term of the loan from the 2020-21 income year onwards; and
- Alice pays her minimum yearly repayment on 30 June of each year and has paid her 2018-19 minimum yearly repayment of $174,

Table 1 sets out what Alice would expect her 2019-20, 2020-21 and 2021-22 minimum yearly repayments to be.

Alice is unable to pay any of the 2019-20 minimum yearly repayment due to the COVID-19 situation. The Commissioner makes a decision under s 109RD to disregard the dividend that Wonderland Pty Ltd is taken to have paid Alice in the 2019-20 income year, provided Alice pays the amount of the shortfall ($175) to Wonderland Pty Ltd by 30 June 2021.

Payment obligations for Alice by 30 June 2021

To avoid Div 7A dividend consequences, Alice will need to pay by 30 June 2021:

- the amount of the shortfall from the 2019-20 income year (s 109RD); and
- the 2021 minimum yearly repayment amount (s 109E ITAA36).

Calculation of the 2020-21 minimum yearly repayment

The 2020-21 minimum yearly repayment that Alice will need to pay is calculated under the formula in s 109E(6).

Alice did not pay the 2019-20 minimum yearly repayment by 30 June 2020. The unpaid interest on the loan was not capitalised but Alice will still be required to pay that interest under the terms of the loan agreement.

As a result, Alice's 2020-21 minimum yearly repayment is calculated as set out in Table 2.

On 30 June 2021, Alice will need to pay $357 to meet her obligations for the 2019-20 and 2020-21 income years:

- the 2020-21 *minimum yearly repayment* of $205 to avoid a dividend being included in her assessable income for the 2020-21 income year; and
- a further $152 to satisfy the shortfall from the 2019-20 income year. A payment for s 109RD is one that catches up on the shortfall. In addition to the $152, Alice can also count the increase in the principal component of the 2020-21 minimum yearly repayment (for example, the difference between the principal component in Table 1 and Table 2, $158 – $135 = $23) towards the payment of the shortfall amount of $175.

Calculation of the 2021-22 minimum yearly repayment

Alice has paid the shortfall. For calculating the 2021-22 minimum yearly repayment, the loan balance as at 30 June 2021 will be $615 [$878 less payments made on 30 June 2021 not attributed to interest ($357 – $94 = $263)].

The 2021-22 minimum yearly repayment will return to the normal schedule of payments. Alice will calculate her 2021-22 minimum yearly repayment as set out in Table 3.

Table 1

Income year	Loan balance on previous 30 June ($)	MYR ($)	Principal component ($)	Interest component ($)
2020	878	175	128 ($175 – $47)	47 ($878 × 5.37%)
2021	750 ($878 – $128)	175	135 ($175 – $40)	40 ($750 × 5.37%)
2022	615 ($750 – $135)	175	142 ($175 – $33)	33 ($615 × 5.37%)

Table 2

Income year	Loan balance on previous 30 June ($)	MYR ($)	Principal component ($)	Interest component ($)
2021	878	205	158 ($205 – $47)	47 ($878 × 5.37%)

Table 3

Income year	Loan balance on previous 30 June ($)	MYR ($)	Principal component ($)	Interest component ($)
2022	615 ($878 – $263)	175	142 ($175 – $33)	33 ($615 × 5.37%)

Failure to make the payments by 30 June 2021

If the shortfall amount is not paid by 30 June 2021, the Commissioner's decision will cease to apply and Alice will need to include a dividend in the 2019-20 income year. If Alice does not make at least the 2020-21 minimum yearly repayment of $205, there could be a dividend in that year.

Alice could at any time apply for a further extension of time under s 109RD to pay the 2019-20 and 2020-21 shortfall amounts to have the dividends disregarded. Alternatively, she could apply to have the dividends disregarded under s 109Q (Commissioner may allow amalgamated loan not to be treated as dividend), the reason being that they would cause undue hardship.

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References

1 See item 1 in the Tax News column of this issue of the journal (page 105).

2 See the ATO document: *Request to extend time to make minimum yearly repayments for COVID-19 affected borrowers under section 109RD*, last modified 26 June 2020. Available at https://www.ato.gov.au/Forms/Request-to-extend-time-to-make-minimum-yearly-repayments-for-COVID-19-affected-borrowers-under-section-109RD/. This document contains a link to the special application form that should be used and instructions for completing the form. For convenience, this document is referred to as the ATO Div 7A COVID-19 document. It is assumed in this article that a regular 30 June accounting period is involved.

3 S 109RD(1). See also s 33 of the *Acts Interpretation Act 1901* (Cth).

4 S 109RD(2).

5 S 109RD(3)(b).

6 A separate application would need to be lodged in respect of each Div 7A loan for which an extension is sought.

7 There does not seem to be any basis on which the decision of the High Court in *Finance Facilities Pty Ltd v FCT* [1971] HCA 12 could be relevant. That this is so is reinforced by the parenthesis in subs (3): "(or refusing to make such a decision)".

8 [2006] VSC 64.

9 [1987] FCA 22.

10 Unless, perhaps, there were some protective measure that was required to be, or that reasonably could have been, taken but was not.

Mid Market Focus

by Guy Brandon, CTA, HLB Mann Judd

ASX-listed junior exploration companies and tax losses: part 2

This article reviews the ability to carry forward, and utilise, tax losses and net capital losses in the absence of satisfying the continuity of ownership test.

Introduction

This article continues on from part 1 that appeared in the October 2019 issue of this journal. While that part reviewed the continuity of ownership test, part 2 concentrates on the business continuity test.

Junior exploration companies

For the purposes of this article, the author takes the view that a junior exploration company (JEC) generally falls within two categories:

1. a company that has an exploration mandate with no initial view to produce (income is derived by way of interest and asset sales), though production *may* occur at a future point; or
2. a company that has an exploration and subsequent production mandate (but production is in the future).

Context

A tax loss for an income year (the loss year) can be carried forward and deducted from assessable income in future income years if the company passes either:

– the continuity of ownership test (COT);[1] or

– the same business test (SBT) (which is failed unless the company carries on the same business and has not derived income from any new kinds of business or transactions) or, for tax loss years occurring on or after 1 July 2015, the similar business test (SiBT). Collectively, the SBT and the SiBT are referred to as the business continuity test (BCT).

Same business test

Generally, a company satisfies the SBT if it carries on the same business in the income year when it wants to use the loss (the "same business test period") as it carried on immediately before the change of ownership or control that caused the company to fail the COT.[2]

Additionally, a company does not satisfy the SBT if either of the negative limbs of the SBT applies. The negative limbs apply if the company:[3]

– derives assessable income from a business of a kind that it did not carry on before the test time, ie the "new business test";[4] or

– derives assessable income from a transaction of a kind that it had not entered into in the course of its business operations before the test time, ie the "new transactions test".[5]

At para 1.9 of the EM, it is stated:

> "The need to satisfy the same business test may discourage certain companies from innovating or adapting their businesses to changing economic circumstances. In particular, the two negative limbs in the same business test may discourage companies from entering into new kinds of transactions or new kinds of businesses."

It should also be noted that the proposal for the SiBT was announced on 7 December 2015 as part of the government's $1.1b National Innovation and Science Agenda.[6] Key phrases taken from that announcement in respect of the SiBT are:

> "This reform will relax the existing 'same business test' and introduce a new, more flexible, 'similar business test'."
>
> "This reform was considered as part of the 2012 Business Tax Working Group review into losses, and was raised as an area for potential reform in the Government's tax discussion paper *'Re:think'*."
>
> "Loss utilisation rules are necessary and important. They maintain the integrity of Australia's tax system by preventing the activity of loss-trading whereby companies are able to buy losses from or sell losses to other entities."

Similar business test

The SBT was introduced into legislation by the enactment of the *Treasury Laws Amendment (2017 Enterprise Incentives No. 1) Act 2017*, with effect for income years starting on or after 1 July 2015. The following is from the general outline in the EM:

> "… the Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) and the *Income Tax Assessment Act 1936* (ITAA 1936) to supplement the same business test with a more flexible similar business test. The similar business test improves access to losses for companies (and certain trusts) that have changed ownership and allows those companies and trusts to seek out opportunities to innovate and grow without losing access to losses."

In respect of the SBT, it appears that the SiBT will:

– *supplement* the SBT;

– be *more flexible*;

– *improve access* to tax losses;

– allow companies and trusts *to seek out opportunities*; and

– allow those companies and trusts *to innovate and grow*.

According to para 1.19 of the EM:

> "Generally, a company satisfies the similar business test if the business it carries on throughout the income year when it wants to use a loss (the 'business continuity test period') is similar to the business it carried on at the time immediately before the change of ownership or

control that caused the company to fail the continuity of ownership test (the 'test time')."

To determine whether current business is similar to the former business, the EM sets out four factors (though not exhaustive):

1. the same assets are used to generate income: the extent to which the assets (including goodwill) used in the current business to generate assessable income throughout the BCT period were also used in the former business to generate assessable income;[7]
2. the assessable income is generated from the same activities and operations: the extent to which the activities and operations from which the current business generates assessable income throughout the business continuity period were also the activities and operations from which the former business generated assessable income;[8]
3. the identity of the business: a comparison between the identity of the former business and the current business;[9] and
4. the development of the former business: the extent to which any changes to the former business result from the development or commercialisation of assets, products, processes, services, or marketing or organisational methods of the former business.[10]

Examples of the operation of the SiBT in the EM

It is noted that there are no examples on point in the EM. However, from the examples that are provided in the EM, the following should be noted.

Satisfying the SiBT:

– first factor: the current business is generating income from the same assets and it is also generating income from new assets (Example 1.1); the current business is also generating income from the same key asset (Example 1.2);

– second factor: the current business is generating income from the same activities and operations, and income is also being generated from new activities (Example 1.1); the original activities and operations still continue "to be a central part of the business's income-generating activities" (Example 1.2);

– third factor: "the change [to the business] supplements the former business's identity as a subsidiary or ancillary business activity, rather than replacing the former business" (Example 1.1), and the "identity of the business does change to a certain extent as the company exploits additional commercial applications for its technology. Importantly, however, the business identity remains predominantly associated with the exploitation of the [current] technology" (Example 1.2); and

– fourth factor: "the change to the business is one that reflects the ongoing development of the former business's assets and processes. The current business makes use of many of the assets, processes and methods of the former business, including the business website, marketing strategies and organisational methods" (Example 1.1).

Not satisfying the SiBT:

– first factor: "to a significant extent, [the] current business no longer generates assessable income from the assets that were used in the former business" (Example 1.3); "[t]he extent to which these assets were relevant to the derivation of income for the … business would be limited" (Example 1.4);

– second factor: "the income-producing activities of the company changed substantially after the ownership change" (Example 1.3); "there was a significant change in the nature of the business's income-producing activities" (Example 1.4);

– third factor: "there is a significant change in the identity of the company's business" (Examples 1.3 and 1.4); and

– fourth factor: "there is no significant development or commercialisation of the former business's assets, products or processes" (Examples 1.3 and 1.4).

Private binding rulings

It is noted that no private binding rulings appear to be available on point at this time.

LCR 2019/1

It is frustrating that the only example in the EM and in LCR 2019/1 that makes any comment on exploration is example 5 of LCR 2019/1 — and it leaves a number of questions unanswered:

"Example 5 – gold mining business to mixed mining business

30. Mammon Ltd is a gold mining company … The company had previously carried out exploration activities which revealed that the gold ore also contained traces of copper. Mammon Ltd applied for, and was granted, a mining tenement, which permits the company to extract, process and refine gold and copper from the ore.

31. As part of the process for extracting gold, the copper in the ore is either wasted or it can be recovered provided that further systems are installed. As copper prices were low and there was little demand for the product, the company did not consider it commercially viable to install the necessary systems to process copper concentrate. As such, Mammon Ltd's business activity involved extracting the gold and selling the refined product to customers worldwide.

32. Mammon Ltd incurs large tax losses due to a recent drop in gold prices and the majority shareholder sells their shares, causing it to fail the continuity of ownership test. After this change in ownership, there is a sharp increase in copper prices and Mammon Ltd decides to start processing copper concentrate from the extracted gold ore for sale. The company invests in new equipment to process the copper concentrate from the ore, as well as hiring trained staff.

33. The company commences selling the copper, although the assessable income generated from the sale of copper is insignificant compared to the revenue Mammon Ltd derives from selling gold. Mammon Ltd would satisfy the similar business test because:

– the mining lease, which is a key asset of the company, is used to the same degree in Mammon Ltd's business as it permits the mining of gold and copper (factor one)

– the new equipment acquired to enable the processing of copper forms a small part of Mammon Ltd's core business activities, being the extraction, refining and sale of gold (factor one)

- the company continues to generate its assessable income primarily from its core business activities of gold mining. Due to the copper mining activities generating comparatively insignificant assessable income, there is very little change to the activities which generate assessable income (factor two)
- the acquisition of new equipment to facilitate the processing of copper concentrate (factor one) is a result of Mammon Ltd evolving. The recovery of the copper as part of its gold mining business has always been envisaged as a possibility during the exploration stage and at the time Mammon Ltd applied for a mining tenement, and
- as the copper production is relatively insignificant to its gold production activities, the overall identity of the business remains sufficiently similar (factor three)."

The Commissioner had the opportunity to make this example so much more:

- Had Mammon Ltd always been a gold mining company?
- How were the tax losses from the original exploration treated?
- Why did the example choose that time for the sale of the majority shareholder?

It is noted that there were four examples in TR 1999/9 that related to companies that were already mining. Interestingly, example 7 in TR 1999/9 appears to be a precursor to example 5 in LCR 2019/1, and example 5 is used to compare the SBT and the SiBT.

Ability for a JEC to pass the SBT

It is the author's opinion that it is difficult for a JEC to pass the SBT and, in particular, to satisfy the "new transactions test".

According to TR 1999/9,[11] the new transactions test:

- includes all transactions entered into in the course of the company's business operations;
- is generally not failed by transactions of a type that are usually unmotivated by tax avoidance, namely, transactions that could have been entered into ordinarily and naturally in the course of the business operations carried on by the company before the change-over;
- deals with a transaction(s) entered into during the period of recoupment and which is outside the course of the business operations before the change-over, or which is extraordinary or unnatural when judged by the course of the business operations before the change-over. It is usually a transaction of a different kind from the transactions actually entered into by the company before the change-over; and
- is a transaction from which income is derived during the period of recoupment, which could have been entered into before the change-over in the course of the company's business operations, and which is neither extraordinary nor unnatural in the context of the business carried on by the company at the change-over, is generally a transaction of the same kind as transactions actually entered into by the company before the change-over.

To the extent the company is going into production post-COT failure, even though it is noted that it has generally not failed by transactions of a type that are usually unmotivated by tax avoidance, namely, transactions that could have been entered into ordinarily and naturally in the course of the business operations carried on by the company before the change-over, it is believed that "could have been entered into" would require all of the assets and procedures in place to have entered into the transaction(s) prior to change-over. Even the sale of significant assets (eg tenements) may be problematical as they may not have been entered into ordinarily and naturally in the course of business.

Ability for JEC to pass the SiBT

The author believes the addition of the SiBT for tax losses incurred on or after 1 July 2015 does little to assist a JEC. It is debatable that the SiBT may be seen as the SBT without the negative limbs (the "new business test" and the "new transactions test"). Paragraph 1.20 of the EM states:

> "As with the same business test, the focus of the similar business test is on the identity of the business. It is not sufficient for the current business to be of a similar 'kind' or 'type' to the former business … Instead, the test looks at all of the commercial operations and activities of the former business and compares them with all the commercial operations and activities of the current business to work out if the businesses are similar."

Reviewing each of the four factors to determine whether a similar business is operating post-COT failure (noting that they are not exhaustive) for a JEC that has never produced previously:

- it is unlikely that it would have the asset base to have gone into production (factor 1);
- it is unlikely that the activities and operations from which the current business would generate assessable income were also the activities and operations from which the former business generated assessable income (factor 2);
- the identity of the current business and the identity of the former business will be dependent on how broad the mandate was for the JEC prior to the failure of the COT (factor 3); and
- what if there is a significant development or commercialisation of an asset (eg a tenement) (factor 4)? Paragraph 8 of LCR 2019/1 states that the "weight to be given to each factor will depend on the facts and circumstances of each case". Therefore, could satisfying factor 4 alone be sufficient to satisfy the SiBT if factors 1 and 2 are failed, and factor 3 is questionable?

Final remarks

Junior exploration companies are critical to Australia as they are generally responsible for most new mining discoveries.

Considerable resources are used at this time of the year to determine whether JECs are able to carry forward tax losses (in respect of deferred tax assets used to offset deferred tax liabilities — usually caused by the deductions that created the tax losses), even more so when the company is close to failing, or has failed, the COT.

This article is to open dialogue on a critical area of law in Australia. Whether the BCT is available will be subject to the facts and circumstances of each case, and it would be wise to seek a private binding ruling (or at least having a 'reasonably arguable position' prepared) prior to offsetting tax losses using the BCT. The author believes that it is difficult for a JEC to satisfy the BCT as it is currently drafted. This is problematic for a JEC that has capital raisings over time that reduces the level of shareholders that can be included in the single notional shareholder,[12] or that is sold (generally as some form of scrip-for-scrip transaction) to another company that has the resources to continue with exploration or who has the expertise to take the project into production.

To reduce the burden/uncertainty with regard to this matter, consideration should be given to:

– tax laws being drafted so that deductions for exploration for JECs are only available on the commencement of generating income (by way of production or asset sale), with consideration of any appropriate changes for Subdiv 165-CC ITAA97; and
– at the very least, the Commissioner of Taxation providing greater guidance in respect of a JEC and the parameters under which it would satisfy the BCT.

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References

1 G Brandon, "ASX listed junior exploration companies and tax losses: part 1", (2019) 54(4) *Taxation in Australia* 174.

2 Para 1.6 of the EM to the Treasury Laws Amendment (2017 Enterprise Incentives No. 1) Bill 2017 (the EM).

3 Para 1.8 of the EM.

4 S 165-210(2)(a) of the *Income Tax Assessment Act 1997* (Cth) (ITAA97).

5 S 165-210(2)(b) ITAA97.

6 In addition to "increasing access to company losses, other National Innovation and Science Agenda -related changes announced were "new arrangements for venture capital limited partnerships" and "tax incentives for early stage investors".

7 Para 1.24 of the EM.

8 Para 1.26 of the EM.

9 Para 1.28 of the EM.

10 Para 1.31 of the EM.

11 Paras 15 to 18 of the EM.

12 Refer to the concessional tracing rules in Subdiv 166-E ITAA97.

Tax Education

Development of analytical and advisory skills in tax law

The Tax Institute's 2019 study period 3 dux discusses how CommLaw1 provides new confidence in understanding, analysing and applying tax law to technical business transactions.

Pearl Weinberger, Accountant, Guests Accounting, Victoria

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

I completed a certificate in accounting and found employment initially as a bookkeeper in a tax accounting firm seven years ago. Over the years, I have been given a variety of roles within the firm, progressing from providing bookkeeping and payroll services for clients to preparing the financial accounts and income tax returns for larger client groups with multiple entities.

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

The most valuable aspect of studying Commlaw1 was the background that it provided on the interpretation and application of legislation and common law within the Australian legal system.

What are your areas of new confidence?

A new area of confidence achieved through study with The Tax Institute is the knowledge and ability to research legislation, case law and rulings — an immensely useful skill, as tax law is constantly evolving. I now understand legal technical reasoning and how to analyse, research and advise on technical tax issues which require research and analysis.

What was the reason for undertaking CommLaw1 with the Institute?

My reasons for undertaking study of CommLaw1 was to gain the skillset required to understand, analyse and apply tax law to business transactions. I sought to gain a thorough understanding of the Australian legal system, with the eventual goal of completing a Graduate Diploma of Applied Tax Law.

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

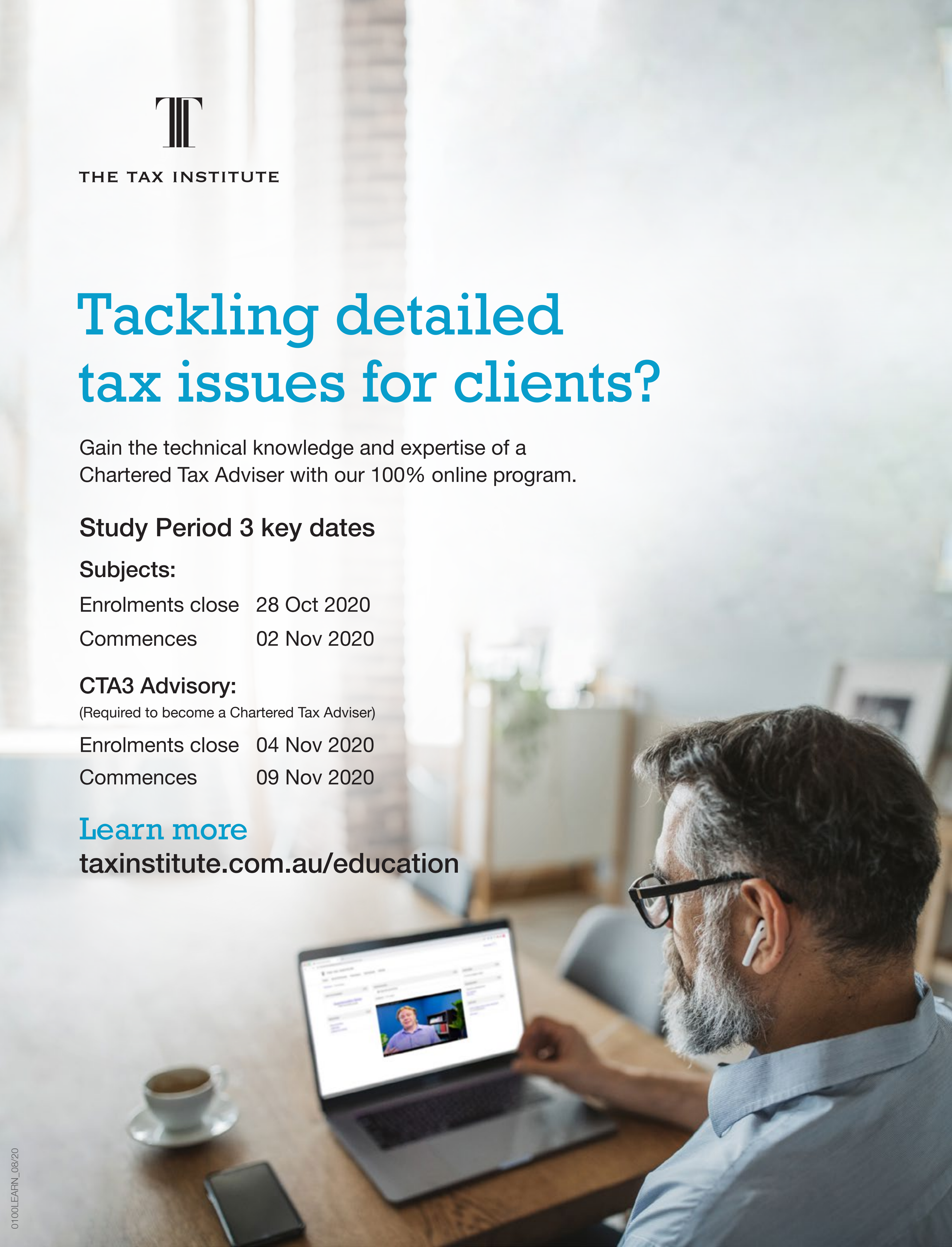
I will continue with The Tax Institute's education program, undertaking study of the three modules remaining to complete the Graduate Diploma of Applied Tax Law, thereby broadening and further developing my tax analytical and advisory skills.

What are the challenges of juggling study and work?

As a working mother of three young children and being pregnant with the fourth during the study period, the biggest challenge of juggling study, home life and work was time management. My advice is to set a timetable for work and study that is realistic and achievable and then to commit and adhere to it as far as possible.

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

My advice to other tax professionals who are considering the Tax Agent Program is that, while it requires commitment, the program is rewarding and worthwhile in order to develop the skillset and professionalism in the tax field. I highly recommend it.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SG amnesty unpacked

by Robyn Jacobson, CTA, Senior Advocate, The Tax Institute

The superannuation guarantee (SG) amnesty provides a one-off opportunity for employers to self-correct historical SG non-compliance. Following the expiration of the amnesty on 7 September 2020, the standard rules revert and employers face stronger penalties for non-compliance in the future. This article considers the fundamentals of the SG regime, dispels some misapprehensions and reminds practitioners that there are no limits on the review period for SG shortfalls. The benefits of the SG amnesty are unpacked and the circumstances in which employers should consider coming forward are identified. Nuances may arise such as the effect of amnesty payments on the concessional contributions cap, Div 293 tax and how to deal with shortfalls relating to non-residents and deceased employees. The benefits offered by the amnesty are contrasted with the severe consequences of not coming forward during the amnesty period. Finally, the article sets out the case for extending the amnesty period beyond September.

The expiration of the superannuation guarantee (SG) amnesty on 7 September 2020 has refocused attention on employers' superannuation obligations. The one-off opportunity afforded by the amnesty provides a number of benefits designed to encourage employers to self-correct historical SG non-compliance.

Subject to any extension announced by the government after the date of writing this article, the standard rules revert from 8 September 2020 and employers face stronger penalties for non-compliance in the future. This article examines some of the nuances of the amnesty and what employers can expect following of the expiration of the amnesty if they fail to self-correct historical and future SG shortfalls.

Legislative framework

The government announced on 24 May 2018 that it would introduce a one-off amnesty "to allow employers to wipe the slate clean and pay their workers what they're owed". The original Bill, the Treasury Laws Amendment (2018 Superannuation Measures No. 1) Bill 2018, was introduced into parliament on 24 May 2018. The original Bill proposed to establish a 12-month amnesty until 23 May 2019. However, this Bill lapsed[1] without passing the parliament.

The government announced on 18 September 2019 that it was reintroducing the SG amnesty, and introduced the Treasury Laws Amendment (Recovering Unpaid Superannuation) Bill 2019 (the Amnesty Act) into parliament the same day. This Bill, enacted[2] on 6 March 2020, established and extended the amnesty.

SG fundamentals

The *Superannuation Guarantee (Administration) Act 1992* (Cth) (the SGAA) sets out employers' SG obligations. Many practitioners are under the misapprehension that employers have an obligation under the superannuation or tax laws to pay 9.5% of ordinary time earnings (OTE) to a complying superannuation fund for their employees. Technically, no such obligation exists. Rather, employers face penalties if they fail to pay a prescribed amount of superannuation for their employees.

Section 19 of the SGAA imposes an SG charge (SGC) liability on an employer if they have an SG shortfall for a quarter for an employee.

The SG shortfall is equal to 9.5% of the total salary or wages paid by the employer to the employee for the quarter. Any sacrificed[3] salary or wages amounts of the employee for the quarter in respect of the employer are included in total salary or wages from 1 January 2020.

The SGC liability for a quarter is reduced by contributions the employer makes to a complying fund within 28 days of the end of the quarter based on OTE. No SG shortfall arises and no SGC liability is imposed on an employer for a quarter if they contribute 9.5% of OTE for all their eligible employees for the quarter.

Unlike standard income tax assessments, there are no limits on the review period for an SG shortfall.

The Commissioner states at para 4 of PS LA 2007/10 that, as a general rule, the ATO will only make assessments for quarters that the employer is required to have retained records (that is, five years). However, if there is sufficient written evidence of an SG shortfall, and that liability can be determined[4] with a fair degree of certainty, the ATO can raise assessments for *any* previous quarter as far back as 1 July 1992 (the commencement of the SGAA).

Even if employers are unable to locate records such as bank statements, pay slips and award documents to ascertain the amount of an SG shortfall, historical information provided by current or former employees may result in an audit on any quarter.

Components of the SGC and penalties

The SGC liability for a quarter comprises the following three components:

- **SG shortfall:** calculated as 9.5% of the *quarterly salary and wages base* (not OTE) in respect of the employee;
- **nominal interest component:** calculated at 10% of the SG shortfall from the beginning of the quarter until the date on which the SGC is paid to the ATO (not until the date on which a late contribution is paid to a superannuation fund); and

– **administration component:** $20 per employee.

The Commissioner has no power to remit any of the above components.

Additionally, the following penalties apply:

– the SGC payable is specifically non-deductible under s 26-95 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97);

– Part 7 of the SGAA imposes a penalty equal to double the SGC payable for failure to provide an SG statement to the Commissioner by the 28th day of the second month following the end of the quarter ("the Part 7 penalty"). The Commissioner has the power to remit the Part 7 penalty (subject to a limitation pertaining to the amnesty discussed below);

– an administrative penalty[5] at the rate of 75% of the SGC payable can be imposed under s 284-75(3) of the *Taxation Administration Act 1953* (Cth) (TAA) and item 7 of the table in s 284-90 of the TAA — in practice, this penalty is usually remitted;

– general interest charge (GIC) is payable where the SGC liability or Part 7 penalty is not paid by the due date;

– the ATO can issue an employer with an estimate of the SGC liability under Div 268 of Sch 1 to the TAA; and

– the ATO can issue a director of a company with a penalty notice for the amount of the SGC liability under Div 269 of Sch 1 to the TAA.

SG amnesty

The amnesty is available for SG shortfalls for quarters starting on or after 1 July 1992 and all subsequent quarters until and including the quarter starting on 1 January 2018. Accordingly, the period in which SG shortfalls may be eligible for the amnesty is 1 July 1992 to 31 March 2018.

The amnesty period started on 24 May 2018 and ends (according to the Amnesty Act) six months after the day on which the Amnesty Act received royal assent. As 6 September 2020 falls on a Sunday, the ATO is allowing employers **until 11:59 pm on Monday 7 September 2020** to make disclosure and payment of historical non-compliance.

Benefits under the SG amnesty

The following benefits are available to employers who qualify for and take advantage of the amnesty in relation to their SG shortfall for a quarter:

– no administrative component will be imposed;

– no Part 7 penalties will be imposed; and

– payments of SGC are deductible.[6]

As a further incentive for employers to come forward during the amnesty period, where an employer fails to come forward, new s 62(4) of the SGAA prevents the Commissioner from remitting the Part 7 penalty after 7 September 2020 to less than 100% of the SGC other than in exceptional circumstances.

The SG shortfall (based on the *quarterly salary and wages base*) and the nominal interest remain payable under the amnesty. Whether GIC is also imposed or remitted remains at the discretion of the Commissioner.

Who must the payment under the amnesty be paid to?

Where an employer has the capacity to pay on the day they make the disclosure and does not have an existing SGC assessment for the quarter, they can choose to make a payment comprising the SG shortfall, the nominal interest and the GIC directly into an employee's superannuation account and elect to offset these amounts against their SGC liability under s 23A of the SGAA.

Employers who are unable to contribute directly into an employee's superannuation account or have an existing SGC assessment for the quarter will need to pay the SG shortfall, the nominal interest and the GIC to the Commissioner.

Payment arrangements are available to employers who have difficulty paying by the due date. However, any payments made after 7 September 2020 are not deductible, even if they are made under a disclosure made before that date.

Who should consider the amnesty?

Employers who have an SG shortfall for a quarter between 1 July 1992 and 31 March 2018 should consider making a disclosure and payment under the amnesty where:

– there has been non-payment of superannuation for an employee;

– there been an underpayment of superannuation for an employee;

– superannuation was paid late for an employee — this includes where the employer was just one day late in making[7] the contribution;

– superannuation was not paid to persons under the expanded definition of 'employee' in s 12(3) of the SGAA, that is, contracts for the labour of a person;

– OTE has been incorrectly calculated, such as where payments to employees include leave loadings or bonuses; or

– directors are concerned about personal liability for SGC liabilities payable by companies.

Difficulties in characterising a worker as an employee or a contractor

One of the most difficult aspects of the SG regime is identifying when an employer has a superannuation obligation for a worker. Section 12(1) of the SGAA provides that the term 'employee' has its ordinary meaning, but the meaning is expanded by s 12(3) which includes as an employee a person who works under a contract that is wholly or principally for the labour of the person.

Companies cannot be employees, and the SGAA does not contain a deeming rule to include companies as employees. However, the use of a corporate contractor could trigger an SG obligation if the use of a company as the contractor is a sham or the contract provides that the corporate contractor must provide a particular individual to do the work, as was the case in *Roy Morgan Research Pty Ltd v FCT*.[8]

A litany of cases[9] have examined whether an individual is an employee, which usually involved characterising the workers by reference to traditional case law indicators such as control delegation, provision of tools, producing a result and risk. The cases have had varying results and include:

- *Hollis v Vabu Pty Ltd*;[10]
- *Vabu Pty Ltd v FCT*;[11]
- *Stevens v Brodribb Sawmilling Company Pty Ltd*;[12]
- *Builders Workers' Industrial Union of Australia v Odco Pty Ltd*;[13]
- *World Book (Australia) Pty Ltd v FCT*;[14]
- *Australian Air Express Pty Ltd v Langford*;[15]
- *On Call Interpreters and Translators Agency Pty Ltd v FCT (No. 3)*;[16]
- *Jiang Shen Cai trading as French Accent v Do Rozario*;[17]
- *ACE Insurance Ltd v Trifunovski*;[18]
- *Voros v Dick*;[19]
- *Kaseris v Rasier Pacific VOF*;[20]
- *FCT v Racing Queensland Board*;[21]
- *FCT v Scone Race Club Ltd*;[22]
- *Dental Corporation Pty Ltd v Moffet*;[23]
- *Jamsek v ZG Operations Australia Pty Ltd*;[24] and
- *Construction, Forestry, Maritime, Mining and Energy Union v Personnel Contracting Pty Ltd.*[25]

Can the amnesty be used for closely held payees?

Nothing in the Amnesty Act restricts the benefits available to employers to arm's length employees. It is common for companies and trusts to underpay, or not pay at all, superannuation relating to the company directors or directors of the corporate trustee who are employed in the business carried on by the entity (hereafter referred to as 'closely held payees'). This is often due to limited cash flow or a perception that no moral obligation has been breached. An SGC liability nonetheless arises for closely held payees.

Provided there is sufficient documentary evidence of a genuine employment relationship with the closely held payee, any historical SG shortfalls should be rectified. Collective benefits include reduced penalties, deductibility, no exposure to Div 293 tax and no risk of excess concessional contributions for payments that could extend back many years.

When is the amnesty not available?

The amnesty is not available where:

- the SG shortfall relates to a quarter starting on or after 1 April 2018;
- the disclosure relates to an SG shortfall that has previously been disclosed to the Commissioner — the amnesty is designed to provide an incentive to disclose historical under- or non-payment of superannuation rather than benefit employers who have come forward before the start of the amnesty period to provide them with reduced penalties or charges for past disclosures;
- the employer has been notified that the ATO is reviewing, or intends to review, the quarter;
- the disclosure or payment of the historical under- or non-payment is made outside the amnesty period;
- the disclosure or payment of the historical under- or non-payment is not made using the approved form; or
- the employer fails to pay the SGC liability payable, enter into a payment arrangement or comply with a payment arrangement.

What are the consequences of not taking up the amnesty?

If an employer fails to make a disclosure and payment during the amnesty period, they can expect the following consequences after 7 September where the ATO identifies any historical non-compliance:

- the SGC liability remains payable, and the ATO could issue an employer with an estimate of the SGC liability or a company director with a penalty notice under Div 268 and Div 269 of Sch 1 of the TAA, respectively, as mentioned earlier;
- no deduction is available for the SGC;
- the ordinary rules revert and the employer is liable for the administrative component;
- the Part 7 penalty is imposed at 200% of the SGC liability, and the Commissioner is unable to remit it to less than 100% of the SGC liability other than in exceptional circumstances; and
- the ATO has wide-ranging powers including issuing garnishee notices and directions orders, referring the debt to credit reporting bureaus and prosecuting employers in the more egregious cases.

With the implementation of mandatory Single Touch Payroll (STP) reporting for all employers,[26] and increased reporting by superannuation funds, the ATO has greater transparency than ever before. While STP reporting is not retrospective to the SG quarters covered by the amnesty, it does assist the ATO in profiling employers and identifying current and future SG non-compliance. This could result in audit activity which could easily lead to reviews of earlier periods. Employers with historical SG non-compliance should not be complacent and assume the ATO won't find them.

Associated issues

No additional tax under Div 293

Additional tax at the rate of 15% is imposed by Div 293 of the ITAA97 where an individual's *low tax contributed amounts*[27] exceed $250,000.

Amendments in the Amnesty Act ensure that contributions made as a result of the amnesty are excluded from the calculation of an individual's *low tax contributed amounts* so that amnesty contributions do not attract, or cause other *low tax contributed amounts* to attract, additional tax under Div 293.

Excess concessional contributions

The amnesty may result in employers paying SGC amounts which represent late payments of SG covering a number of years which must be paid to the employee's superannuation account. This would likely cause affected employees to exceed their $25,000 concessional contributions cap. This would result in the employee having to include the excess concessional contributions in their assessable income (with a 15% tax offset being applied).

The Commissioner has discretion under s 291-465 of the ITAA97 to determine to disregard or reallocate an excess concessional contribution if there are special circumstances and the determination is consistent with the object of Div 291 of the ITAA97.

Amendments in the Amnesty Act provide an exception to the requirement for an individual to apply for the Commissioner to make a determination to disregard or reallocate an excess concessional contribution. The amendments streamline the exercise of the Commissioner's discretion to make a determination by allowing the Commissioner to make such a determination without the employee having to apply for it. However, this exception applies only if the employer made payments under the amnesty directly to the Commissioner due to the lack of visibility and reliance on third-party reporting by funds.

Where the employer has made the contributions directly to an employee's superannuation account and made an election under s 23A of the SGAA to offset the payment against their SGC liability, the employee may still seek the Commissioner's discretion under s 291-465.

What if the employee is aged 75 years or over, or is aged 65–74 and doesn't pass the work test?

The Amnesty Act does not contain any amendments that change the character or treatment of payments made by employers under the amnesty. The ATO has confirmed to the author that payments made under the amnesty, whether to the Commissioner or directly to the employee's superannuation account, meet the definition of *mandated employer contributions* within the meaning of reg 5.01 of the *Superannuation Industry (Supervision) Regulations 1994* (Cth).

Payments made to the:

– ATO are payments of shortfall components that fall within para (a)(ii) of the meaning of *mandated employer contributions*;

– employee's superannuation account where the election is made under s 23A of the SGAA are payments that reduce the employer's potential liability for the SGC that fall within para (a)(i) of the meaning of *mandated employer contributions*.

Accordingly, the age of the employee or their circumstances at the time the amnesty payment is made will not prevent a superannuation fund from accepting the payment.

Where the employer pays the ATO under the amnesty and the employee is aged 65 years or over, the employee can request that the ATO pay these amounts to them directly under s 65A of the SGAA.

What if the employee is now a non-resident for tax purposes?

Assume that the employee was at one time employed by the employer but is a non-resident for tax purposes at the time the employer makes the amnesty payment. The outcome depends on whether the employee was a *former temporary resident* within the meaning of the *Superannuation (Unclaimed Money and Lost Members) Act 1999* (Cth).

If the employee was:

– a *former temporary resident* — the amnesty amount is treated as though it were paid as unclaimed money under s 65AA of the SGAA. This allows the ATO to pay the amnesty amount directly to the employee as a *departing Australia superannuation payment* (see QC 24169);

– not a *former temporary resident* — the ATO needs to pay the amnesty amount to a complying superannuation fund. The ATO will take steps to identify the employee's superannuation account where possible.

If the ATO is unable to locate a former temporary resident, the amount would remain as unclaimed money.

In the case of an individual who was not a former temporary resident, if the ATO cannot identify a superannuation account for the individual, the amount will be paid to the superannuation holding account (SHA) special account. The SHA special account is used by the ATO to deposit government superannuation contributions or SG payments that have not been paid to a fund. Once an amount is paid into the SHA special account, the individual can use the ATO's online services to nominate the eligible superannuation fund they would like the money transferred to. If the individual is aged 65 or over, they can request direct payment of the amount.

What if the employee is now deceased?

Employers are liable for the SGC where there is an SG shortfall for an employee for a quarter. This includes former employees who are included in the meaning of 'employee' by s 15B of the SGAA. The term 'former employee' is not defined in the SGAA so it takes its ordinary meaning and therefore includes deceased employees. Employers are not relieved of their SG obligations as a result of the death of an employee.

Where the employee has died, unless they were a *former temporary resident* and covered by s 65AA of the SGAA, the Commissioner must pay the shortfall to the employee's legal personal representative (LPR) under s 67 of the SGAA. Under s 23(9A) of the SGAA, amounts paid to the employee's LPR are taken to have been a contribution made by the employer to a complying superannuation fund for the benefit of the employee.

Ordinarily, a deceased estate will be closed once it is fully administered. However, there are occasions which necessitate reopening the estate, such as when further assets are discovered. This includes additional superannuation benefits arising from an amnesty payment after the date of death and even after an estate has been fully administered. There is no time limit on reopening a deceased estate.

Once the Commissioner pays the LPR the shortfall amount, the LPR will need to refer to the will of the deceased or letters of administration (where the individual died intestate) to determine who is entitled to the amount. Any binding death benefit nomination (BDBN) made by the deceased is irrelevant because the amnesty payment sidesteps the employee's superannuation account and is paid directly to the LPR, so any instructions previously given to the trustee of the superannuation fund are of no consequence in this case.

The amount received by the LPR under s 67 of the SGAA is a superannuation death benefit (see item 7 of the table in s 307-5 of the ITAA97) even though it bypasses the superannuation fund. The LPR then needs to determine the tax treatment of the superannuation death benefit under s 302-10 of the ITAA97. This will depend on whether the beneficiary is a *death benefits dependant* of the deceased. For example, a child of a deceased employee may have been aged 16 years when their parent died but is aged 25 when the LPR looks to distribute the amnesty payment from the reopened deceased estate.

The meaning of *death benefits dependant* is set out s 302-195(1) of the ITAA97. While paras (c) and (d) of that meaning specifically state that the relationship to the deceased is determined just before they died, paras (a) and (b) are silent on this point.

The Commissioner states in para 5 of TD 2013/12 that:

> "On the basis that the definition of a 'death benefits dependant' relates to 'a person who has died', the relevant time as at which a person's satisfaction of either of paragraphs (a) or (b) of that definition is to be tested is logically related to the time the deceased person died."

Accordingly, the time at which the identity of a *death benefits dependant* is determined is just before the deceased person died and not when the amnesty payment is made by the employer or distributed by the employee's LPR.

In the case that the employee's LPR is also now deceased, the ATO will generally pay the amnesty amount to the LPR of the LPR. However, caution should be taken as this outcome will vary from state to state and may also depend on whether the estate has an executor or an administrator, and whether the estate has a sole executor.

One can only begin to imagine the quagmire of issues that will inevitably arise for SG shortfalls relating to deceased employees and fully administered estates dating back over a 28-year period.

Is there any possibility of an extension to the amnesty?

The Commissioner has no power to extend the amnesty beyond 7 September 2020. This would necessitate a legislative amendment passed by parliament.

A submission of the joint bodies, including The Tax Institute, sought a six-month extension of the deadline to 7 March 2021 due to the various challenges arising from COVID-19. The amnesty became law on 6 March 2020 but the additional period of six months following the enactment for employers to come forward has unfortunately coincided with the impact of the COVID-19 pandemic.

Depleted cash flow has left many employers without the capacity and resources to apply for the amnesty by 7 September 2020.

Applying for the amnesty is a very time-consuming process because the amnesty stretches back as far as 1992.

Employers need to identify superannuation shortfalls for up to 103 quarters, including for any former and now deceased employees. They need to correctly characterise whether the worker is an SG employee or is deemed to be an SG employee under the extended meaning which can include contractors and other workers. Then there is the process of calculating the employee's OTE to determine whether there is a shortfall.

If a shortfall is identified, a separate calculation based on total salary and wages, which includes overtime, is then necessary to work out the total amount that must be paid to the ATO or as a late contribution to a superannuation fund. Additional charges apply which are not able to be waived under the amnesty.

Making the payment is not the end of it. Employers also need to prepare and lodge an SG statement with the Commissioner which is a time-consuming process. Employers inevitably need to engage the assistance of professionals who can guide them through the payment and disclosure process.

Add to this the Victorian COVID-19 stage 4 restrictions which are in place until at least 13 September. The restrictions prevent practitioners from being able to see any of their clients or access their business premises for any reason, and employers other than those involved in permitted activities from accessing their business premises. This prevents the collection or sharing of paper payroll records which, given the timeframe involved, are typically stored in physical archive boxes at inaccessible offices or off-site third-party storage areas. It is impossible to determine a shortfall for a quarter dating back many years without access to the necessary payroll and associated records.

As mentioned earlier, the ATO is offering payment arrangements for those employers who may struggle to make payments in full by the deadline. However, aside from being unable to claim a deduction for any payments made after 7 September, the bigger risk for the employer is the failure to lodge an SG statement.

As discussed, much larger penalties apply after the deadline for those who could have come forward under the amnesty but did not and are subsequently caught.

There is common agreement that employees' legitimate entitlements are the priority. But in light of the extraordinary challenges currently facing employers and their advisers, it is incredibly difficult in this environment for employers to make the necessary payments and disclosures by 7 September.

On 5 August, the Minister for Superannuation, Financial Services and Financial Technology, Senator Jane Hume, issued a media release reminding employers of the approaching deadline. It is hoped that, given the challenges facing employers due to the COVID-19 pandemic and the stage 4 restrictions in Victoria, an extension to the amnesty period will be announced.

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References

1 The original Bill was before the Senate when the 46th parliament commenced on 1 July 2019. When parliament is prorogued, any business before the Senate lapses immediately before the commencement of the next parliament.

2 Act No. 21 of 2020.

3 Salary sacrificed superannuation contributions are explicitly included in the *quarterly salary and wages base* and *ordinary time earnings base* from 1 January 2020 as a result of amendments made by the *Treasury Laws Amendment (2019 Tax Integrity and Other Measures No. 1) Act 2019*.

4 The Commissioner observes at footnote 6 of PS LA 2007/10 that the amount of a shortfall can be more easily determined than a decision as to whether a worker is an employee for superannuation purposes.

5 PS LA 2019/D1 states that the ATO should consider remitting in full the employer's liability to the TAA default assessment penalty. This is regardless of the extent to which the Part 7 penalty is remitted. The Part 7 penalty is the penalty specifically provided for by the SGAA and is generally the appropriate penalty to apply where both penalties are imposed.

6 New s 26-95(2) of the ITAA97 allows a deduction for payments of SGC during the amnesty period.

7 Paragraphs 12 and 13 of TR 2010/1 (see also further guidance at paras 181–182) explain that a contribution is taken to be 'made' when the capital is increased, ie when the funds are received by the superannuation fund. Guidance at paras 183–186 of the ruling further explains that it has been suggested that a contribution made by electronic funds transfer may occur as soon as the contributor has done everything necessary to effect a payment, but the Commissioner does not accept that is sufficient to increase the capital of the fund.

For SG purposes, the terms and conditions of the ATO's Small Business Superannuation Clearing House provide that: "If you pay the correct super guarantee contribution amount on or before the relevant payment due date, your super guarantee obligation is discharged at the time of payment to the SBSCH, where the SBSCH accepts the payment."

This concessional approach does not apply to commercial clearing houses, where the SG contribution must be received by the fund rather than the clearing house by the due date.

8 [2011] HCA 35.

9 The author is grateful to Phil Broderick of Sladen Legal, Melbourne, for compiling this list of cases.

10 [2001] HCA 44.

11 (1996) 33 ATR 537.

12 [1986] HCA 1.

13 [1991] FCA 87.

14 92 ATC 4327.

15 [2005] NSWCA 96.

16 [2011] FCA 366.

17 [2011] FWAFB 8307.

18 [2013] FCAFC 3.

19 [2013] FWCFB 9339.

20 [2017] FWC 6610.

21 [2019] FCAFC 224.

22 [2019] FCAFC 225.

23 [2020] FCAFC 118.

24 [2020] FCAFC 119.

25 [2020] FCAFC 122.

26 Other than a few specific groups covered by exemptions determined by the Commissioner, including reporting of closely held payees which continues to be exempt until 30 June 2021.

27 Division 293 tax is an additional tax on superannuation contributions which reduces the tax concession for individuals whose combined income and contributions are greater than the Div 293 threshold. From 1 July 2017, the Div 293 threshold is $250,000. Prior to this, it was $300,000. Division 293 tax is charged at 15% of an individual's taxable contributions.

Residency in a global pandemic: advising the returning Australian

by Matthew Marcarian, CTA, Principal, CST Tax Advisors

Principles of tax residency can be notoriously difficult to apply in practice, sometimes even in quite simple cases. The recent decision in *FCT v Addy* demonstrates that. In *Addy*, the Full Federal Court unanimously reversed the decision of the single bench in relation to whether a taxpayer was a resident according to ordinary concepts and how the 183-day test should apply. During the COVID-19 pandemic, Australians living overseas have returned in droves, often temporarily, without necessarily considering the tax implications. Many are waiting out the pandemic in Australia. What does this mean for their income tax residence and how might practitioners advise on the complex issues that can arise? Given the inherent uncertainty in how tax residency laws apply, even in simple cases, the Commissioner should issue a practice statement clarifying how he would look to apply Australia's tax residency laws in a global pandemic.

Introduction

The extraordinary events of 2020 have seen hundreds of thousands of Australians[1] return to Australia, some permanently but many to wait out the COVID-19 pandemic.

When the Department of Foreign Affairs and Trade announced in March 2020 that Australians who wanted to return to Australia should do so immediately,[2] thousands of Australians living abroad took notice.

The action taken by one Australian expatriate family known to the author was typical. Almost immediately following the announcement, they locked up their home in a neighbouring country, made arrangements with their employers, and scrambled to catch a flight to Australia, happy to endure the 14-day quarantine directive announced by Prime Minister Scott Morrison on 19 March.[3]

For many Australians who live overseas, the decision to return to Australia will have been taken with only short notice given to family members, overseas landlords, employers and schools. The time normally available to plan for the issues that can arise with an international move may not have been available. In such circumstances, the potential income tax implications of returning to Australia are unlikely to have been of immediate concern. However, now that the 2021 tax year has commenced, returning Australians are likely to seek guidance from their advisers so that they can deal appropriately with their income tax obligations.

This article deals with the residency issues that practitioners will face with regard to clients who are in this predicament.

Will the client become a resident?

Usually, if a client becomes a resident of Australia, their income tax position will change significantly. If a change of residency is unplanned, a whole gamut of potential complications arises.

Depending on the circumstances of a client, ascertaining when a client becomes a resident can be one of the more difficult exercises in international tax. It is a task which requires careful consideration of the client's circumstances and a considerable degree of professional judgment. As Rich J said in *FCT v Miller*:[4]

> "In many cases, including most of those which become subjects of litigation … the question whether a person is a resident of a place … depends not upon the applicability of some definite rule of law, but upon the view taken by a tribunal of whether he comes within a field which is very loosely defined. The question is ordinarily one of degree, and therefore fact."

For the returning Australian, the three main tests[5] of residency are the common law test, the domicile test and the 183-day test.

The common law test, also known as the "resides test", is beguilingly simple. A person is a resident of Australia if they reside here, with the word "reside" taking its ordinary meaning.[6]

Under the domicile test, a person is a resident of Australia if their domicile[7] is in Australia unless the Commissioner is satisfied that they have a permanent place of abode outside Australia.[8]

As fundamental as the "resides test" is to determining residency, the domicile test is often just as relevant. It is not well appreciated, but for an Australian domiciled individual, whether or not they actually return to Australia will be a moot point if it becomes clear that they no longer have a "permanent place of abode" overseas.

Of course, it is usually the case that one follows the other closely, that a person will give up their overseas permanent place of abode as part of returning to Australia.

In everyday tax practice, one usually treats the returning Australian as becoming a resident on the day of their return to Australia. Rarely does the enquiry extend to determining when the client left or gave up their overseas residence. That is usually a common-sense approach, but there is danger in assuming that it is always the correct one.

While a global sojourn prior to returning to Australia is not a likely path in the middle of a pandemic, it is nonetheless a possibility that practitioners should be aware of. "Know your client" rings as true today as it ever did.

There are other types of "returns" to Australia which are not so straightforward. Many practitioners will have had client situations which could be described as "creeping returns". This is often characterised by the return to Australia of some but not all family members, with the main "income-earning" spouse still living and working overseas.

Such split family situations present challenging problems for advisers not only in relation to residency per se, but also in relation to the consequential treatment of international assets, companies or trusts that may be owned or controlled by members of the family.

The issues with residency have become even more complicated than usual because of the COVID-19 pandemic. This year, more than ever, the 183-day test will come into sharp focus and this is discussed later in the article.

For its part, the Australian Taxation Office has provided some limited guidance to Australian expatriates who find themselves back in Australia because of the pandemic. In answer to the question of "whether a person's tax residency will change as a result of returning to Australia due to COVID-19", the ATO's position is that, if a person is in Australia temporarily, for some weeks or months, because of COVID-19, they will not become an Australian resident for tax purposes as long as the person "usually lives overseas permanently" and intends to return there as soon as they are able.[9]

The ATO acknowledges that tax residency issues may be more complicated if a person ends up staying in Australia for a lengthy period and does not plan to return to their country of residency when able.

An inconvenient truth?

The difficulty for some returning Australians will be that, despite the well-documented ban on Australians travelling overseas, Australian citizens who live abroad (and can demonstrate that) have not been prohibited from returning to their place of residence.[10]

Although safety and health concerns may have compelled many Australians to return to Australia, it does not follow that they would not be considered a tax resident here.

Almost 100 years ago, Lord Buckmaster was of the view in *Inland Revenue Commissioners v Lysaght*[11] that, simply because circumstances necessitated that a person live in a place, they were not any less of a resident:

> "A man might well be compelled to reside here completely against his will; the exigencies of business often forbid the choice of residence and though a man may make his home elsewhere and stay in this country only because business compels him, yet none the less, if the periods for which and the conditions under which he stays are such that they may be regarded as constituting residence, it is open to the Commissioners to find that in fact he does so reside …"

However, having the intention to reside is an important factor. Therefore, if a choice to remain in Australia is made, either because of convenience (a desire to avoiding quarantine directives on both ends of an international flight) or because of health fears,[12] the issue is that such a choice might be interpreted as evidence of an intention to reside in Australia, even if only for a time.

In *Miller*, Latham CJ considered the residency of a man who spent nine months in the territories of Papua and New Guinea because he was required to do so as a result of commitments he made as part of the war effort:[13]

> "It has been contended that the respondent [Mr Miller] was not resident in the Territories because he did not voluntarily choose the Territories as a place of residence. He went there because he was directed to go there under his contract of employment. It appears to me that the same thing might be said of many millions of people in the world who reside in a particular place only because they have to do their work at or near a place. But, if voluntary choice is to be regarded as an important element in determining residence, I see no reason why it should not be said that the respondent, in entering into an agreement to serve in such places as might be specified, voluntarily ordered his life so as to reside from time to time in those places as required by the exigencies of his duties."

At the end of the day, when advising a client in relation to residency, it will be critical to get to the nub of the person's individual circumstances.

A person's intention will inevitably be important when it comes to considering residency. However, it must be borne in mind that residency has to be assessed annually (if only to prepare a tax return) and an intention to return overseas at some point is quite a different thing to not having the intention to reside in Australia.

The Australian courts have dealt with the significance of intention in some notable cases. In *Hafza v Director-General of Social Security*,[14] Wilcox J indicated that:

> "As a general concept residence includes two elements: physical presence in a particular place and the intention to treat that place as a home; at least for the time being, not necessarily forever."

The facts in *Hafza* were of an "outbound" family who intended to return to Australia after three months, but who ended up staying in Lebanon for almost four years before returning. It might be that many Australians will find themselves in Australia intending to return to their overseas residences but who may not do so for some years.

Recently, in *Harding v FCT*,[15] Derrington J said:

> "Necessarily the question of where a person resides is a question of fact (and, perhaps, of degree *per* Dixon J in *Miller* at 103), the conclusion of which is reached by a consideration of all of the person's circumstances. Those circumstances will be directed to ascertaining whether a person has a physical presence or retains a 'presence' in one location whilst at the same time maintaining an intention to reside there. The consideration also involves identifying the person's 'habits and conduct within the period', however, that will include a consideration of the events occurring prior to and subsequent to the relevant period as illuminating the relevance of the events in the relevant period."

At this time of unprecedented crisis, the most appropriate advice to give an Australian expatriate who has returned to Australia because of the COVID-19 pandemic, but who ordinarily lives overseas, is that their intention to remain in Australia *temporarily* is important.

In TR 98/17, the ATO's views in this area are made relatively clear in the following passages:

> "17. When an individual arrives in Australia not intending to reside here permanently, all the facts about his or her presence must be considered in determining residency status.

> …
>
> 27. On entering this country, individuals may demonstrate they do not intend to reside in Australia, e.g., they may be visitors on holiday. When a change in their behaviour indicates an intention to reside here, e.g., they decide to migrate here, they are regarded as residents from the time their behaviour that is consistent with residing here commences. Intention is to be determined objectively, having regard to all relevant facts and circumstances. (See Example 5 at paragraphs 84 to 89.)
>
> 28. On the other hand, an intention to leave Australia after a brief stay is of little significance if the individual does not, or is unable to, depart: Case 104 10 TBRD 299."

The difficulty is that the longer the crisis continues, the greater the possibility that a person's stay in Australia, although initially thought to be temporary, might begin to exhibit a degree of habit and routine, with familial and financial connections that are consistent with residing here.

Indeed, the situation of a returning Australian is not "on all fours" with a foreigner who might have entered Australia temporarily. This is because a returning Australian will usually have strong family ties with Australia, a wider social network, and will often have retained financial connections while they were away. More fundamentally, they are likely to treat Australia as home.

The relevant issue for practitioners is to explain to clients that there may be a tipping point when the person's self-declared intention not to live in Australia becomes at odds with how actual events transpire. That issue is identified in recent comments by Logan J in *Pike v FCT*:[16]

> "The intention of a person in relation to residence is always relevant, but not determinative. Intention is but one factor to be considered in the context of the whole of the circumstances of a given case."

Inevitably during this crisis, there will be Australians who have returned to Australia not intending to stay, but who will end up becoming residents for tax purposes. Identifying the "turning point" will not always be easy, but there will usually be signs of a change of intention.

Such indicators might include the person resigning from an overseas job, giving up an overseas residence, or simply telling friends and family that they have decided to stay in Australia. Other indicators might be the enrolment of children in Australian schools or moving from temporary accommodation into a more permanent family home. If these indicia become relevant to the proper administration of the client's tax affairs, they should be clearly documented.

In practice, it would also be important to ask the client to confirm their intentions as this will help practitioners to ensure that, when preparing returns, they do not inadvertently assume that the client has become a resident at an earlier time than may be the case.

However, there is a warning for practitioners in the *Harding* case in the following comments by Derrington J:[17]

> "However, the objective manifestation of a person's intention is often a more accurate indicator of their state of mind at a particular time in the past than is an assertion about that alleged prior intent. A person's present belief about what their intention may have been in the past will necessarily be affected by their sub-conscious and the context in which they are called upon to identify that past intention. That is especially so when, at the relevant time, the person did not then consider what their then intention may have been."

His Honour's statements are prophetic as there would be many Australians who have returned to Australia during the pandemic but who may not necessarily have considered in much detail what their intentions were at the time of their return. They are likely to have simply returned to Australia in a crisis, doing nothing more than seeking the safety of Australian shores, but leaving overseas homes intact and employment arrangements on hold.

No doubt these are difficult times for clients and advisers alike. However, the inconvenient truth for those Australians who are not able to return to their overseas homes, or who choose not to return, is that they are likely to have become a resident of Australia when they formed the intention to stay. This may be the case even if they return to resume their lives overseas next year or the year after.

Ultimately, it will be the practitioner's duty to provide independent and objective advice.

183-day test

Practitioners should ensure that they do not overlook the 183-day test, particularly in relation to the 2021 income tax year. While this test has always been important, the way that tax practitioners think about this test may need to change, especially following the decision of the Full Federal Court in *FCT v Addy*[18] which was handed down on 6 August 2020.

The decision in that case has been timely because it contains several statements about the 183-day test and how it operates.

In *Addy*, the Commissioner argued that the 183-day test should not apply unless the Commissioner had formed the view that the person intended to reside in Australia and did not have a usual place of abode overseas. However, the court unanimously rejected that approach. Steward J explained how the court viewed the application of the 183-day test, at para 299, when he said:

> "… the purpose of the test is to supplement the test of residency in ordinary concepts in a practical way. It permits a conclusion to be reached about residency by the simple expedient of the taxpayer being physically in Australia during more than one-half of a year of income. It would seriously undermine the utility of this test if it also required, *in every case,* the Commissioner to form a view about the taxpayer's usual of abode and intentions about residency."

His Honour further noted at para 313:

> "By its terms, and as already mentioned, that test results in a person being a resident of Australia if they satisfy the objective requirement of being actually in Australia for more than the stipulated period 'unless' the Commissioner is 'satisfied' that the taxpayer's usual place of abode is not in Australia and the person does not intend to take up residence in Australia."

And further at para 314:

> "… the valid existence of a state of satisfaction concerning the matters required by the carve out to the 183 day test is a necessary precondition to an assessment issued to a taxpayer on the basis that she or he is a non-resident, where that taxpayer has actually been in Australia for more than one-half of the year of income."

This suggests that, even if a person finds themselves in Australia on a *temporary* basis with no intention to reside here, if they have been in Australia for more than 183 days in an income year, they will be a resident of Australia, unless the Commissioner is *demonstrably* satisfied that the person's usual place of abode is outside Australia and that they did not intend to reside here ("the exclusionary provisos").

By way of example, it will be safe to assume that there will be people who will have returned to Australia, without intending to reside here and without giving up their permanent place of abode overseas, but who do not leave Australia again until after 31 December 2020.

Irrespective of the how their time in Australia would be viewed under the "resides test", they will have stayed longer than the 183 days (measured from 1 July 2020) and consequently they will automatically be considered a resident for that time.

If they do not wish to be treated as a resident for that period, it would seem that, after *Addy*, best practice would be to provide the Commissioner with all of the facts about that person's situation so he has the opportunity to consider, and then be satisfied, about the exclusionary provisos.

In practice, it is difficult for a taxpayer to know whether the Commissioner is satisfied, let alone whether the taxpayer's disclosures have been considered. However, assuming such disclosures are made in a return and an assessment issues on the basis that the taxpayer is a non-resident, the Commissioner will ordinarily have only two years to issue an amended assessment.

Dual resident clients?

For some clients, it may be that the COVID-19 pandemic has essentially caused them to become "dual residents", meaning that they are a resident of Australia under our domestic laws while they remain a tax resident of a foreign country.

In such cases, it may be that relief from double taxation is available because the client can claim a foreign income tax offset in respect of the income that has become taxable here.

It is true, of course, that many Australians working abroad are taxed on their employment income at lower rates than would apply if they were a resident of Australia. In such cases, even after claiming a foreign income tax offset, they may still be exposed to significant additional Australian tax.

In other cases, if a client is a "dual resident", they may be able to obtain relief under a double tax agreement (DTA). Much will depend on the person's circumstances and, of course, on whether Australia has a DTA with the country that the Australian may have returned from. Treaty relief may apply to shelter foreign employment income from Australian tax in certain cases.

For some Australians, particularly those who derive most of their income from foreign employment, becoming a resident of Australia may not be as problematic as it might first appear. The analysis must be done.

Tie-breaker provisions

Most of Australia's DTAs provide "tie-breaker" rules that apply where a person is a dual resident.

The most common tie-breaker provisions are constructed on the basis that the dual resident will be treated as a resident only of the country where the person has either a permanent home or, failing that, a habitual abode.

If the "tie" cannot be broken using those tests, either because the person has a permanent home or a habitual abode in both countries or in neither, the person will often be deemed to be a resident only in the country where they have closer "economic and personal relations".[19] Some of Australia's treaties instruct that citizenship is to be a factor when determining that question.

It is important to note that the deeming of residency under a tie-breaker test will only be for the purpose of the taxation of the income and gains dealt with under a particular treaty. If a client is deemed under a tie-breaker provision to be a resident of another country, they will still be a resident of Australia for all other domestic tax purposes.

In *Pike*, a dual Australian and Thai resident was found to be a resident of Thailand for the purposes of the Australia–Thailand DTA because of the application of the tie-breaker test.[20] That finding meant that Mr Pike's employment income was only subject to tax in Thailand. However, Mr Pike would still have been assessable as a resident of Australia generally and would still have been required to lodge an income tax return as a resident.

> *"The issues with residency have become even more complicated than usual because of the COVID-19 pandemic."*

Implications of becoming a resident of Australia

At the end of the day, if a client has become an Australian resident, whether because of the COVID-19 pandemic or otherwise, the day they became a resident must be nominated in their personal income tax return for the year of their return. That residency date is critical to the proper tax assessment of the client, not only for the year of their return, but also for later years where, for example, the client owns CGT assets at the time of their return.

Cost base setting

For clients who return to Australia with CGT assets which are not taxable Australian property (examples would include foreign real estate, shares, business interests, foreign currency deposits, and collectibles), the date of the return is important because of the cost base setting rule in s 855-45 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97). That section provides that an individual is taken to have acquired the relevant CGT asset on the day they became a resident of Australia, for the market value on that day.

Given how changeable financial markets have been during 2020, not only in respect of equity values, but also in respect of the value of the Australian dollar, whether a client becomes a resident in March, April or May 2020 might have materially different CGT outcomes. When markets are moving quickly (in either direction), the deemed acquisition rule in s 855-45 ITAA97 could work to a client's advantage or disadvantage.

For a CGT asset purchased for a lower value than the market value on the day of residency, there is a benefit in that "pre-residency gains" are not brought into the Australian tax system. However, for a client who owns an asset which was purchased for a higher value than its market value on the day they become a resident, the cost base setting rule will work against them. Essentially, they will be exposed to CGT even if all that happens is that the asset is sold at its original cost price. Paying CGT when there is no economic gain is an unhappy prospect.

Other implications arising from an unplanned return to Australia

If a client becomes a resident of Australia without having had sufficient time to plan, the risk is that they may be caught out dealing with tax liabilities that they did not foresee.

There can be a minefield of returning tax issues, some of which are more basic than others, including:

- employment income is assessable in Australia when received, even if it relates to work performed prior to becoming a resident;
- withholding tax can apply if foreign bank loans remain on foot;[21]
- dealings with foreign currency balances post-residency can trigger penal outcomes under the forex realisation events;[22]
- foreign companies owned by the returning Australian may become a resident;[23]
- certain equity interests held in foreign companies may attract the operation of Australia's controlled foreign company rules;[24]
- the transferor trust rules may apply;[25]
- loans from private companies incorporated overseas can be deemed to be dividends either because of Div 7A ITAA36[26] or s 47A ITAA36;[27] and
- distributions from foreign trusts, including overseas savings plans which do not qualify as "foreign superannuation funds" (such as US 401K plans), may be taxable because of the operation of s 99B ITAA36.[28]

An opportunity for assistance

Given the significant number of Australians who have returned under the duress of the COVID-19 pandemic, it is hoped that the Commissioner will issue a practice statement addressing how he would assess returning Australians, particularly those who have kept homes overseas and who leave Australia again sometime during the 2021 income year.

Following the developments in *Addy*, understanding how the Commissioner would propose to handle assessments where the 183-day test is at issue will also be important, given the numbers of Australians who have had to return due to the pandemic.

Bright-line guidance, if only for one year, would provide certainty to Australians about the choices that they may wish to make going forward. Otherwise, arbitrary outcomes are likely to arise due to the difficulties with assessing the residency of individuals with complex cases.

Without such guidance, a great variety of approaches might be taken by taxpayers, tax agents, assessing officers and tribunals alike.

Given that we are living through extraordinary times, the certainty of a practice statement is not only needed but would be fair and equitable to Australian expatriates. This is particularly so following the raft of tax changes that have been legislated over the past decade which have increased the incidence of tax on the Australian expatriate population.[29]

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CST Tax Advisors

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1 See Senator the Hon. Marise Payne, "Australians returning from overseas", media release, 9 May 2020 (available at www.foreignminister.gov.au/minister/marise-payne/media-release/australians-returning-overseas), where it is reported that over 300,000 Australians have returned to Australia since March 2020. It has also been reported by ABC News that over 25,000 people entered Australia during June 2020, mostly citizens or permanent residents (see www.abc.net.au/news/2020-07-15/australians-overseas-coronavirus-support-dfat-government-borders/12454226).

2 ABC News, *Australians who want to return from overseas warned to do so ASAP ahead of possible COVID-19 border closures*, 17 March 2020. Available at www.abc.net.au/news/2020-03-17/coronavirus-australians-should-return-home-from-overseas/12065050.

3 Prime Minister of Australia the Hon. Scott Morrison, "Border restrictions", media release, 19 March 2020. Available at www.pm.gov.au/media/border-restrictions.

4 *FCT v Miller* [1946] HCA 23.

5 The meaning of "resident" is defined in s 6(1) of the *Income Tax Assessment Act 1936* (Cth) (ITAA36). Although there are four tests, for brevity, the superannuation test is excluded from the analysis.

6 According to Viscount Cave LC in *Levene v Inland Revenue Commissioners* [1928] UKHL 1, and endorsed by Latham CJ in *FCT v Miller*: "… the word 'reside' is a familiar English word and is defined in the Oxford English Dictionary as meaning to 'dwell permanently or for a considerable time, to have one's settled or usual abode, to live in or at a particular place'."

7 A person's domicile is essentially the country that an individual identifies as their permanent home, often arising because of their birth. Most Australian expatriates will be Australian domiciled individuals, with Australia being their domicile of origin and therefore the domicile test will apply to them.

8 In *Harding v FCT* [2019] FCAFC 29, the Full Federal Court concluded that the words "permanent place" require the identification of a country in which the taxpayer is living permanently, not a particular form of accommodation (see specifically the joint judgment of Davies and Steward JJ at [40]).

9 Australian Taxation Office, *COVID-19 frequently asked questions*. Available at www.ato.gov.au/general/covid-19/covid-19-frequently-asked-questions/individuals-frequently-asked-questions/#NonresidentstemporarilyinAustraliaasares.

10 According to the Department of Home Affairs, there is a ban on Australians travelling overseas unless they are ordinarily resident in another country. A person will be considered ordinarily resident in another country if international movement records show that they have spent more

time outside Australia than in Australia for the last 12 to 24 months. See https://covid19.homeaffairs.gov.au/leaving-australia.

11 *Inland Revenue Commissioners v Lysaght* [1928] AC 234 at 248.

12 On 17 March 2020, an ABC News article reported that DFAT advice read: "Consider whether you have access to health care and support systems if you get sick while overseas. If you decide to return to Australia, do so as soon as possible." Available at www.abc.net.au/news/2020-03-17/coronavirus-australians-should-return-home-from-overseas/12065050.

13 *FCT v Miller* [1946] HCA 23.

14 *Hafza v Director-General of Social Security* [1985] FCA 164.

15 *Harding v FCT* [2018] FCA 837 at [35].

16 *Pike v FCT* [2019] FCA 2185 at [59].

17 *Harding v FCT* [2018] FCA 837 at [43].

18 *FCT v Addy* [2020] FCAFC 135.

19 The OECD, in its commentary on the *Model Tax Convention on Income and Capital 2017*, introduces a concept of "centre of vital interests" as an aid to analysis without necessarily explaining what the concept means.

20 See, for example, art 4(3) of the Australia–Thailand DTA.

21 Relief from withholding tax is available under certain treaties if the borrowing is from a financial institution. For example, see art 11(3)(b) of the Australia–US DTA which exempts United States financial institutions from withholding tax if they have dealt wholly independently with the payer.

22 The rules in Div 775 ITAA97.

23 Under s 6(1) ITAA36, a foreign company may be treated as a resident of Australia if it carries on a business in Australia and if either its central management and control is in Australia or its voting power is controlled by shareholders who are residents of Australia.

24 The controlled foreign company rules contained in Pt X ITAA36.

25 Div 6AAA of Pt III ITAA36.

26 Div 7A of Pt III ITAA36.

27 S 47A ITAA36 deems certain distributions from a controlled foreign company of an unlisted country to be a dividend.

28 Under s 99B ITAA36, where an amount, being property of a trust estate, is applied for the benefit of a beneficiary who was a resident at any time during the year of income, the amount is included in the assessable income of the Australian resident unless exceptions apply.

29 Those changes include: the removal of the exemption of foreign employment income where there was a continuous period of foreign service of greater than 90 days; the removal of the 50% CGT concession for foreign residents; and, only recently, the introduction of inequitable amendments to Australia's CGT laws in Subdiv 118-B ITAA97 to prevent foreign residents from claiming the CGT exemption for their former main residence if sold.

Acquiring an interest in a CFC during an income year

by Wendy Hartanti, Partner, Deloitte

The Australian controlled foreign company (CFC) rules are contained in Pt X of the *Income Tax Assessment Act 1936* (Cth). Broadly, these rules seek to attribute to Australian taxpayers certain income derived by a non-resident company that is controlled by Australian residents and tax such income on an accruals basis, unless the non-resident company is subject to a tax system that is deemed comparable to Australia's or the non-resident company is predominantly engaged in active business. This article focuses on the implications of the CFC rules where an Australian taxpayer acquires an interest in a CFC during an income year. The author is of the view that it could give rise to certain undesired outcomes and recommends that such taxpayers consider the potential impact of the transaction and possible ways to minimise such impact as part of its due diligence process.

Introduction

The Australian controlled foreign company (CFC) rules, which are contained in Pt X of the *Income Tax Assessment Act 1936* (Cth) (ITAA36), celebrated their 30th anniversary on 1 July 2020. Since their introduction on 1 July 1990, there had been limited amendments made to the CFC rules. This is unlike their foreign investment fund (FIF) rules counterpart which were introduced with effect from 1 January 1993 and were subsequently repealed in July 2010.

The Australian CFC rules broadly operate to include in the assessable income of certain Australian tax residents (the attributable taxpayers) their share (attribution percentage) of certain income (the attributable income) of a foreign company that they "control" on an accruals basis. This is notwithstanding that no cash has been distributed by that foreign company to the Australian attributable taxpayers.

This article discusses some of the consequences of the application of the Australian CFC rules in circumstances where an Australian taxpayer becomes an attributable taxpayer in respect of a CFC during an income year. An Australian taxpayer which acquires an interest in a foreign company that meets the requirements to be a CFC during an income year may find that the Australian CFC rules have unexpected and uneconomic outcomes.

Control tests and the "upward attribution" concept

For a foreign company to be a CFC for Australian tax purposes, one of the following three "control tests" must be satisfied:

- **strict control test:** a group of five or fewer Australian entities (either alone or together with associates) collectively owns or is entitled to acquire control interest of at least 50% in the foreign company;
- **assumed controller test:** a single Australian entity (either alone or together with associates) owns or is entitled to acquire an interest of at least 40% in the foreign company and the foreign company is not controlled by a group of other entities; or
- **de facto control test:** a group of five or fewer Australian entities (either alone or together with associates) effectively controls the foreign company.

Other than the "de facto control test" which looks at actual control, the CFC control tests require an analysis of the aggregate percentage of direct and indirect control interests that a single Australian entity, or a group of five or fewer Australian entities (either alone or together with associates), holds in the foreign company.

It is a well-known issue that the "associate-inclusive" aspect of the control tests can result in a foreign company being a CFC for Australian tax purposes although most of or all of the shares in the foreign company are directly or indirectly owned by non-Australian companies. This is best illustrated by Example 1.

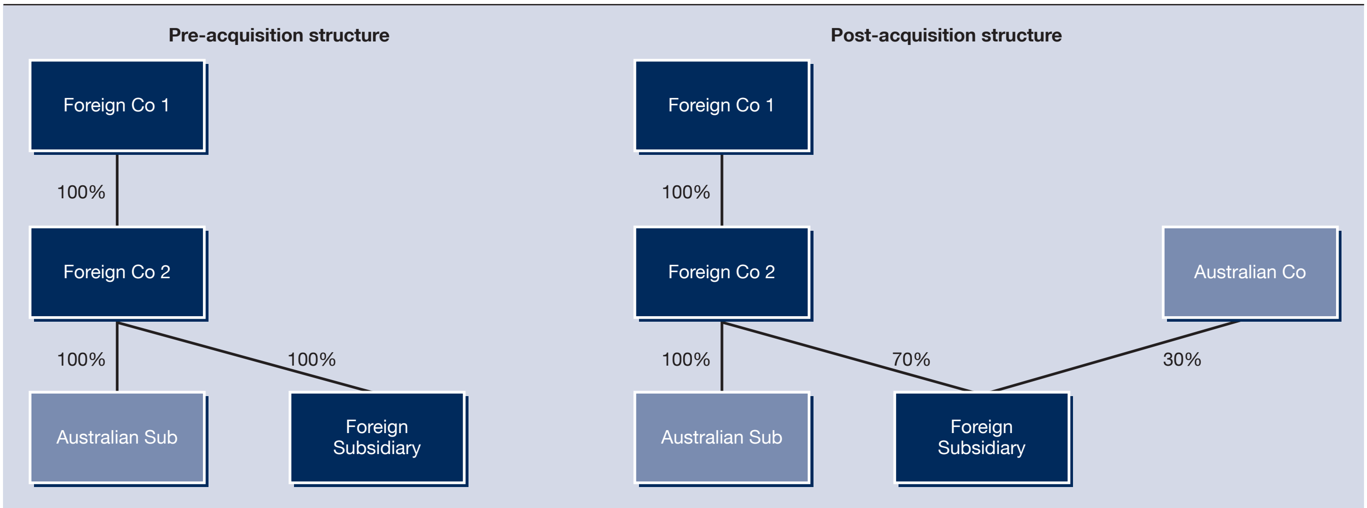
Example 1

Assume that a foreign resident company (Foreign Co 1) owns 100% of the shares in another foreign resident company (Foreign Co 2). Foreign Co 2 in turn owns 100% of the shares in an Australian company (Australian Sub) and a foreign company that is resident in an unlisted country (Foreign Subsidiary). On 1 June 2020, an Australian company (Australian Co) acquired a 30% interest in Foreign Subsidiary from Foreign Co 2 (see Diagram 1).

Prior to the acquisition by Australian Co, Foreign Subsidiary should have already been a CFC under the assumed controller test. This is because Foreign Co 2 is an associate of an Australian company (being Australian Sub) and it held 100% of the direct interest in Foreign Subsidiary prior to the acquisition. As a result, Australian Sub's total associate-inclusive control interests in Foreign Subsidiary was 100%. However, as no Australian entity held any direct or indirect attribution interests in Foreign Subsidiary, the Australian CFC rules should not have resulted in any attribution of CFC income to any Australian entity in the pre-acquisition structure.

Post-acquisition by Australian Co, Foreign Subsidiary should continue to be a CFC as the total associate-inclusive control interests held by Australian Sub and Australian Co in Foreign Subsidiary is 100%. This is notwithstanding that the

Diagram 1. "Upward attribution" issue



majority of the interests in Foreign Subsidiary are held by a non-Australian tax resident entity.

Example 1 illustrates that, for an Australian shareholder to be able to determine whether its ownership of a foreign subsidiary constitutes an interest in a CFC in the first place, the Australian shareholder (being Australian Co in this case) may be required to have a certain level of knowledge of the group structure of the other shareholder of the foreign subsidiary (being Foreign Co 2). Where the other shareholder is part of a listed group, the Australian shareholder is likely to be able to obtain the relevant information on the other shareholder's group structure from publicly available information. However, this becomes a more difficult task where the foreign subsidiary is held by multiple other shareholders, or where the other shareholders are members of privately owned groups. In such circumstances, it may become necessary for the Australian shareholder to request that the other shareholders provide the information required to determine whether the foreign subsidiary is a CFC.

Attribution arises in respect of income for the entire acquisition year

An attributable taxpayer must have an attribution percentage (being the total of direct and indirect attribution interests) in the CFC before it will have any CFC attributable income included in its assessable income. It is important to note that attribution of CFC income only arises to each attributable taxpayer which has an attribution percentage in the CFC *at the end* of the substituted accounting period (SAP) of the CFC. However, the attributable income of the CFC itself is calculated in respect of the whole SAP, which is generally a 12-month period ending 30 June unless the company has made an election for the SAP to end on a day other than 30 June due to reasons specified in the legislation, or if the company ceases to exist before the end of the SAP.

As such, an Australian entity which acquires an interest in a foreign company (that is a CFC) during an income year should be mindful that it may be required to include its share of the CFC attributable income *for the whole SAP* in its Australian assessable income. This is notwithstanding that it only acquired the interest in the CFC during the income year or even a day before the end of the SAP. Similar consideration equally applies to an Australian entity which increases its ownership percentage in a CFC during an SAP.

In Example 1, if it is assumed that Foreign Subsidiary's SAP for Australian CFC purposes ends on each 30 June, Australian Co (which acquired an interest in Foreign Subsidiary on 1 June 2020 and continued to hold such interest on 30 June 2020) would be required to include its share of the CFC attributable income of Foreign Subsidiary for the whole of the 30 June 2020 SAP in its Australian assessable income. This is irrespective of the fact that it only acquired the interest in the CFC on 1 June 2020 and may not eventually receive any distribution of the profits generated by the CFC prior to its acquisition.

Certain exclusion may, however, be available for capital gains realised in relation to a CGT event which occurred before the CFC's "commencing day". This is discussed further below.

Pre-acquisition dividends may not be excluded from the CFC attributable income

Broadly, the CFC rules provide that, if a CFC paid an interim dividend to an attributable taxpayer out of its attributable income for that SAP and the whole or part of the dividend was included in the assessable income of the attributable taxpayer, the attributable income of the CFC for that SAP in relation to that particular attributable taxpayer should be reduced by an amount equal to the whole or part of the "grossed-up assessable component" of the dividend. For this purpose, the "grossed-up assessable component" in relation to the whole or part of the dividend which is included in the assessable income of the attributable taxpayer is defined as the whole or the part divided by the attributable taxpayer's attribution percentage for the CFC *at the time of payment of the dividend.*

The definition of the "grossed-up assessable component" suggests that the CFC attributable income in respect of an attributable taxpayer should only be reduced by the interim dividend paid by the CFC if that attributable taxpayer was also the ultimate recipient of the interim dividend. In circumstances where there have been no changes in the ownership of the CFC throughout the income year, the above discussed rule should apply to prevent the double taxation of the relevant interim dividend. However, such protection may not be available in circumstances where an Australian taxpayer acquired an interest in a CFC during an SAP and the CFC has made a pre-sale dividend out of its attributable income to its previous owner(s). In such a scenario, because the pre-sale dividend was neither received nor included in the assessable income of the new Australian shareholder, the Australian shareholder's share of the CFC attributable income for that SAP should not be reduced by the pre-sale dividend.

In Example 1, assume that Foreign Subsidiary's total CFC attributable income for the 30 June 2020 SAP is $100,000. During the 30 June 2020 SAP but prior to the acquisition of the 30% interest by Australian Co, Foreign Subsidiary distributed $60,000 out of the pre-acquisition attributable income to Foreign Co 2 as an interim dividend.

As none of the of the $60,000 pre-sale dividend is included in Australian Co's assessable income, Australian Co's share of the CFC attributable income (ie $100,000 × 30% = $30,000) for the 30 June 2020 SAP should not be reduced by any portion of the $60,000 pre-sale dividend. Therefore, Australian Co would be taxed on the $30,000 of CFC attributable income for the year ended 30 June 2020, although the amount includes $18,000 (ie 30% × $60,000) of pre-acquisition attributable income which had been distributed to Foreign Co 2 and in respect of which Australian Co would never receive.

Functional currency election may not be available for the acquisition year

The calculation of the CFC attributable income to be included in an attributable taxpayer's assessable income is prima facie undertaken in Australian dollars. This generally involves the translation of individual income items derived and expenses incurred by the CFC from the foreign currency into Australian dollars using the relevant exchange rates as prescribed by the tax legislation. Any foreign exchange gains or losses in respect of the CFC's non-Australian dollar rights and obligations will also need to be calculated. As a result, the settlement of any of the CFC's non-Australian dollar rights and obligations which does not give rise to any foreign exchange gains or losses for its accounting purposes, may in fact give rise to foreign exchange gains or losses for the purposes of calculating its CFC attributable income.

To avoid the additional layer of complexity involved in the foreign currency translation process, an attributable taxpayer of a CFC may make a functional currency election which has the effect of the attributable income of the CFC being calculated in the applicable functional currency. However, such functional currency election would only be applicable from the start of the SAP in which the election was made if the relevant attributable taxpayer made the choice within 90 days after the beginning of the SAP. Otherwise, the foreign currency election should only be effective from the start of the SAP following the one in which the choice was made.

On this basis, an Australian entity which acquired an interest in a CFC and became an attributable taxpayer more than 90 days after the beginning of the CFC's SAP would not be able to make a valid functional currency election for the SAP in which the acquisition occurred. The Australian entity would be required to calculate the CFC attributable income for the acquisition year in Australian dollars and could only make a valid functional currency election effective from the start of the following SAP.

Disregard any CGT events that occur before the "commencing day"

The CFC rules provide that any CGT events involving a CFC, which occurred before the end of the commencing day, are disregarded for the purposes of calculating the attributable income of the CFC if the CFC commencing day is after 30 June 1995. A CFC commencing day is defined as the later of 30 June 1990 and the last day of the most recent CFC period during which there was not an attributable taxpayer with an attribution percentage of greater than nil.

In Example 1, the commencing day of Foreign Subsidiary should be 1 June 2020. This is because, even though Foreign Subsidiary was already a CFC prior to 1 June 2020, there was no attributable taxpayer with an attribution percentage of greater than nil prior to 1 June 2020. Therefore, in this case, if Foreign Subsidiary made a capital gain in relation to the disposal of "tainted assets" prior to 1 June 2020, the CFC rules should operate to exclude such capital gain from the calculation of Foreign Subsidiary's CFC attributable income for the 30 June 2020 SAP. The outcome would, however, be different if there was already an attributable taxpayer with an attribution percentage of greater than nil at the time Australian Co became an attributable taxpayer in respect of Foreign Subsidiary.

Example 2

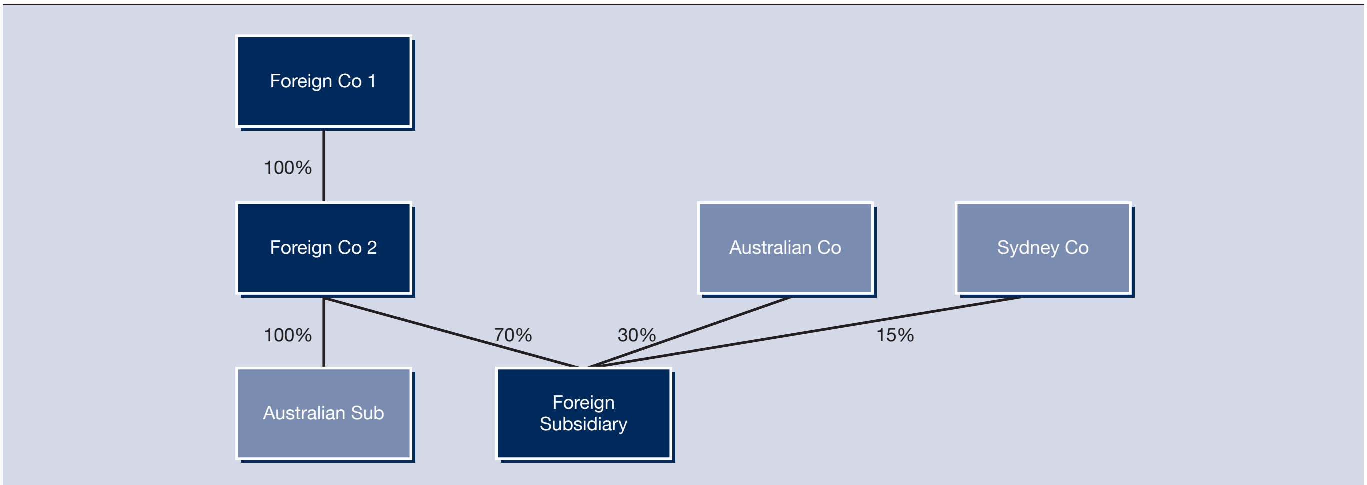
Following on from the facts of Example 1, another Australian resident company (Sydney Co) acquired Foreign Co 2's 15% interest in Foreign Subsidiary on 15 June 2020. As Foreign Subsidiary already had an attributable taxpayer with an attribution percentage of nil (ie Australian Co) at the time Sydney Co became an attributable taxpayer in Foreign Subsidiary, Foreign Subsidiary's commencing day continues to be 1 June 2020 (see Diagram 2).

Accordingly, if a CGT event occurred in respect of a tainted asset owned by Foreign Subsidiary during the period from 1 June 2020 to 14 June 2020, such a CGT event should not be disregarded for the purposes of calculating Sydney Co's share of the CFC attributable income of Foreign Subsidiary. Any capital gain realised from that CGT event should continue to be included in the calculation.

Example 3

If, on the other hand, following on from the facts of Example 1, Australian Co disposed of its 30% interest in Foreign Subsidiary back to Foreign Co 2 on 30 June 2020, and Sydney Co acquired the 15% interest in Foreign Subsidiary from Foreign Co 2 on 15 July 2020, Foreign Subsidiary's commencing day for the purposes of calculating Sydney Co's share of the CFC attributable income should be 15 July 2020. This is because the definition of

Diagram 2. Commencing day example



"commmencing day" effectively ignores the earlier period during which Foreign Subsidiary had an attributable taxpayer with an attribution percentage of greater than nil (ie Australian Co's ownership period in Foreign Subsidiary).

Check the "cost base" of your "commencing day asset"

A "commencing day asset" is defined as a CGT asset (other than taxable Australian property) that is owned by the CFC at the end of its commencing day.

The CGT cost base of a "commencing day asset" is modified by ss 411 to 413 ITAA36 for the purposes of calculating the attributable income of a CFC. Broadly, the adjustments are as follows:

– the commencing day asset is taken to have been acquired by the CFC on the commencing day;
– the first element of the cost base of each commencing day asset is the greater of the asset's market value at the end of the CFC's commencing day and the asset's cost base on that day; and
– the first element of the reduced cost base of each commencing day asset is the lesser of the asset's market value at the end of the CFC's commencing day and the asset's cost base on that day.

The modifications to the cost base of the commencing day assets mean that any unrealised gain or loss accumulated on a commencing day asset prior to the commencing day should be disregarded. This provides some recognition that such unrealised gain or loss should not be attributed to the attributable taxpayer as they have not economically derived such gain or suffered such loss. However, no similar recognition appears to be afforded for the purposes of calculating the capital allowances or balancing adjustment amounts for Div 40 and Div 43 ITAA97 assets. The cost of Div 40 and Div 43 assets for the purposes calculating the tax depreciation amounts appears to revert to the historic cost base of the assets in the hands of the CFC.

The CFC rules, however, provide for some modifications where a CFC has held a property during an SAP where there was no requirement to calculate attributable income in relation to an attributable taxpayer or there was such a requirement but a notional allowable deduction was not claimed in the calculation (non-attributable income period). In these circumstances, the Commissioner has the power to take into account the holding of the property during the non-attributable income period in order to make a determination of the amount of the notional allowable deduction (eg tax depreciation) or notional assessable income (eg balancing adjustment gain).

Conclusion

As discussed above, the Australian CFC rules may give rise to unexpected and uneconomic outcomes to Australian taxpayers that acquired interests in a foreign company during an income year and became attributable taxpayers other than at the start of the SAP of a CFC. If left unmanaged, such outcomes may result in significant economic loss to Australian taxpayers, particularly where the foreign companies are expected to have significant attributable income during the acquisition year.

Accordingly, when undertaking the tax due diligence and structuring exercise with respect to the acquisition, Australian taxpayers must ensure that they perform an analysis of the possible Australian income tax consequences under the Australian CFC rules. Depending on the relevant circumstances of the acquisition, Australian taxpayers may wish to consider whether it is appropriate and/or possible to shift, to the seller, the financial burden in respect of the Australian income tax liability on the CFC attributable income that relates to the pre-acquisition period.

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A Matter of Trusts

by Caitlin Coyne, Sladen Legal

Life interest trusts and their use among blended families

Life interest trusts are a popular strategy for blended families in estate planning, but it is important to remember that there's no one-size-fits-all.

What is a blended family?

A blended family in relation to estate planning is one in which a testator or the spouse of the testator has been involved in a previous relationship and a child or children has been born of that relationship.

Examples of blended families include:

- a husband and wife marry for the second (or subsequent) time, both have children from their first marriages and then they have two more children;
- a widow, with children, marries for a second (or subsequent) time and has another child with her new husband; and
- a husband and wife do not divorce, but the husband enters into a de facto relationship and has a child outside the marriage.

The problem

If a testator is currently married or in a de facto relationship and they have children from a prior relationship, their will and related succession planning can present a particular challenge.

If the testator and the spouse of the testator are independently wealthy, there may be no problem in each of them leaving their assets to their respective children and leaving nothing to the surviving spouse — the surviving spouse should have sufficient assets to provide for themselves during their lifetime. However, if the spouse of the testator does not have the wealth or assets to live comfortably after the passing of the testator, the testator may have an obligation to make proper and adequate provision from their estate for their surviving spouse.

Not surprisingly, a large portion of family provision applications arise from situations where there are competing claims between the surviving spouse and the testator's children from a previous relationship.

The strategy

One popular strategy for use in a blended family situation is where the testator provides a life interest in the estate for the surviving spouse, with the children from the first relationship being the remainder beneficiaries. The trust has the effect of providing all beneficiaries with a benefit, even if the interests of the children are delayed. It has even been described as an "orthodox solution".[1]

A life interest trust can be established over the whole of the testator's estate or over part of the estate.

Often, a life interest is created over the principal place of residence of the testator to ensure that the testator can provide a place for the surviving spouse to live for their lifetime. Then, on the death of the spouse, the property is usually distributed among the testator's children.

Considerations

When drafting and administering life interest trusts, it is important that the testator carefully consider appropriate terms in relation to the operation of the life interest trust, including but not limited to the following:

- the payment of expenses and outgoings;
- the risk of family provision claims;
- providing for appropriate substitute accommodation; and
- the choice of trustee of a life interest trust.

Payment of expenses and outgoings

While the surviving spouse may occupy the principal residence, the terms in relation to the operation of the life interest trust should aim to address issues in relation to the payment of any expenses and outgoings, such as who has the obligation to insure the property and to pay for any required maintenance and upkeep of the property, and whether the surviving spouse can rent out the property and receive any rental income.

If the costs are to be borne by either the estate or the surviving spouse, consideration must be given as to where the funds may come from — particularly in circumstances where the surviving spouse may not have the financial means to do so, and if they fail to meet those expenses, whether or not that would terminate their right to occupy the property under the terms of the trust.[2]

An advantage of creating a life interest over the principal place of residence under s 118-195 of the *Income Tax Assessment Act 1997* (Cth) is that it can ensure that the property of the testator will continue to be exempt from capital gains tax while the surviving spouse occupies it as their principal residence.

Risk of family provision claims

As always, the risk of family provision claims should be considered. This can include considerations in relation to the financial needs and position of both the surviving spouse and the children of the testator, as well as their respective ages.

A family provision claim from children of the testator may be encouraged where they have little to no opportunity to enjoy their inheritance. This may be applicable where the children and surviving spouse are close in age.

In family provision claims, where an older surviving spouse feels that they have not been adequately provided for by the testator's will, an order from the court for provision to be made by way of portable life interest is often referred to as a "Crisp order".[3]

A Crisp order gets its name from the decision of Holland J in *Crisp v Burns Philp Trustee Co Ltd*.[4] It is often made by judges in circumstances whereby the applicant is an older surviving spouse of the deceased to ensure that they are given sufficient provision without unfairly prejudicing other beneficiaries who may have competing claims (such as the children of the deceased from their relationship with their former spouse). Ipp JA in *Milillo v Konnecke* stated:[5]

> "… a *Crisp* order may entitle a plaintiff, from time to time, to require the executor of a will to sell a home devised by the will, or otherwise owned by the estate, and to use the proceeds for purposes that may include purchasing another home for the plaintiff's use and occupation, or providing accommodation for the plaintiff in a retirement village or similar institution, or in like accommodation providing hospitalisation and nursing care. The flexibility provided by such an order underlies the notion that a *Crisp* order confers a 'portable life interest'."

Providing for appropriate substitute accommodation

Life interest trusts are often criticised by the courts because they do not provide flexibility to deal with the changing needs of a surviving spouse during their lifetime. When drafting the terms of a life interest trust, it is important to take into consideration that the needs of a surviving spouse change over time. It may be that, as the surviving spouse ages, there is a need for a more appropriate type of substitute accommodation, either in a retirement village or similar aged care facility, such as a nursing home.

Wide powers and flexibility should be given to the trustee, for example, the power to sell assets of the trust and use the proceeds of such sale to provide the surviving spouse with appropriate substitute accommodation. The terms of the trust should be explicit about the trustee's ability to advance capital, enter into loan arrangements, and cover any other associated costs of appropriate substitute accommodation.

The choice of trustee of a life interest trust

Another consideration that the testator should address is who will be the trustee of the life interest trust.

Often, there is animosity between the surviving spouse of the testator and the children of the testator who are the remainder beneficiaries of the trust. Appointing either of those parties as the trustee is fraught with difficulties as their interests and use of the capital and income of the trust generally would not align.

The role of the trustee of a life interest trust will be onerous and possibly undesirable and could expose the trustee to claims where a party believes that the trustee provided an unfair benefit to the other party.[6] The choice will be critical and care should be taken in choosing such an appointment.

Conclusion

Some of the problems which can arise with life interest trusts (including the payment of outgoings, changing accommodation needs, and the role of the trustee) can be alleviated with careful drafting of the will. However, addressing blended family issues in a will may not necessarily be the only way to approach the situation of competing interests.

Ideally, a testator should be proactive in their estate planning strategies. The testator should give careful consideration as to whether there are any strategies which could be adopted during their lifetime to minimise the risk of claim or impact of a claim as opposed to dealing with assets via their will. These may include entering into arrangements, transferring ownership or disposing of assets during their lifetime. There are various strategies which can be adopted, each unique to a testator's individual circumstances — the important thing is to find the best fit.

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6 *Re Mulligan (dec'd)* [1998] 1 NZLR 481

Superannuation

by Daniel Butler, CTA, DBA Lawyers

What ATO publications can be relied on?

Generally, the ATO feels bound by its published material from an administrative viewpoint. However, only certain publications bind the ATO.

The ATO is a large bureaucracy and produces a lot of guidance material. Thus, it is important that advisers and taxpayers understand the range of material (or products) published by the ATO and the level of protection that each provides.

Generally, the ATO feels bound by its published material from an administrative viewpoint. However, only certain publications bind the ATO, for example, a tax ruling is generally binding on the ATO. While the ATO generally feels bound to follow its own written materials, in the event that the ATO is wrong, the tax remains payable but penalties may be remitted.

Only certain documents provide a "precedential ATO view". This is the ATO's documented view about the application of any of the law administered by the ATO in relation to a particular interpretative issue. The ATO has precedential views to ensure that its decisions on interpretative issues are accurate and consistent. PS LA 2003/3 states that precedential ATO views are set out in the following documents:

- public rulings (including draft public rulings);
- interpretative decisions;
- decision impact statements; and
- documents listed in the schedule of documents containing precedential ATO views (attached to PS LA 2003/3).

The main types of ATO publications are discussed below and a handy summary is provided in Table 1.[1]

Public rulings

Public rulings are binding advice that express the ATO's interpretation of the law. The ATO publishes different types of public rulings, including:

- taxation rulings (TRs);
- taxation determinations (TDs) (short-form rulings);
- GST rulings (GSTRs);
- miscellaneous taxation rulings (MTs);
- superannuation guarantee rulings (SGRs);
- class rulings (CRs); and
- product rulings (PRs).

Where a taxpayer follows a public, private or oral ruling that applies to them, the ATO is bound to assess them as set out in the ruling. If the correct application of the law is less favourable to a taxpayer than the ruling provides, the ruling protects the taxpayer from the law being applied by the ATO in that less favourable way.

A public ruling usually applies to both past and future years and protects a taxpayer from the date of its application, which is usually the date of effect of the relevant legislative provision. In addition, a public ruling that is withdrawn continues to apply to schemes that had begun to be carried out before the withdrawal.

TR 2006/10 is an ATO public ruling that provides details on the protection offered by public rulings etc.

The ATO's "advice under development program" tracks the development of rulings, determinations and significant addenda, including topics that have been added or withdrawn, and rulings and determinations that have been finalised.

Administratively binding advice

Some laws that the ATO administers do not enable it to provide advice in a legally binding form. But, in the interest of assisting taxpayers, the ATO provides administratively binding advice in limited circumstances.

The ATO considers that it is administratively bound by its advice and an early engagement (for advice) request can lodged with the ATO to discuss the matter before applying for such advice.

Generally, the ATO stands by its advice and will not depart from it unless:

- there have been legislative changes since the advice was given;
- a tribunal or court decision has affected the ATO's interpretation of the law since the advice was given; or
- the advice is no longer appropriate for other reasons.

If a taxpayer follows the advice and the ATO later finds out that it does not apply the law correctly to them (and none of the points above apply), the taxpayer will be protected from having to repay amounts of tax that would otherwise be payable, and any penalties and interest on those amounts.

Application for administratively binding advice is via a private ruling application form.

Private binding rulings

A private binding ruling (PBR) on a tax query is binding on the ATO. Note that this is the information provided at the start of most PBRs:

- you cannot rely on the rulings in the register of PBRs in relation to your tax affairs. You can only rely on a private ruling that the ATO has given to the particular taxpayer or to someone acting on their behalf;
- the register of PBRs is a public record of edited private rulings issued by the ATO. The register is a historical

record of rulings which is not updated to reflect changes in the law or ATO policies; and
– the rulings in the register have been edited and may not contain all of the factual details relevant to each decision. Do not use the register to predict ATO policy or decisions.

The ATO aims to provide a private ruling within 28 calendar days of receiving all of the necessary information. If the request is complex, the ATO may seek further time. If the ATO has not made a private ruling within 60 days of receiving all of the necessary information, a taxpayer may request a ruling to be made. The ATO has 30 days from such a written request to either provide the private ruling or to decline to rule on the matter.

As noted above, a PBR only provides protection to the particular taxpayer who requests the PBR. Thus, the register of PBRs does not provide any protection to anyone else who may seek to rely on another taxpayer's PBR.

An example of where this has proved to be risky is with a number of self-managed superannuation funds that relied on favourable PBRs issued to other taxpayers on a nil interest limited recourse borrowing arrangement (LRBA) from a related party. Note that, following several PBRs issued by the ATO in FY2014, numerous other SMSFs entered into similar no or low interest LRBAs without a PBR, and these SMSF trustees were exposed to significant tax risks.

The ATO issued PCG 2016/5 in April 2016 which stated that SMSFs with non-arm's length LRBAs that did not bring them in compliance with arm's length terms prior to 31 January 2017 would be subject to non-arm's length income. Fortunately, these SMSFs did not suffer additional tax or penalties for relying on a strategy that had been covered in other taxpayers' PBRs as there was other ATO material that suggested this activity may have been acceptable. In contrast, there have been other situations where taxpayers have suffered extra tax and penalties for relying on another taxpayer's PBR which did not provide any protection to them.

Taxation determinations

A taxation determination provides similar protection to a public ruling. By way of example, the protection provided by a taxation determination, as described in TD 2013/22, follows:

> "**This publication provides you with the following level of protection:**
>
> This publication (excluding appendixes) is a public ruling for the purposes of the Taxation Administration Act 1953.
>
> A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.
>
> If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you — provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you."

Interpretative decisions

An interpretative decision is a summary of a decision on an interpretative issue and is indicative of the ATO's view on the interpretation of the law on that particular issue. Interpretative decisions are produced to assist ATO officers to apply the law consistently and accurately to particular factual situations. They set out the precedential ATO view that applies when resolving an interpretative issue. An interpretative decision therefore differs from a taxation ruling or taxation determination.

The following is an example of the level of protection provided by ID 2015/10:

> "**This ATO ID provides you with the following level of protection:**
>
> If you reasonably apply this decision in good faith to your own circumstances (which are not materially different from those described in the decision), and the decision is later found to be incorrect you will not be liable to pay any penalty or interest. However, you will be required to pay any underpaid tax (or repay any over-claimed credit, grant or benefit), provided the time limits under the law allow it. If you do intend to apply this decision to your own circumstances, you will need to ensure that the relevant provisions referred to in the decision have not been amended or repealed. You may wish to obtain further advice from the Tax Office or from a professional adviser."

Law administration practice statements

A law administration practice statement provides direction and assistance to ATO staff on the approach to be taken when performing duties involving the application of the laws administered by the Commissioner. They are published to promote open administration and to inform taxpayers what to expect. For more information, see PS LA 1998/1.

Practical compliance guidelines

Practical compliance guidelines provide broad law administration guidance, addressing the practical implications of tax laws and outlining the ATO's administrative approach. For example, they might set out:

– how the ATO assesses tax compliance risk across a range of activities or arrangements in relation to a certain area of the law, ie where the ATO would consider an activity or arrangement low risk (unlikely to require scrutiny) and where the ATO might consider an activity or arrangement high risk (likely to attract scrutiny); or
– a practical compliance solution where tax laws are creating a heavy administrative or compliance burden, or where the tax law might be uncertain in its application.

Practical compliance guidelines can provide taxpayers with additional certainty and compliance savings, and they allow the ATO to direct its compliance resources to higher risk areas of the law.

From 2016, practical compliance guidelines have largely overtaken law administration practice statements as the appropriate communication product to provide broad law administration guidance to taxpayers.

Provided a taxpayer follows a practical compliance guideline, the ATO will administer the law in accordance with the approach reflected in that guideline. Practical compliance guidelines are not binding on the ATO and are used as safe harbours to provide an indication of how the ATO will apply its compliance resources. For example, PCG 2016/5 provides safe harbour terms for related party LRBAs that, if satisfied, will not result in the ATO applying resources to review and audit LRBAs prior to FY2016.

Note that a practical compliance guideline covering a matter where the ATO is not dedicating its compliance resources will not provide comfort to a taxpayer that is under ATO scrutiny in the normal course of the ATO's activities, eg a taxpayer who becomes subject to a typical ATO review or audit.

Law companion rulings

A law companion ruling (formerly known as a law companion guideline) provides the ATO view on how recently enacted law applies and is usually developed at the same time as the drafting of the Bill.

A law companion ruling will normally be published:

- in draft form for comment when the Bill is introduced into parliament and will be finalised soon after the Bill receives royal assent. It provides early certainty in relation to the application of the new law; or
- where taxpayers need to take additional action to comply with the law, to provide certainty about what needs to be done.

A law companion ruling will not usually be issued where the new law is straightforward, is limited in its application, or does not relate to an obligation to pay tax, penalties or interest. For example, the ATO issued LCR 2019/D3 in relation to the 2019 amendment to the *Income Tax Assessment Act 1997* (Cth) on non-arm's length income and expenditure incurred under a non-arm's length arrangement.

A law companion ruling will usually be finalised as a public ruling at the time the Bill receives royal assent and becomes law, unless issues arise during consultation or the Bill is significantly amended in the Bill's passage through parliament.

Because law companion rulings are prepared at such an early time, they will not be informed by experience of the new law operating in practice. Therefore, while they offer the same protection in relation to underpaid tax, penalties or interest as a normal public ruling, this will only apply if a taxpayer relies on a law companion ruling in good faith.

LCR 2015/1 covers the purpose, nature and role in the ATO's public advice and guidance.

SMSF-specific advice

The ATO, as the regulator of SMSFs, has no power to make a binding ruling in relation to a *Superannuation Industry (Supervision) Act 1993* (Cth) (SISA) or a *Superannuation Industry (Supervision) Regulations 1994* (Cth) (SISR) question. Typically, SMSF-specific advice is sought in relation to how the superannuation law applies to a particular transaction or arrangement for the following topics:

- investment rules, including:
  - the acquisition of assets from related parties;
  - borrowing and charges;
  - in-house assets; and
  - business real property;
- in specie contributions/payments; and
- the payment of benefits under a condition of release.

In certain cases, if taxpayers request a private binding ruling and SMSF-specific advice, the ATO generally asks that these be separated into different requests. However, the author has noticed that the ATO has combined these two forms of guidance in a number of private binding rulings with the ATO expressly setting out where the private binding ruling starts and finishes and, similarly, where the SMSF-specific advice starts and finishes so there is no confusion as to what part is binding (as the private binding ruling) and what part is not binding (as the SMSF-specific advice) on the ATO.

Taxpayer alerts

Taxpayer alerts are intended to be an early warning of the ATO's concerns about significant and emerging potential aggressive tax planning issues or arrangements that the ATO has under risk assessment. Moreover, the ATO usually develops its views more comprehensively following the issue of a taxpayer alert on a topic and prior taxpayer alerts can be superseded shortly after being issued.

The comment at the beginning of a taxpayer alert is:

> "Taxpayer Alerts are intended to be an early warning of our concerns about significant or emerging higher risk planning issues or arrangements that the ATO has under risk assessment, or where there are recurrences of arrangements that have been previously risk assessed."

Decision impact statements

Decision impact statements are succinct statements of the ATO's response to significant cases decided by the courts or tribunals. They provide the details of the case, including the implications of the decision and whether any ATO rulings, interpretative decisions etc need to be amended.

Invariably, the ATO seeks to distinguish a decision based on the facts and circumstances of the case where the ATO does not succeed. For example, the decision impact statement on *Greig v FCT* states:[2]

> "The Commissioner considers that this case does not change the principle in *Myer Emporium* and, in particular, does not disturb the Commissioner's understanding of the factors that will be relevant in determining whether an acquisition of shares is made in carrying out a 'business operation or commercial transaction'."

Superannuation circulars

Superannuation circulars explain the various legislative requirements which apply to the operation of SMSFs under the SISA and the SISR. For example, a popular circular was Superannuation Circular 2003/1 providing guidance on the valuation of assets for SMSFs. However, this circular was recently replaced.[3]

SMSF regulatory bulletins

Self-managed superannuation fund regulator's bulletins outline the ATO's concerns about new and emerging arrangements that pose potential risks to SMSF trustees and their members from a superannuation regulatory and/or income tax perspective.

These bulletins are specifically designed for the SMSF sector. The ATO's aim is to share its concerns early to help people make informed decisions about their SMSF. Each bulletin has the following guide on its protection:

> "**Relying on this Bulletin**
>
> To the extent that this Bulletin provides guidance to you, and you apply it in good faith to your own circumstances, the Commissioner will administer the law in accordance with the guidance outlined in this Bulletin."

For example, SMSFRB 2020/1 examines the ATO's position on SMSFs and property development and the common mistakes that arise in these types of arrangements.

ATO website and fact sheets

The ATO website and fact sheets can be useful but cannot be relied on as binding on the Commissioner in a legal sense. The general administrative practice is that the ATO feels bound to follow its own written materials but, in the event that the ATO is wrong, the tax is still generally payable but penalties may be reduced or may not be imposed.

PS LA 2008/3 explains that, in the interests of sound administration, the ATO's practice has been to provide administratively binding advice in a limited range of circumstances. For example, the ATO provides administratively binding advice on matters under the *Superannuation Guarantee (Administration) Act 1992* (Cth) (SGAA). There is no legislative framework for the provision of public, private or oral advice in relation to matters under the SGAA.

Media releases and speeches

Media releases are brief announcements used to deliver ATO messages on newsworthy topics and to communicate the ATO's intentions in relation to certain issues. A media release reflects the ATO's position at the time of its publication which may subsequently be updated.

Speeches by senior ATO officers reflect the ATO's thinking on particular issues and are published for transparency reasons.

Oral rulings for individuals

An oral ruling is a form of legally binding advice that the ATO gives over the phone to individuals in relation to their specific circumstances, typically in relation to personal income tax or Medicare levy queries.

If an individual relies on an oral ruling, the ATO is bound to assess its liability in accordance with the oral ruling.

If the oral ruling is incorrect and disadvantages an individual, the ATO may apply the law in a way that is more favourable to that person provided there is no time limit in doing so.

Tailored technical assistance

The ATO provides tailored technical assistance in some circumstances, orally or in writing, depending on the nature and complexity of the query. For example:

- a taxpayer may seek tailored technical assistance if they are not able to find an ATO view of how the law applies to a particular technical issue;
- if a taxpayer is not certain how the ATO view of the law applies to their circumstances; or
- if a taxpayer is seeking greater certainty (protection) than what ATO published products provide.

Typically, this is best managed by a tax agent or a tax expert.

Summary of ATO materials

There is a vast array of information issued by the ATO. Advisers should be aware of each type of product and understand how it applies to taxpayers. In particular, different levels of protection apply to taxpayers relying on ATO materials. Table 1 provides a summary of the numerous ATO products.

Daniel Butler, CTA
Director
DBA Lawyers

Table 1. Summary of ATO products

Product	Binding on ATO	Comments
Public ruling	Yes	Issued by the ATO for all taxpayers to rely on
Administratively binding advice	No	Designed to assist taxpayers
Private binding ruling (PBR)	Yes	Issued for a specific taxpayer and a register of PBRs is available. A taxpayer cannot rely on another's PBR.
Taxation determination (TD)	Yes	Similar to a public ruling
Interpretative decision (ID)	No	ATO view on a technical issue
Law administration practice statement (PS LA)	No	Practical guidance to ATO staff
Practical compliance guideline (PCG)	No	Practical guidance to taxpayers
Law companion ruling (LCR)	Yes	Practical guidance on new laws
SMSF-specific advice	No	ATO advice on SISA and SISR queries

cont …

Table 1. Summary of ATO products (cont)

Product	Binding on ATO	Comments
Taxpayer alert (TA)	No	ATO warnings of new or emerging aggressive tax planning concerns
Decision impact statement (DIS)	No	Succinct statements of the ATO's response to significant cases decided by the courts or tribunals
Superannuation circular	No	Explains the legislative requirements that apply to SMSFs under the SISA and the SISR
SMSF regulator's bulletin	No	Explains the ATO's regulatory and/or income tax concerns about risks to SMSFs from new or emerging arrangements
ATO fact sheet	No	Practical guidance on tax and superannuation matters
Media release/speech	No	Brief ATO announcements to the media on newsworthy topics; speeches published for transparency reasons
Oral ruling for individuals	Yes	Oral phone advice on personal income tax and Medicare levy queries for individuals
Tailored technical assistance	No	To provide an ATO view of how the law applies to a particular technical issue

References

1 This article was previously published in the May 2019 issue of *Taxation in Australia*; it has been significantly updated for the current issue of the journal.

2 [2020] FCAFC 25.

3 See Australian Taxation Office, *Valuation guidelines for self-managed super funds* (QC 26343). Available at www.ato.gov.au/Super/Self-managed-super-funds/In-detail/SMSF-resources/Valuation-guidelines-for-self-managed-super-funds.

Alternative Assets Insights

by Stefan DeBellis, ATI, and Jess Fantin, PwC

Queensland land tax foreign surcharge: ex gratia relief

Foreign-owned entities holding Queensland freehold land should consider their eligibility for ex gratia relief from the land tax foreign surcharge to prevent their land tax bills from almost doubling.

The Queensland Government has recently released Public Ruling LTA000.4.1, which sets out the guidelines for ex gratia relief from the Queensland land tax foreign surcharge (the guidelines).

The guidelines, which are similar to those adopted by the Victorian State Revenue Office, include the details of the eligibility criteria for determining the availability of relief, the application process and ongoing notification requirements. To be eligible for ex gratia relief, the following criteria must be satisfied:

- the foreign entity is Australian-based;
- the foreign entity has complied with all Foreign Investment Review Board (FIRB) requirements in relation to the acquisition of land for which ex gratia relief is sought (where applicable);
- the foreign entity meets its regulatory requirements, including compliance with Queensland taxation laws; and
- the foreign entity conducts commercial activities that make a significant contribution to the Queensland economy and community.

These requirements are considered in more detail below.

In detail

The land tax surcharge of 2% which applies to foreign corporations and trustees of foreign trusts (the surcharge) was announced as part of the Queensland Budget in June 2019, and was initially intended to take effect from 30 June 2019 but was subsequently delayed to 30 June 2020.

The surcharge generally applies to *all* freehold land owned by "foreign companies" or "foreign trusts" (as defined) that is not exempt from general land tax. This is different to the Queensland foreign stamp duty surcharge and New South Wales foreign land tax surcharge which only applies to "residential land".

In the absence of relief, it is expected that the surcharge will almost double the annual Queensland land tax costs of those affected.

It is important to note that even Australian incorporated or resident entities can be subject to the surcharge where they have direct or indirect foreign ownership. Further guidance on the definition of "foreign companies" and "foreign trusts" is available in Public Ruling LTA000.3.1.

Ex gratia relief

At the time the surcharge was announced, the Queensland Government noted that it was anticipated that ex gratia relief would be available in limited circumstances, with ex gratia guidelines to be prepared by the Queensland Office of State Revenue (QOSR) in consultation with industry bodies and released by 31 July 2019. However, following initial feedback and submissions from industry bodies and various stakeholders, the consultation process was extended and the release of the guidelines was delayed and only released in July 2020 in the form of Public Ruling LTA000.4.1.

The Queensland Government announced the waiver of the application of the surcharge for the 2019-20 land tax year as part of its COVID-19 land tax relief measures. Accordingly, the first application of the surcharge will be on land tax assessments for the 2020-21 land tax year (ie based on ownership of land as at 30 June 2020), which will begin to issue in October 2020.

Despite the significant lobbying efforts of the Property Council of Australia, unlike Victoria, the guidelines do not automatically exclude publicly listed entities and widely held trusts. Accordingly, these entities which are holding Queensland land will need to consider whether they constitute a "foreign company" or a "foreign trust" as at 30 June of each year and, if eligible, lodge an application for ex gratia relief. The Property Council has announced that it intends to continue to lobby the QOSR on this issue, so it is possible that these entities may be excluded from the surcharge in the future.

In addition, unlike other states, the surcharge will also apply to foreign-owned primary production land. This is due to unique provisions in Queensland which generally prevent the application of the primary production exemption from land tax in circumstances where foreign persons have a direct or an indirect interest in the land. As a result, foreign-owned primary producers with significant land holdings in Queensland could be required to pay annual land tax at a rate of up to 4.75% in Queensland, compared to no land tax in other states.

Criteria to be satisfied

The guidelines set out in detail the factors that the QOSR will consider when determining whether each of the individual eligibility criteria are met. The more of these factors that are established, the stronger the likelihood of demonstrating that the criteria will be met. Further details on each of the criteria are set out below.

Australian-based

The factors that the QOSR will consider when determining whether a foreign entity satisfies the condition of being "Australian-based" include, but are not limited to:

- the entity has a head office or principal place of business is in Australia;
- the entity has significant management staff and office presence in Australia;
- the entity employs Australian citizens or permanent residents;
- the entity carries on business in Australia;
- there is a considerable level of Australian participation in the entity (eg decisions relating to Queensland commercial activities are primarily made by management or employees in Australia); or
- the entity primarily contracts for services and materials of Australian contractors and suppliers for its commercial activities in Australia (ie 50% or more).

Commercial activities which make a significant contribution to the Queensland economy and community

The extent to which the foreign entity conducts commercial activities in Queensland, engages local labour and utilises local materials and services will be key considerations for the QOSR when determining whether the entity makes a "significant contribution" to the Queensland economy and community.

Importantly, when determining whether a foreign entity makes a significant contribution, where the foreign entity is wholly owned by a parent entity, the commercial activities of the parent entity and any entity that is 100% owned by the same parent entity may be considered. This acknowledges that it is common in corporate structures for the land ownership to be held separately from the commercial activities of the business.

Specifically, the QOSR will have regard to:

- the size of the entity's commercial activities relative to their landholdings;
- the number of local workers engaged (eg 75 or more full-time equivalent employees (not labour hire or contractors) in Queensland would generally be considered to make a significant contribution);
- the amount expended on local resources, such as materials and services (eg $20m annually, comprising Queensland payroll tax and land tax liabilities, expenditure on Queensland goods and services, and wages paid to Queensland residents, would generally be considered to make a significant contribution); and
- the extent of commercial activities in Queensland, particularly if the commercial activities are significant to the particular region and/or industry in which the activities are undertaken, having regard to factors specific to the context of the region and/or industry (eg less than 75 employees may be sufficient where the entity is a major employer in regional Queensland).

The examples set out above are taken from the guidelines. At this stage, it is anticipated that the figures of 75 employees and $20m of expenditure have been included as a guide only rather than minimum thresholds, and that each foreign entity will be considered on a case-by-case basis. However, it is expected that further clarification on the QOSR's practice will become available as it begins to consider applications.

Foreign property developers may also be considered as making a "significant contribution" while development activities are being undertaken. When considering whether the developer is making a significant contribution to the Queensland economy, the QOSR will consider the extent and duration of the development activities, and whether the development is being carried out on land that is in a priority development area or whether it is part of a coordinated project as declared under the relevant legislation.

Ex gratia relief may also be available for foreign entities that cannot demonstrate a significant contribution as at 30 June but have committed future commercial activities within the next 12 months which will result in a significant contribution to the Queensland economy (having regard to the factors set out above).

FIRB and other regulatory requirements

In addition to the above, the entity will also need to provide information showing that it has met its regulatory requirements, such as compliance with ASX listing rulings, ASIC requirements and Queensland taxation laws.

The QOSR will also consider compliance with FIRB requirements in respect of the acquisition of the relevant land, including ensuring that approval was obtained and that the entity complied with any conditions associated with the approval.

Application process and ongoing notification requirements

Where the QOSR determines that a foreign entity satisfies the conditions for ex gratia relief, relief will apply to all Queensland land owned by the foreign entity and the surcharge should not be payable in respect of this land. However, general land tax will still be required to be paid.

Once granted, ex gratia relief should continue to apply for as long as the foreign entity continues to satisfy the conditions for relief. However, unlike Victoria, the foreign entity will need to provide a statutory declaration on an annual basis confirming that the conditions will be met for that year.

Ex gratia relief is not automatic and an application must be made to the QOSR, either prospectively or retrospectively. Foreign taxpayers considering purchasing land will also be able to apply for in-principle approval that ex gratia relief will apply to certain land. Where in-principle pre-approval is granted, a further application for ex gratia approval will need to be made once the relevant liability for land tax arises.

The takeaway

Entities with foreign ownership and Queensland freehold land should seek to confirm whether the surcharge applies to them and, if so, consider whether they may be eligible for ex gratia relief having regard to the criteria set out in the guidelines.

Taxpayers which may be subject to the surcharge should have received letters from the QOSR in July and August last year, requesting them to declare their foreign status through an online portal. As taxpayers have a positive obligation to inform the QOSR if their land tax assessment is incorrect, it is important that taxpayers that fall within the surcharge provisions notify the QOSR if the surcharge is omitted from their 2020-21 land tax assessment. Failure to do so may result in the imposition of penalties and interest at a later date.

Although the issue of 2020-21 land tax assessments has been delayed to October 2020, potentially affected taxpayers should seek to lodge their applications for relief as soon as possible so as to obtain a determination prior to the due date of their land tax payment. This will assist in removing the administrative burden of paying the surcharge upfront and seeking a refund once relief has been granted. It will also provide developers and businesses with greater certainty and the ability to better manage cash flows.

As the surcharge will almost double the annual land tax payable by affected taxpayers, it is very important that potential taxpayers confirm the impact of the surcharge on their assets and their potential eligibility for ex gratia relief. The process of evaluating eligibility and applying for relief requires gathering and disseminating a large amount of information regarding the relevant land and business operations. It is important that this is presented to the QOSR in a way that is easy to understand, aligns with the relevant criteria, and is supported by as much documentary evidence as possible.

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Events Calendar

September/October 2020

EVENT	DATE	CPD
Online		
2020 National GST Intensive Online: Dealing with the director penalty regime for GST | Session 7 webinar	7/9/2020	1
2020 National GST Intensive Online: Build-to-rent – navigating GST & other tax issues | Session 8 webinar	7/9/2020	1
2020 National GST Intensive Online: Justified trust, streamline assurance reviews and risk frameworks from an indirect tax perspective | Session 9 webinar	7/9/2020	1
2020 National GST Intensive Online – Part 3 | Webinar and live Q&A	7/9/2020	3.75
Taxing Times Webinar Series – Part 6: Ensuring trust losses are available for later use	8/9/2020	1.5
2020 National Transfer Pricing Online – Part 1: The economic and transfer pricing impacts of COVID-19 on corporate Australia	8/9/2020	1
Tax Disputes Online Series – Part 3: ATO debt recovery practices during and post-COVID-19	9/9/2020	1
2020 National Transfer Pricing Online – Part 2: Transfer pricing aspects of cross-border transfers of intangibles	10/9/2020	1
2020 National Superannuation Online Conference	10/9/2020	8
2020 Property Online Series – Part 1: The state of property update in a COVID-19 and post-COVID-19 Australia	14/9/2020	1
2020 Young Tax Professionals – Part 4: Tax residency for individuals and corporates	14/9/2020	1.5
2020 National Transfer Pricing Online – Part 3: Cross-border financing arrangements – the release of long-awaited consensus guidance	15/9/2020	1
Tax Disputes Online Series – Part 4: Running a tax case	16/9/2020	1
2020 National Transfer Pricing Online – Part 4: Litigation: Glencore case and ATO's appeal	17/9/2020	1
States' Taxation Online Series – Part 6B: Payroll tax cases – "The big ones"	17/9/2020	1
2020 Property Online Series – Part 2: State taxes and COVID-19 emergency measures for property (NSW, Vic, Qld, SA and WA)	21/9/2020	1
2020 National Transfer Pricing Online – Part 5: What is the ATO thinking about/doing regarding transfer pricing and COVID-19	22/9/2020	1
Tax Disputes Online Series – Part 5: Conducting litigation & dispute resolution virtually	23/9/2020	1
2020 National Transfer Pricing Online – Part 6: Private groups – ATO ramps up review activity	24/9/2020	1
2020 Property Online Series – Part 3: Vacant land rules	28/9/2020	1
2020 National Transfer Pricing Online – Part 7: Tax challenges of digitalisation	29/9/2020	1.5
Tax Disputes Online Series – Part 6: Key observations in tax disputes	30/9/2020	1
2020 National Transfer Pricing Online – Part 8: Transfer pricing across the Tasman	1/10/2020	1
2020 National Transfer Pricing Online – Part 9: Expert evidence in transfer pricing cases	6/10/2020	1
October Morning Tax Club 2020 – Stimulus measures and ATP reviews and disputes	6/10/2020	1.5
2020 National Transfer Pricing Online – Part 10: Financial transactions from an Australian perspective	8/10/2020	1

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

Cumulative Index

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