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The Tax Institute

Taxation in Australia

Navigating potholes and sinkholes on "vacant" land
David Krunic, CTA

Australia's hybrid mismatch rules: current issues
Melanie Earl, CTA, and Melissa Gile

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Tax News – at a glance

by TaxCounsel Pty Ltd

November – what happened in tax?

The following points highlight important federal tax developments that occurred during November 2024. A selection of the developments is considered in more detail in the "Tax News – the details" column on page 241 (at the item number indicated).

Corporate tax crackdown

In a joint media release, the Treasurer and the Assistant Minister for Competition, Charities and Treasury stated that the government is delivering on its commitment to ensure that big corporations pay their fair share of tax with a new report revealing a record level of corporate tax receipts. **See item 1.**

Objection issues: IGOT report

On 30 October 2024, the final report of the Inspector-General of Taxation on the ATO's administration and management of objections was released. **See item 2.**

Corporate collective investment vehicle regime

The Commissioner has released a final law companion ruling in relation to the amendments that have been made to specify the tax treatment for corporate collective investment vehicles (LCR 2024/1). **See item 3.**

Restructures and the new thin capitalisation and debt deduction creation rules

The Commissioner has released a draft practical compliance guideline which primarily sets out the ATO's compliance approach to restructures carried out in response to the enactment of the amendments which strengthened the thin capitalisation rules in Div 820 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) and the debt deduction creation rules in Subdiv 820-EAA ITAA97 (PCG 2024/D3). **See item 4.**

GST: ATO update for public and multinational businesses

In a paper delivered on 24 October 2024 to The Tax Institute's National GST Conference, an ATO deputy commissioner (Public Groups) and an ATO senior director (Public Groups) has provided an overview of the progress that has been made since responsibility for GST compliance for large business moved to Public Groups five years ago. **See item 5.**

TPB: draft code guidance

The Tax Practitioners Board has released for consultation draft information sheets in relation to the new Code obligations that come into force on 1 July 2025 or, for larger firms with more than 100 staff, 1 January 2025. **See item 6.**

Land tax debt: company reinstated

In a recent decision on an application brought by the Western Australian Commissioner of State Revenue, the Western Australian Supreme Court (Hill J) has ordered that the registration of a company be reinstated and that the company be then wound up for the purpose of the recovery of land tax that was owing by the company (*Commissioner of State Revenue v Australian Securities and Investments Commission* [2024] WASC 392). **See item 7.**

Work-related car expenses

The AAT has upheld the Commissioner's decision which allowed the taxpayer only $5,258 of his claim of $14,607 for work-related car expenses for the 2017 income year (*Hudson and FCT* [2024] AATA 3678). **See item 8.**

New Second Commissioner

In a media release on 25 October 2024, the Assistant Treasurer announced that Mr David Allen was being appointed as a full-time Second Commissioner of Taxation for a seven-year period beginning on 1 November 2024.

Luxury car tax

A 3:2 majority of the High Court has allowed the taxpayer company's appeal in *Automotive Invest Pty Ltd v FCT* [2024] HCA 36. The decision turned on the way luxury car tax operated where the taxpayer held a number of luxury and collectable cars in a car museum to attract purchasers. The decision of the High Court is considered in the Tax Tips column of this issue of the journal. See page 246.

President's Report

by Todd Want, CTA

An Institute fit for the future

President Todd Want reflects on his year as President and how the Institute is evolving for the future.

At the beginning of this year, I wrote to you that I was excited to get back to the core of what we do at the Institute. That includes educating the tax profession, supporting our members, and amplifying their voices within the tax profession and the wider community.

Last month, we launched Tax Academy, a new standard of tax education in Australia. The Institute has long been known for providing high-quality, relevant and highly tailored tax education, not only through our structured education, but also through experiential learning. Our CPD events deliver some of the best tax technical content around and our member resources keep practitioners up to date and consistently adding to their toolbelts.

Tax Academy is our answer to the changing educational needs of the profession and the shifting and dynamic world of work and learning that we live in.

As part of the recent Tax Academy launch, we conducted a survey of our community, which found that 99% of all respondents felt continued, specialised learning was beneficial for their career in tax. Plus, 80% said they'd found themselves in a role that required them to upskill beyond their current education level. It's clear that the tax community values and needs accessible and effective learning options.

Our focus with Tax Academy is on making tax education practical for all, no matter their current education level, background or career aspirations. It also opens up education to a new generation of tax practitioners.

As President this year, I have had a distinct focus on readying the Institute to support the needs of this cohort of up-and-coming tax professionals. Whether they are coming to our profession from a career in an adjacent field or entering tax as a fresh graduate joining the workforce, theirs are the fresh perspectives and ideas that will enrich our profession for years to come. As an Institute, it's so important that we are able to offer them chances to grow and learn, and ways to become involved in their community.

Our members' voices are, as always, at the centre of our work. Scott speaks more in his report about responding to the needs of members, but I will say that, in my capacity as President, I have been continually impressed not only by the outcome of the Institute's member advocacy, but also the passion and dedication with which the team of staff and volunteers approach it.

Continual growth has been a theme, not only for our members in their careers, but for us as an organisation. From refinements in our organisational structure and governance processes, to new products like Tax Academy, we are constantly evolving to be future fit and to support our members.

I know that, personally, my career has flourished thanks in part to lifelong learning and strong ties to a professional community through the Institute. In my year as President, I'm grateful to have been able to contribute to leaving the ladder down for other professionals walking a similar career path.

I'm also grateful for the significant contributions our members, volunteers and team continue to make to ensure that the Institute prospers, both now and into the future. Without these tireless contributions, it wouldn't be possible for the Institute to deliver on its objectives and to play such a significant role in the tax community.

CEO's Report

by Scott Treatt, CTA

Members' voices heard and amplified

CEO Scott Treatt reflects on 2024 and putting members at the centre of the Institute.

My focus while making plans for 2024 was on ensuring that our members' voices are at the centre of the conversation – the centre of the tax conversation and the centre of the conversation regarding the Institute, our future and our priorities.

As a member organisation, "by members for members" is a guiding principle that I'm reminded of each time we embark on a new project or take stock of our direction. The fact that our volunteer presence has been as strong as ever throughout the year is a wonderful indication that we are putting this belief into practice every day.

Part of centring members is working to reflect member voices outside of the Institute. This year, changes impacting the regulation of the profession have been front of mind for many of us. Our advocates and volunteers have worked tirelessly not only to supply members with resources to help navigate the changes, but also to represent them in discussions with government and regulatory stakeholders.

We have spent many years building a reputation for reasonable, responsible and valuable input into consultative matters. We have a positive reputation for fairly representing our members' concerns, questions and ideas, always with a goal of finding appropriate solutions and outcomes for all involved. This year, through dealing with various advocacy matters, including the regulation of the profession, I feel confident that our representatives have proven themselves to be effective representatives and guardians of our member interests. I hope you feel the same.

Centring our members' voices also means listening to what they want from us as an educational body, which remains our core focus as an organisation. As Todd mentioned, Tax Academy, our new micro credential platform, launched to the public last month. As part of this process, we surveyed our community about the place that lifelong, specialised learning holds in their lives and careers.

I'm pleased to say that among those insights, we found Tax Academy was right on the money in terms of the resourcing that practitioners have available to them. Among respondents, 81% said they could devote one to four hours a week to continued learning. That means most of our community could complete a Tax Academy unit in just 2.5 to 10 weeks, based on the indicated study time of 10 hours per unit. At $375 + GST, Tax Academy units also fell well within budget for most learners, with 90% saying they would spend $251+ on learning in a year and 72% happy to spend more than $500.

One in five respondents said they'd be looking to change specialties in the next five years. That's a lot of professionals looking to upskill, learn about new topics, and explore new interests. As an Institution committed to tax learning in many different forms, we are proud to support these individuals as they move through their careers and continue learning in flexible and practical ways.

As we close out the calendar year, it is my hope that you have felt heard and supported as a member of the Institute. I will of course be back in February to tell you all about what we have planned for the new year, so stay tuned.

Tax Counsel's Report

Wrap of 2024

In this month's column, we reflect on some of the tax highlights from 2024. The status of each measure is current at the time of writing.

Individuals

Personal income tax cuts

Effective from 1 July 2024, income tax rates were reduced, with the 19% tax rate dropping to 16% and the 32.5% rate decreasing to 30%. Additionally, the 37% tax rate threshold was raised to $135,000 and the 45% tax rate threshold to $190,000.

Student loans

The Federal Budget 2024–25 proposed substantial changes to HELP loan repayments, including capping indexation to the lower of the Consumer Price Index or the Wage Price Index. The enabling Bill is before the Senate and is proposed to apply from 1 June 2023.

HELP repayments will shift to a marginal rate system starting 1 July 2025, pending the passage of enabling legislation. A one-off 20% reduction in outstanding balances before indexation is applied on 1 June 2025 has also recently been announced.

Small businesses

Instant asset write-off

A Bill before the Senate proposes to extend the temporary increase in the instant asset write-off threshold to $20,000 until 30 June 2025. Amendments moved by the Opposition in the Senate propose a permanent threshold of $30,000.

Denying deductions for GIC and SIC

The government announced that the general interest charge (GIC) and shortfall interest charge (SIC) will be non-deductible from 1 July 2025. Exposure draft legislation was released on 24 September 2024.

Bendel appeal on UPEs

In September 2023, the Administrative Appeals Tribunal (AAT) decided in favour of the taxpayer in *Bendel and FCT*,[1] rejecting the ATO's position that approximately $1.5m in unpaid present entitlements (UPEs) of a private company should be treated as loans under Div 7A of Pt III of the *Income Tax Assessment Act 1936* (Cth). The Full Federal Court heard the ATO's appeal in August 2024 and the decision has been reserved. The ATO's interim decision impact statement confirms that until "the appeal process is finalised, the Commissioner does not intend to revise the current ATO views" on UPEs as set out in TD 2022/11.

International tax

Global and domestic minimum tax

A package of Bills — the Global and Domestic Minimum Tax Bill, the Imposition Bill, and the Consequential Amendment Bill — was introduced into parliament on 4 July 2024. The package, which implements the OECD's Pillar Two Global Anti-Base Erosion Model Rules, is before the Senate.

The domestic minimum tax and the income inclusion rule are proposed to apply from 1 January 2024, and the undertaxed profits tax from 1 January 2025. The ATO is developing administrative systems, with initial lodgments due by 30 June 2025.

Rules to enable the Minister to detail the computation of top-up tax will apply from 1 January 2024.

Thin capitalisation

Significant changes were made to Div 820 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) to align Australia's thin capitalisation rules with BEPS action 4. The enabling legislation limits the amount of debt deductions that multinational entities can claim in an income year by allowing an entity to deduct net interest expense up to a benchmark earnings ratio.

Most of the amendments apply from 1 July 2023. The enabling legislation also introduces new debt deduction creation rules in new Subdiv 820-EAA ITAA97, which apply from 1 July 2024. The ATO's draft compliance approach is in PCG 2024/D3.

Consolidated entity disclosure statement

Schedule 1 to the enabling Bill introduces new rules for Australian public companies (listed and unlisted) to disclose certain information about subsidiaries (including tax residency) in annual financial reports. The measure applies from 1 July 2023.

Public country-by-country reporting

A Bill before the Senate proposes to introduce public country-by-country (CbC) reporting which, for the first time, will require multinational entities to publish tax information on a CbC basis. The Senate Economics Legislation Committee has recommended that the Bill be passed.

Foreign resident capital gains withholding

A Bill before the Senate proposes to:

- increase the foreign resident capital gains withholding rate from 12.5% to 15%; and
- remove the $750,000 threshold below which withholding does not apply for transactions involving taxable

Australian real property and certain indirect Australian real property interests.

Cases

The High Court refused the taxpayer's application for special leave following the Full Federal Court's decision in *Singapore Telecom Australia Investments Pty Ltd v FCT*.[2] The court had upheld the Commissioner's disallowance of interest deductions from related-party loans and denial of a carry forward loss deduction.

Separately, the ATO has been granted special leave to appeal the Full Federal Court's decision in *PepsiCo, Inc v FCT*.[3] The court held that the taxpayer was not liable to royalty withholding tax or the diverted profits tax. The ATO advised by media release that it will defer finalising TR 2024/D1, pending the appeal process.

Superannuation

Division 296: targeted superannuation concessions

A Bill before the Senate proposes to insert new Div 296 into the ITAA97. Division 296 will tax earnings attributable to the proportion of a superannuation fund member's total superannuation balance that exceeds $3m at 15%.

Legacy retirement product conversions

Draft regulations expand on a previous announcement to provide a five-year exit for legacy retirement products. The regulations are yet to be registered.

Payday Super

From 1 July 2026, Payday Super will require employers to pay their employees' superannuation at the time they pay salaries and wages. Treasury's recent factsheet sets out further policy details.

Tax practitioner updates

myID

On 13 November 2024, the government's digital ID app myGovID was renamed myID to reduce confusion with myGov. Users' login details and identity strength remain the same. Users do not need to set up a new myID or reconfirm their details. Be wary of suspicious emails or SMS containing links as these are a scam.

Client-agent linking

The ATO's client-agent linking (CAL) initiative requires taxpayers to directly authorise their registered tax and BAS agents (practitioners), enhancing taxpayer control over agent appointments. CAL was fully implemented for ABN holders in November 2023. Individuals and sole traders remain outside CAL, for now.

Breach reporting and new Code of Professional Conduct rules

New breach reporting rules require practitioners to self-report and report breaches by other practitioners of the Code of Professional Conduct (Code), where the breach occurred on or after 1 July 2024.

Practitioners are also required to comply with eight additional Code obligations in a new legislative instrument. The new rules apply from 1 January 2025 or 1 July 2025, depending on whether the practitioner has more than 100 employees. The Tax Practitioners Board will finalise its draft guidance soon.

Part IVA

Cases

In *Mylan Australia Holding Pty Ltd v FCT (No. 2)*,[4] the Federal Court allowed the taxpayer's appeal against determinations issued by the Commissioner disallowing deductions and consequential carry forward losses in relation to the acquisition of a global pharmaceutical business. The court considered that the taxpayer had obtained a tax benefit but did not have a dominant purpose of obtaining a tax benefit under s 177D ITAA36.

In *Minerva Financial Group Pty Ltd v FCT*,[5] the Full Federal Court (court) overturned the Federal Court's decision,[6] finding that, while the taxpayer derived a tax benefit, Pt IVA did not apply. The court's decision emphasised that taxpayer choices alone do not automatically imply that Pt IVA applies and confirmed that the inquiry should be directed towards objective factors. The ATO's decision impact statement confirms the Commissioner's long-held view that schemes including a trustee's exercise of discretion to distribute income can attract the operation of Pt IVA.

Dispute resolution

On 14 October 2024, the Administrative Review Tribunal (ART) replaced the AAT. The ART is a new federal body tasked with conducting merits reviews of administrative decisions, including tax rulings, and has assumed all existing AAT cases.

State taxes

Payroll tax

In *Uber Australia Pty Ltd v Chief Commissioner of State Revenue*,[7] the NSW Supreme Court ruled that Uber's payments did not constitute wages under the *Payroll Tax Act 2007* (NSW), as they were not "for or in relation to the performance of work". This decision may influence other states' approaches to payroll tax compliance.

References

1 [2023] AATA 3074.
2 [2024] FCAFC 29.
3 [2024] FCAFC 86.
4 [2024] FCA 253.
5 [2024] FCAFC 28.
6 [2022] FCA 1092.
7 [2024] NSWC 1124.

Tax News – the details

by TaxCounsel Pty Ltd

November – what happened in tax?

The following points highlight important federal tax developments that occurred during November 2024.

Government initiatives

1. Corporate tax crackdown

In a joint media release, the Commonwealth Treasurer and the Assistant Minister for Competition, Charities and Treasury stated that the government is delivering on its commitment to ensure that big corporations pay their fair share of tax with a new report revealing a record level of corporate tax receipts.

The ATO's tenth annual corporate tax transparency report reveals that the ATO received almost $100b in income tax from big business in 2022–23, an increase of almost 17% on the previous year.

This comes after significant investment by the government to bolster the ATO's compliance operations, including increased funding for the Tax Avoidance Taskforce by around $200m per year. This investment has strengthened crackdowns on tax dodging by multinational enterprises, large Australian public and private groups, and wealthy individuals operating in Australia.

The ministers said that Australia is now a world leader when it comes to corporate tax compliance, and the results reflected a sustained effort by the government to ensure that the ATO has the resources necessary to recoup tax dollars owed.

It may be noted that the highlights for the 2022–23 corporate tax transparency report as set out by the ATO include the following:

- there are 3,985 entities in the transparency population;
- taxable income was $380.1b;
- tax payable was $97.9b;
- foreign-owned entities accounted for 41.3% of the population and 41.5% of tax payable; and
- approximately 31% of entities paid nil tax (14% incurred an accounting loss, 7% incurred a tax loss, 2% utilised offsets, and 8% utilised tax losses from a prior year).

2. Objection issues: IGOT report

On 30 October 2024, the final report of the Inspector-General of Taxation on the ATO's administration and management of objections was released. This finalises a review that has been conducted by the Inspector-General over several years, including the publication of an interim report on 10 October 2022.

Objections are an essential part of the tax system and are often the only affordable option open to many taxpayers to challenge ATO decisions. It is imperative that the function is easily accessed and operates without undue delays.

The final report recommends changes to make it faster and simpler for all taxpayers to lodge an objection with the ATO. The report highlights four areas of improvement:

1. increasing accessibility by extending online lodgment to all taxpayers;
2. streamlining processes to reduce time and resources devoted to high-volume, low-risk objections;
3. increasing taxpayer engagement to speed up the time taken to complete an objection; and
4. learning lessons from objections to prevent the number of objections needing to be made.

The Commissioner's perspective

3. Corporate collective investment vehicle regime

The Commissioner has released a final law companion ruling in relation to the amendments that have been made[1] to specify the tax treatment for corporate collective investment vehicles (CCIVs) (LCR 2024/1).

A CCIV is a new type of company limited by shares that is available for funds management. From a regulatory perspective, a CCIV is a registered company with all of its assets and liabilities segregated into "sub-funds" and which is operated by a single corporate director.

However, the tax framework treats each CCIV sub-fund as a separate tax entity that is a trust. The general intent is to align the tax outcomes of CCIVs and their investors with the existing treatment of investors in attribution managed investment trusts (AMITs). Subject to some modifications, the general trust taxation rules apply to CCIVs, where they do not qualify for the AMIT regime.

LCR 2024/1:

- outlines the operation of the CCIV regime;
- explains the deeming principle and its effect on the tax treatment of a CCIV, a CCIV sub-fund trust and investors; and
- provides views on specific tax interpretative issues.

4. Restructures and the new thin capitalisation and debt deduction creation rules

The Commissioner has released a draft practical compliance guideline which primarily sets out the ATO's compliance approach to restructures carried out in response to the enactment of the amendments[2] which strengthened the thin capitalisation rules in Div 820 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) and the debt deduction creation rules (DDCR) in Subdiv 820-EAA ITAA97 (PCG 2024/D3).

PCG 2024/D3 provides a risk assessment framework rating on the application of certain anti-avoidance provisions (in particular, the general anti-avoidance provisions of Pt IVA of the *Income Tax Assessment Act 1936* (Cth) and the new specific anti-avoidance rule (SAAR) in s 820-423D ITAA97) to restructuring in response to the amending Act.

The risk assessment framework sets out matters that the ATO will take into account in deciding whether or not the ATO will have cause to devote compliance resources to further examine a restructure. It does not mean that any anti-avoidance provision necessarily applies.

PCG 2024/D3 is structured as follows:

- the main body which sets out the general principles of the ATO's risk approach and application of compliance resources, and includes:
  - a brief summary of relevant changes to the income tax laws made by the amending Act;
  - the ATO's compliance approach; and
  - the ATO's risk assessment framework; and
- schedules which expand on the principles in respect of specific examples.

Schedule 1 covers examples where the DDCR may need to be considered.

Schedule 2 covers the compliance risks arising from restructures in response to the DDCR. Some restructures in Schedule 2 build on examples in Schedule 1 and the two schedules should be read as complementary when considering whether to restructure arrangements.

Schedule 3 (which has not been included in the draft guideline) is to cover the ATO's view of risks arising from restructures in response to the introduced thin capitalisation rules. PCG 2024/D3 is to be updated to include Schedule 3 concurrently with the publication of a draft public ruling on the third party debt test which is currently under development.

5. GST: ATO update for public and multinational businesses

In a paper delivered on 17 October 2024 to The Tax Institute's National GST Conference, an ATO deputy commissioner (Public Groups) and an ATO senior director (Public Groups) has provided an overview of the progress that has been made since responsibility for GST compliance for large business moved to Public Groups five years ago.

The paper states that, supported by government funding to improve assurance and compliance in the large market, the ATO has embarked on an ambitious program to generate long-term change in the market. The ATO has taken on a number of difficult systemic issues, such as governance (including systems and controls), apportionment issues related to financial supplies, and product classification. The ATO acknowledges that there is still a way to go.

Interestingly, the paper considered a number of current GST risk focus areas, including those discussed below.

Financial services and insurance

The types of issues that the ATO has recently seen that cause concern include "set and forget" approaches to apportionment models without consideration of whether the method is fair and reasonable, in relation to claiming reduced input tax credits based on general ledger codes, and without conducting periodic self-review transactional analysis.

Product classification

The ATO has been working to provide public advice and guidance on priority food and health product classification issues, with the aim of providing certainty and stability to the industry.

Property, construction and retirement villages

The ATO has had a focus on ensuring a good understanding of what risks arise in the property, construction and retirement village segments of the public and multinational market, through both the ATO assurance programs and risk-based engagements. In particular, the ATO has had a recent focus on build-to-rent developments. It has observed that taxpayers are treating the relevant supplies as being input taxed in line with the ATO's expectations, and the main issues arising have involved adjustments (for instance, failure to make adjustments under Div 135 of the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) when a property is acquired as a GST-free going concern).

International GST

Another one of the ATO's risk focus areas is ensuring that Australian GST obligations are being met by offshore entities making supplies to Australian consumers.

The role of advisers

The paper also states that the ATO has been focused on the role of advisers in supporting large business. This includes initiatives such as the large market adviser principles, which was facilitated by working closely with the Big 4 advisory firms. These principles provide an objective and transparent basis against which firms, their clients and the community can be confident that the firms are not engaged in marketing, or the promotion of, tax avoidance or other high-risk arrangements. All firms offering tax advisory services may choose to adopt the principles and the ATO actively encourages firms to do so.

6. TPB: draft code guidance

The Tax Practitioners Board has released for consultation draft information sheets in relation to the obligations under the Code of Professional Conduct that come into force on 1 July 2025 or, for larger firms with more than 100 staff, 1 January 2025.

The obligations and the information sheet references are as follows:

- upholding and promoting the ethical standards of the tax profession (TPB(I) D56/2024);

- false or misleading statements (TPB(I) D57/2024);
- managing conflicts of interest when undertaking activities for government and maintaining confidentiality in dealings with government (TPB(I) D58/2024);
- obligation to keep proper client records of tax agent services provided (TPB(I) D59/2024);
- supervision, competency and quality management under the *Tax Agent Services Act 2009* (Cth) (TPB(I) D60/2024); and
- keeping clients informed (TPB(I) D61/2024).

When developing the draft guidance, the TPB held two roundtable discussions with professional bodies and consumer groups, seeking their initial views. The TPB Chair said that recognising the key role that professional associations have in the co-regulation of tax practitioners, their engagement and practical insights had been invaluable in informing and improving the draft guidance.

The TPB encourages all stakeholders to share their views on the draft policy guidance, and tax practitioners and other stakeholders can make a written submission. They can also provide feedback by participating in the TPB series of "Code Determination" webinars or responding via their professional association.

As part of finalising the guidance, the TPB will also be issuing complementary material, such as factsheets and website content, to assist tax practitioners in understanding the new requirements.

Recent case decisions

7. Land tax debt: company reinstated

In a recent decision on an application brought by the Western Australian Commissioner of State Revenue, the Western Australian Supreme Court (Hill J) has ordered that the registration of a company be reinstated and that the company be then wound up for the purpose of the recovery of land tax that was owing by the company (*Commissioner of State Revenue v Australian Securities and Investments Commission*[3]).

By an originating process, the plaintiff sought orders (pursuant to s 601AH of the *Corporations Act 2001* (Cth) (the Corporations Act)) for the reinstatement of the registration of a company Lakewood Estate Development (No. 1) Pty Ltd (ACN 119 975 852) (Deregistered) (Lakewood). If Lakewood was reinstated, the plaintiff sought an order that it be wound up pursuant to s 461 of the Corporations Act on its reinstatement.

Lakewood was the registered proprietor of Lot 13 of Diagram 41978 (the property). Between October 2001 and November 2023, RevenueWA issued Lakewood with 13 land tax assessments in relation to the property.

On 27 November 2011, Lakewood was deregistered by ASIC for a failure to pay fees pursuant to s 601AB of the Corporations Act. As a result of Lakewood's deregistration, all property owned by Lakewood at the time of its deregistration vested in ASIC, and since that date, ASIC was the only party which was legally able to deal with Lakewood's property.

Pursuant to s 601AH(2), where a company has been deregistered, the court may make an order that ASIC reinstate the company if the conditions required by the Act are met. Relevantly, s 601AH(2) states that an application for reinstatement can be made to the court by a "person aggrieved by the deregistration". Where the court is satisfied that it is just to do so, the company's registration will be reinstated.

Hill J pointed out that the term "person aggrieved" was not expressly defined in the Corporations Act and should not be construed narrowly. When determining whether the plaintiff was a person aggrieved by the deregistration of the company, the court was required to consider whether the plaintiff had shown that deregistration had deprived them of something, or injured or damaged them in a legal sense, or that they became entitled in a legal sense to regard the deregistration as the cause of dissatisfaction. There was no temporal limitation in the term "person aggrieved" and there need only be a causal link between the grievance and the deregistration of the company. As a result, a person can become aggrieved as a result of events which occur after the time of deregistration. Her Honour held that, in the circumstances, the plaintiff was a person aggrieved.

As to whether it was just to make the orders that were sought, her Honour accepted on the evidence before her that no one, except potentially ASIC as the statutory inheritor of the company's property, would be prejudiced by the reinstatement of Lakewood. In contrast, if Lakewood was not reinstated, the plaintiff would suffer prejudice in not being able to recover the land tax debt.

Hill J said that a relevant factor in the exercise of the court's discretion as to whether to order reinstatement was the factor of delay. In this connection, Hill J said that it was important to stress that the claim by the plaintiff was not subject to the *Limitation Act 2005* (WA), nor would it cause any prejudice to any party due to the destruction of records or any impact on the memory of witnesses.

Hill J concluded that it was "just" to make the order that Lakewood's registration be reinstated.

As to the issue of the making of a winding-up order, Hill J said that it was well-established that the court can make a winding-up order on the just and equitable ground if there is evidence of mismanagement, misconduct, or a lack of confidence in the conduct and management of the company's affairs. In these circumstances, given the purpose for which the company was to be reinstated and the fact that there was no person who was willing to act as a director or company secretary of Lakewood, Hill J was satisfied that it was just and equitable for the company to be wound up on reinstatement.

Although not referred to by Hill J, it is suggested that the fact that, by virtue of s 76 of the *Taxation Administration Act 2003* (WA), land tax, from the time it becomes payable, is a charge on the land for which the tax is payable provides a further reason which would justify the conclusions that Hill J arrived at.

8. Work-related car expenses

The AAT has upheld the Commissioner's decision which allowed the taxpayer only $5,258 of his claim of $14,607 for work-related car expenses for the 2017 income year (*Hudson and FCT*[4]).

The basis of the taxpayer's claim for the deductions was that, during the income year, he was required by his work circumstances to carry bulky equipment between his workplaces and home.

The taxpayer's employment arrangements were not controversial or in dispute. He was a sole director and sole shareholder of Gold Quarters Pty Ltd and Hudson Global Investments Ltd. In the 2017 income year, the taxpayer was employed as a business analyst and was contracted to provide services to Sydney Trains via Randstad, an employment agency. Income of Gold Quarters Pty Ltd from Randstad was the taxpayer's personal services income. Gold Quarters Pty did not conduct a personal services business. For the 2017 income year, the amount of consulting fees paid by Randstad to Gold Quarters Pty Ltd was $105,000.

The AAT said that the starting point in a case such as this was the well-established principle that travel between home and a place of employment is not deductible. But there are exceptions to this general principle. One category of exception, which was relevant in the taxpayer's case, was the circumstance in which a taxpayer carries, between work and home, equipment which is both bulky and essential to the income-generating activity. In some circumstances that transport can be characterised as something other than simply "travel between work and home".

The AAT said that the attributes that tend to shift the expense (generally a car expense) from the category of non-deductible private transport to that of a deductible work-related activity are that:

- the equipment being carried is necessary for the income-generating activity;
- the equipment is "bulky";
- there is no secure storage at the workplace; and
- the only practicable way to transport the equipment is by car.

The AAT found that, given the lack of support by the taxpayer's supervisor/employer for the requirement to transport any claimed bulky material, to the extent that the taxpayer carried "essential equipment" between work and home, and the requirement to do so, the taxpayer engaged in such activities as a matter of personal choice; that is, the evidence had not established that the equipment being carried was necessary for the income-generating activity.

Further, even if it were the case that the taxpayer did transport the material at all times, it was not supported by the employer as being essential equipment and so the taxpayer's claim would similarly fail. That would also be a matter of personal choice, and a personal choice of that kind was not enough to displace the principle that the cost of transport between work and home is not deductible.

The AAT also rejected the taxpayer's claims in respect of the depreciation of a motor vehicle (including a large balancing adjustment deduction) above the amount allowed by the Commissioner.

TaxCounsel Pty Ltd
ACN 117 651 420

References

1 The amendments were enacted by the *Corporate Collective Investment Vehicle Framework and Other Measures Act 2022.*

2 The amendments were enacted by the *Treasury Laws Amendment (Making Multinationals Pay Their Fair Share – Integrity and Transparency) Act 2024.*

3 [2024] WASC 392.

4 [2024] AATA 3678.

Tax Tips

by TaxCounsel Pty Ltd

Use for a purpose

The High Court has recently considered the concept of the use of a car for a purpose in the context of the luxury car tax legislation.

Background

The litigation that arose out of the Commissioner's treatment, for the purposes of luxury car tax, of cars held by a car dealer under what was referred to as the "museum concept" has now concluded with the decision of the High Court in *Automotive Invest Pty Ltd v FCT*.[1]

The litigation gave rise to a first instance decision of the Federal Court, a majority decision of the Full Federal Court and, now, a majority decision of the High Court. In the litigation process, things got better for the taxpayer. Although the taxpayer lost in the Federal Court at first instance, the taxpayer's appeal to the Full Federal Court gave a taste of success in the form of a favourable dissent, and the taxpayer's further appeal to the High Court has now produced a favourable 3:2 majority.

This article considers the decision of the High Court.

The statutory context

As has been indicated, the *Automotive Invest* case was concerned with luxury car tax.

Until 1999, wholesale sales tax was generally imposed on motor cars, but a higher rate of tax was imposed on cars deemed to be luxury vehicles. With the introduction of GST, all sales tax enactments were repealed and the sale of cars instead became subject to GST. A separate luxury car tax (LCT) was created by the enactment of the *A New Tax System (Luxury Car Tax) Act 1999* (Cth) (LCTA99). The LCT is a single stage tax that is imposed on taxable supplies and importations of luxury cars and is in addition to any GST that may be payable, but is not levied on top of the GST.

A critical design feature of the LCT is that car dealers (such as the appellant taxpayer) ordinarily do not become liable to pay LCT until a car is sold (or imported) "at the retail level". This is achieved by the dealer quoting its Australian Business Number (ABN) when acquiring or importing a car.

Section 9-5(1) LCTA99 sets out when a person is entitled to quote an ABN in relation to the supply or importation of a luxury car. It provides (so far as is presently relevant):

> "(1) You are entitled to quote your ABN in relation to a supply of a luxury car or an importation of a luxury car if, at the time of quoting, you have the intention of using the car for one of the following purposes, and for no other purpose:
>
> (a) holding the car as trading stock, other than holding it for hire or lease; or
>
> …".

Division 13 of Pt 3 LCTA99 deals with the payment of LCT. In general terms, amounts of LCT for a given period are added to a person's "net amount" for the purposes of the GST legislation. The net amount may be increased by any "increasing luxury car tax adjustments" or decreased by any "decreasing luxury car tax adjustments". These adjustments are made where circumstances occur after the supply or importation of a car that mean that too much or too little LCT was imposed. Accordingly, adjustments are made to increase or decrease the net amount. Adjustments can be made by the supplier, the recipient or the importer, depending on the circumstances.

Section 15-30(3) LCTA99 sets out when a person has an "increasing luxury car tax adjustment". The subsection provides:

> "(3) You have an ***increasing luxury car tax adjustment*** if:
>
> (a) you were supplied with a luxury car; and
>
> (b) either:
>
> (i) no luxury car tax was payable on the supply because you *quoted for the supply; or
>
> (ii) you had a decreasing luxury car tax adjustment under subsection (1); and
>
> (c) you use the car for a purpose other than a quotable purpose."

The phrase "quotable purpose" is defined in s 27-1 LCTA99 to mean "a use of a car for which you may quote under section 9-5". The amount of the adjustment is relevantly the amount of LCT that the supplier of the car would have had to pay if the taxpayer had not quoted for the supply.[2]

The facts

The appellant taxpayer (a company which was controlled by a Mr Denny) carried on a business of acquiring and selling luxury and collectable cars, using the technique of displaying cars in a museum (the "museum concept"). The litigation between the appellant taxpayer and the Commissioner was concerned with 40 of those cars and arose out of a single notice of amended assessments of net amounts for the tax periods commencing from 1 April 2016 to 30 November 2017.

The appellant taxpayer objected to the amended assessments and the Commissioner disallowed the objections. The appellant taxpayer's appeals to the Federal Court and then the Full Federal Court were unsuccessful but the appellant taxpayer's further appeal to the High Court has succeeded.

The amended assessments (which required the payment of an additional amount of LCT by way of adjustments) were premised on the assumption that each car was:

1. used for the purpose of holding the car as trading stock; and
2. also used for the additional purpose (which was not a quotable purpose) of being displayed as an exhibit in a car museum.

The appellant taxpayer's case was that the sole "purpose" for employing the museum concept was as a means to achieve the ultimate end of selling cars.

Mr Denny had previously operated a number of car dealerships in Europe, selling mostly used cars, and for that purpose had deployed a range of marketing activities, such as cafe lounges, cinemas and golf-practice driving ranges at dealerships.

In 2013, Mr Denny discovered a novel way of selling cars at a hotel in Las Vegas and decided to adopt a similar model to selling cars. This was to present the cars for sale in what would be called a "museum" to differentiate the new dealership from the rest of the market and achieve premium prices for the cars for sale. Mr Denny also thought using the term "museum" in the proposed business name would pique interest in the dealership, both in Australia and, as importantly, overseas.

The museum opened in Gosford, New South Wales, in 2016. Until its closure in 2019, the appellant taxpayer sold over 800 cars with gross sales income amounting to $114m. It was accepted that all of the 40 cars were the appellant taxpayer's trading stock and that they were all for sale. None of the 40 cars were on permanent display. The appellant taxpayer operated trading stock software to record the purchase and sale of cars and to manage invoices and stock levels. All cars had a stock number.

The evidence revealed that the business unquestionably took place within a car museum in accordance with Mr Denny's intentions. The display of the cars took place within all of the expected attributes of a museum housing rare and luxury cars.

The appellant taxpayer marketed the museum as a tourist attraction through its website and in social media; it was said to be a desirable "day out" from Sydney. The website proclaimed that it was not just a museum: "we're a car lovers dream". It attracted 13,000 visitors in its first month, and thereafter about 2,500 per week; in about its first year, it attracted 100,000 visitors. In comparison, the premises received only 10 to 15 car sales inquiries per week. The venue could be used for functions and weddings. At first, the website did not state that cars were for sale, nor was there at that time prominent signage in the museum stating that cars were for sale, although Mr Denny gave evidence that was accepted that this was all part of his "marketing strategy". Over 30 employees and 10 volunteers worked at the museum. They were available to discuss the cars. Some of these were devoted to marketing the premises as a museum. In contrast, only about five sales staff would be at the premises. In 2017, a monthly newsletter describing events and cars began to be published.

Mr Denny's evidence was that 98% of the cars were for sale and the reason that the other 2% were not for sale was that some cars had already been sold but "nearly every car we sold would stay with us for two to four weeks before we were paid in full". A business plan in January 2016, prepared by Fortunity Group Pty Ltd for the appellant taxpayer, explained that all cars in the premises would be for sale. After the Commissioner indicated an interest in the business, signage making it clear that cars were for sale became more prominent. In the accounts for the 2016 year, but prepared in 2020, the "principal activities" of the appellant were described as the "Retail Sale of Vehicles".

After the Commissioner's decision to assess it, the appellant taxpayer decided, in 2019, to close down the Gosford showroom and museum. There was no suggestion that continuation of the "museum concept" as an independent venture was even considered. The obvious inference was that, in the absence of a business of selling cars, the appellant taxpayer no longer had any use for a museum.

The Federal Court

As indicated, following the Commissioner's disallowance of its objections, the appellant taxpayer appealed to the Federal Court.

At first instance, Thawley J held that the 40 cars were being used for another purpose through the museum concept, while accepting that the appellant taxpayer's "primary commercial objective" was to sell cars.[3]

Thawley J said that the purpose of an activity is the end that is sought to be accomplished by it, and not the reasons for engaging in it, and concluded that the characterisation of purpose under ss 9-5(1) and 15-30 LCTA99 was an "objective characterisation". His Honour concluded that the 40 cars were being used for another purpose through the museum concept, while accepting that the appellant's "primary commercial objective" was to sell cars.

On an appeal by the taxpayer to the Full Federal Court, a majority of the Full Court (Wheelahan and Hespe JJ; Logan J dissenting) upheld judgment and reasoning of Thawley J.[4]

The High Court

The appellant taxpayer was granted special leave to appeal to the High Court from the decision of the Full Federal Court. A majority of the High Court (Edelman, Steward and Gleeson JJ; Gageler CJ and Jagot J dissenting) has now allowed the appeal.[5]

The majority

In essence, the majority of the High Court held that the second premised assumption on which the amended assessments were made (see (2) above under "The facts") misunderstood the concept of purpose in an LCT assessment, which was concerned with the taxpayer's ultimate end or object. The use of the cars as exhibits in a car museum was intended by the appellant taxpayer only as a means to the ultimate end or object of using the cars as trading stock, ie selling them. The evidence of subjective purpose from Mr Denny was uncontradicted, supported by substantial objective evidence, and accepted by Thawley J at first instance. The second premised assumption mischaracterised the appellant taxpayer's purpose for acquiring and then holding the 40 cars, treating it as an objective purpose abstracted from the appellant taxpayer itself.

The minority

In its joint judgment, the minority of the High Court said[6] that, where a statutory provision requires a use for a single purpose only, the same use for another purpose, no matter how minor, takes the facts outside of the scope of the required use for a single purpose only, unless, on the facts as found, it can be concluded that the other purpose is "wholly ancillary to or directly facilitative" of the single purpose and is not "an additional, independent or collateral purpose".

The minority said that, on the unchallenged findings of Thawley J at first instance, the use of the cars (by displaying them at the premises) was manifestly use of the cars by the appellant taxpayer for two separate (albeit complementary) purposes — as part of a tourist attraction and holding them as trading stock.[7]

The majority: reasons

In its joint judgment, the majority of the High Court said that the evidence about the use of the premises, and the extent of cars sold at the premises, tended to support Mr Denny's evidence that his sole reason for employing the museum concept was as a means to achieve his ultimate object or end of selling cars. The majority said that five further matters reinforced Mr Denny's evidence that this was the sole reason for the use of the museum concept.[8]

These further matters were:

1. it was accepted that, at the premises, all of the 40 cars were for sale; they were trading stock. There was also no suggestion that any of the "classic motor vehicles" were unavailable for sale. To the contrary, classic car auctions were run from the premises. Therefore, it did not detract from Mr Denny's evidence about his purpose whether or not there were some cars that remained on the premises for a period after they had been sold and during which time they were used only as displays to attract customers;
2. making the premises appear as much as possible to be a museum and not an ordinary car dealership was precisely Mr Denny's intended way of advancing his method of selling cars. The more spectacular the premises appeared, and the less that it appeared like an ordinary car dealership, the more people would be attracted to the premises, the more publicity that the premises would receive, and the more cars would be sold;
3. this was not a case about distinctly different uses of the same property, nor was it a case of clashing or inconsistent uses. The display of cars in a museum was precisely the appellant taxpayer's means of selling those cars;
4. to the extent that the museum might be treated as a separate business, there was evidence that the museum made a loss; and
5. the revenue from the museum was, and remained, only a tiny fraction of the revenue from the sale of the cars.

The majority of the High Court said that, in light of these five matters, it was unsurprising that the unchallenged finding of Thawley J at first instance was that Mr Denny wanted to profit from the sale of cars and considered that the "museum concept" would be the best way to achieve that objective.[9]

Approach to construction

In its joint judgment, the majority of the High Court, in referring to the approach to be taken in relation to the construction of the LCTA99, said:

> "105. The LCT Act is drafted to speak directly to the public using ordinary language and communication. As well as applying the ordinary rules of interpretation to this language, it is well to remember that the LCT Act is a law that creates an impost in the course of commercial activity. In the case of car dealers, it is a regular and significant impost. In that respect two further observations are applicable. The first, from the former jurisprudence concerning sales tax, is that it is always important to look 'at the substance and reality of the matter'. The second, from the jurisprudence concerning diesel fuel rebates, is that one should apply a 'commonsense and commercial approach' in applying the LCTA99." (footnotes omitted)

The majority went on to say[10] that the ordinary language of s 9-5(1) showed that it was concerned with the purpose for which "you have the intention" of using the car. It was concerned with the *intended* purpose of use. In this respect, it contrasted with the actual purpose of use with which s 15-30(3) was concerned when that provision imposes an increasing LCT adjustment if "you use the car for a purpose other than a quotable purpose". In order to identify the intended purpose of use, it was necessary first to identify the intended use, then to identify the purpose of that use.

The majority then said:

> "107. In general, a car is used by being driven. But the language in s 9-5 of using a car for the purpose of 'holding it' implies that a car might be used even if it is not driven. Further, the exception to s 9-5(1)(a) indicates that a car may be used by being held for hire or lease. The car need not actually be hired or leased to anyone in order to be used for a non-quotable purpose. It is sufficient that the car is held (as stock, but not trading stock) by the taxpayer for that purpose. Section 9-5 thus recognises a broad conception of 'use'. Both 'display in

a museum' and 'holding as trading stock' are capable of being uses.

108. Once the intended use or uses have been identified, it is necessary to identify the intended purposes of those uses. Based on the quotable purposes, which are specific ends or goals, s 9-5 requires the identification of the specific ends or goals which are the ultimate reason or reasons why a taxpayer is using a car in a particular way. It is necessary, in this respect, to distinguish between this use of purpose to mean a specific 'end' and the different concepts of 'motive' and 'means'."

A purpose or end distinguished from motives and means

The majority of the High Court said that there was much debate on the appeal about the meaning of "purpose" in ss 9-5(1) and 15-30(3) LTA99 and whether the reference to "purpose" in those provisions was to the objective or subjective purpose of the person whose purpose was in issue. The Commissioner relied on the distinction drawn by Thawley J at first instance and the majority of the Full Federal Court between motive and purpose, and the reasoning of the majority that the "statutory question is not why the appellant engaged in the activities it did". The Commissioner also contended that the reference in each provision was to "objective purpose", ascertained by inference from how the cars were in fact used, and to the exclusion, for the most part, of the evidence of Mr Denny.

The majority of the High Court then went on:

> "110. The starting point must be an understanding of the difference between 'motive', 'means' and 'purpose'. A person's purpose is usually the ultimate end, object or goal that the person seeks to achieve. A person's motive is the reason that the person seeks to achieve that purpose or end. And a person's means are the way in which the purpose is to be achieved. In one sense, a person's means to achieving their ultimate object could also be characterised as a purpose but it is only an intermediate or 'proximate' end. The means are distinct from the ultimate end, object or goal, which is the sense in which purpose is used in ss 9-5 and 15-30(3).
>
> 111. It is therefore necessary to characterise the relevant person's purpose or end at the proper level of generality, as distinct from any motive for that purpose or the intended means of achieving that purpose. For instance, an elite athlete might engage in a sporting activity for the purpose or end of competing at the Olympics. The motive for that end might be personal fulfilment, profit, or glory. And the means to achieve that end might be many hours of training." (footnotes omitted)

After quoting a passage from the decision of Gleeson CJ in *News Ltd v South Sydney District Rugby League Football Club Ltd*,[11] the majority said that, in every instance, "purposes", like other "intentions", are the purposes or intentions of a person, whether the person is a natural person, an artificial legal person or a construct.[12] In each case, the purpose or intention is subjective in the sense that it belongs to a subject. A natural person's purposes can only be proved by the person's direct evidence, or by inference from the circumstances, or both. When the purpose is concerned with the purpose of an artificial legal person such as a company, the most common means of identifying that purpose involve the identification of a person whose intentions and purposes are to be attributed to the company. The most obvious instance of such people is a person who controls the company.

The majority went on to say[13] that sometimes the purpose or intention with which the law is concerned is the purpose or intention of a construct, such as the purpose or intention of a reasonable person. That construct is used in interpreting contracts (the intention of a reasonable person in the position of the parties), interpreting trusts (the intention of a reasonable person in the position of the trustee), and interpreting statutes (the intention of the notional parliament). In each case, no natural person can give direct evidence of the purpose or intention of the construct. The purpose of a construct is one that can only be established by inference from the circumstances as to the purpose that such a reasonable person in the relevant position would have had. In common language, this is what is usually meant when a "purpose" is used to describe the objective function or end for an item or thing.

Purpose in the provisions of the LCTA99

The two provisions of the LTA99 which raised the issue as to purpose in the *Automotive Invest* case were:

- s 9-5(1) (you have the intention of using the car for one of the following purposes, and for no other purpose); and
- s 15-30(3) (you use the car for a purpose other than a quotable purpose).

In relation to s 9-5(1) LTA99, the majority said that "purpose" is used in that subsection in its central sense of the purpose of the taxpayer, not some purpose that a reasonable person in the taxpayer's position might hold, in all the circumstances. That was so for two reasons:[14]

1. the concern is with the intention of a specific person to use a car for a purpose, namely, to hold as trading stock and for no other purpose. Section 9-5(1) LTA99 is dealing with the acquisition of a car (in the present case, by a car dealer) before that dealer commences to use it. The focus of the section is on the intention of the taxpayer. The "intention" must, therefore, be that of the actual appellant taxpayer; and
2. s 9-5(1) LTA99 requires an examination of the purpose of using a car by using ordinary communication directed to "you". The "you" is the taxpayer, not an objective construct or reasonable person. By its terms, the section assumes that a taxpayer has an intention of using a car for a purpose or purposes.

The majority went on to say that the concern of s 9-5(1) LTA99 is with an inquiry into the intention and purpose of the taxpayer, and this can be shown by the taxpayer producing contemporaneous evidence of intended use of a car for a purpose, such as in a board paper, a business plan or another document, as well as by the sworn or affirmed testimony of the taxpayer.[15] The majority then said:

> "130. That is not to say that objective evidence about the nature of the car acquired, or how it ends up in fact being used, is irrelevant. It is not. Such evidence may be used to corroborate the purpose of the use that was intended or to demonstrate that the taxpayer's evidence of intended use was in some way false. But if direct evidence is accepted, corroboration is unnecessary."

In relation to s 15-30(3) LTA99, the majority said[16] that it would be a remarkable and surprising interpretation of s 15-30(3) if, as an allied provision to s 9-5, s 15-30(3) were, without any express language to suggest a change, somehow to have switched from a focus on the purpose of the taxpayer to a focus on the "objective" purpose of a reasonable person in the position of the taxpayer. It did not do so.

In short, the majority said that "purpose" in s 15-30(3) is not the type of abstracted or notional purpose of a reasonable person discernible only by inference from objective evidence. Textually, that is because s 15-30(3) is still concerned with "you" and your use of the car. The difference from s 9-5(1) is that recourse can now be had to everything which has happened since acquisition when determining the purpose of the actual use of a car rather than the purpose of the intended use.

Thus, in a simple case, where the car has actually been used for a purpose other than the purpose for which one "may quote", there may be a need for either a decreasing or increasing LCT adjustment. In that respect, evidence of the circumstances in which the actual use occurred is not necessarily more probative than the sworn or affirmed testimony of a witness in inferring actual purpose. What is more, and what is less, probative always depends on the facts and circumstances of a given case.

Characterisation of the appellant taxpayer's purpose

The majority of the High Court said[17] that there was no dispute that the intention of the actual appellant in this case, which was a company, was the intention of the controlling mind of the appellant taxpayer (Mr Denny). It was, of course, for Mr Denny to decide how to run his business, and not for the Commissioner to decide otherwise. Mr Denny's choice of method was, arguably, unusual. But as Brennan J generally observed in *Magna Alloys & Research Pty Ltd v FCT*:[18]

> "The taxpayer is at liberty to determine for himself what the scope and nature of his business or undertaking shall be and how it shall be conducted, the Act having no effect upon those matters but taking 'the result of the taxpayer's activities as it finds them'."

Section 9-5(1)

The majority said that,[19] at the appropriate level of generality, consistently with the legislative purpose of s 9-5(1), Mr Denny's accepted evidence was that the appellant's purpose in holding the cars was to hold them as trading stock. In short, he held the cars to sell. Mr Denny's motive for doing so was obvious: it was to make profits. And Mr Denny's accepted evidence was that the museum was only the means by which the appellant's purpose was achieved. The museum was not the ultimate object or end itself. As the controlling mind of the appellant, Mr Denny's intended means and intended purpose was properly to be attributed to the appellant taxpayer.

The substance and reality here, applying a common sense and commercial approach, is that ultimately the appellant's business was just to sell cars.

This did not confuse motive with purpose. Mr Denny did not give evidence about why he wanted to run a car dealership as a "museum concept". Presumably, like any business person, it was to make money. Instead, his evidence was about the purpose or objective of the appellant taxpayer's business; about what he wanted it to achieve, and the means of achieving it.

Section 15-30(3)

The majority said[20] that Mr Denny's uncontradicted evidence, accepted by Thawley J, was that there was never any change to his initial purpose of selling cars or the use of the museum concept as the means of doing so. That purpose and those means continued right up until the point at which the appellant ceased selling cars from the Gosford showroom, so that the museum (the means to the end of selling cars) was closed. No facts or circumstances cast any doubt on the veracity of Mr Denny's evidence in this respect.

In particular, the museum was never separately accounted for as an independent venture or purpose. As a result, there was no separate treatment of the cars as stock of the museum, which might otherwise have led to consideration of the tax treatment of the cars in relation to the museum as a separate venture. And while the profitability of the "museum concept" was unclear because it was never separately accounted for, the comparison of gross revenues demonstrated that the museum always remained subordinate in a revenue sense to the sale of cars.

Observations

The decision of the High Court in the *Automotive Invest* case has settled the issues that arose on the facts of that case under ss 9-5 and 15-30 LCTA99.

The reasons of the majority refer to several issues of wider relevance which should be noted.

First, the majority said that there was no dispute that the intention of the actual appellant taxpayer in this case, which was a company, was the intention of the controlling mind of the appellant taxpayer. That was Mr Denny.

Second, the majority said that it was for Mr Denny to decide how to run his business, and not for the Commissioner to decide otherwise. Mr Denny's choice of method was, arguably, unusual. But a taxpayer is at liberty to determine for himself what the scope and nature of his business or undertaking shall be and how it shall be conducted. The taxation legislation has no effect on those matters but takes "the result of the taxpayer's activities as it finds them".

Third, as to the need for a taxpayer to adduce corroborative evidence, the majority referred with approval to the following passage from the judgment of Hunt J in *Allied Pastoral Holdings Pty Ltd v FCT*:[21]

> "There is no requirement of law that a taxpayer on a taxation reference or appeal is obliged to produce other evidence to corroborate his own evidence, nor should there be any rule of practice adopted in such cases by which such corroboration is required … There is no legal obligation upon the taxpayer to produce other evidence to corroborate his evidence before it can be accepted."

TaxCounsel Pty Ltd

References

1 [2024] HCA 36.

2 There is an equivalent to s 15-30(3) for cases where a car is imported (see s 15-35(3) LCTA99).

3 *Automotive Invest Pty Ltd v FCT (Gosford Classic Car Museum)* [2022] FCA 281.

4 *Automotive Invest Pty Ltd v FCT* [2023] FCAFC 129.

5 *Automotive Invest Pty Ltd v FCT* [2024] HCA 36. The majority of the court delivered a joint judgment, as also did the minority.

6 [2024] HCA 36 at [53].

7 [2024] HCA 36 at [54].

8 [2024] HCA 36 at [81]–[86].

9 The majority also said that the rejection by Thawley J of Mr Denny's evidence about the reason for increasing fees to the museum did not in any way undermine Thawley J's finding that the museum concept was chosen by Mr Denny only as the way for the appellant taxpayer to achieve its objective of selling cars.

10 [2024] HCA 36 at [106].

11 [2003] HCA 45.

12 [2024] HCA 36 at [113].

13 [2024] HCA 36 at [115].

14 [2024] HCA 36 at [126]–[128].

15 [2024] HCA 36 at [129].

16 [2024] HCA 36 at [131].

17 [2024] HCA 36 at [135].

18 [1980] FCA 150.

19 [2024] HCA 36 at [137].

20 [2024] HCA 36 at [141].

21 [1983] 1 NSWLR 1 at 11.

Mid Market Focus

by Troy Smith, HLB Mann Judd

Navigating tax on digital and crypto assets

This article explores the Australian tax treatment of crypto assets, covering CGT, ordinary income, personal use exemptions, non-fungible tokens, airdrops, and other key tax considerations.

What are crypto assets?

Crypto assets encompass various forms of digital currency, including cryptocurrency coins, tokens, stablecoins and non-fungible tokens (NFTs). Under s 108-5(1) of the *Income Tax Assessment Act 1997* (Cth) (ITAA 1997), these assets are classified as CGT assets, which means that any disposal may trigger CGT obligations. As intangible assets, crypto assets do not have physical form but carry financial value and are therefore subject to specific tax considerations when bought, sold, traded or transferred.

Cryptocurrencies such as Bitcoin and Ethereum are examples of CGT assets. The ATO recognises a wide array of crypto assets as being subject to CGT, and certain activities, such as using or exchanging crypto assets, may result in CGT events. This characterisation also applies to stablecoins and NFTs, broadening the tax implications for diverse types of crypto transactions.

Personal use exemption

In limited cases, crypto assets may qualify as personal use assets, which are CGT-exempt on disposal. However, the ATO has established strict guidelines for this exemption, specifying that cryptocurrency is not a personal use asset if it is primarily held or used for:

- investment;
- profit-making schemes; or
- business activities.

To qualify for the exemption, the crypto asset must be used within a short time frame for the direct purchase of goods or services, which means that it must be acquired solely to use for personal expenses. Crypto assets held primarily for investment, speculation or other profit-oriented purposes will not meet the personal use criteria, meaning any gains on disposal will incur CGT.

GST on crypto assets

Since 1 July 2017, digital currencies have been exempt from GST in Australia, aligning with the GST treatment of traditional currency. This exemption applies to transactions involving crypto assets as a method of payment, ensuring that sales or purchases of digital currency do not attract GST.

However, NFTs are not classified as digital currency for GST purposes. Instead, the GST treatment of NFTs depends on the specifics of each transaction. When a transaction involving an NFT meets the requirements for a taxable supply, GST will apply. Conversely, GST-free transactions will not attract this tax. This distinction requires businesses and individuals trading NFTs to assess each transaction for GST implications.

Crypto trader versus crypto investor

The tax treatment for crypto assets depends largely on whether an individual is classified as a crypto investor or a crypto trader:

- crypto investors: generally, investors buy crypto assets for their portfolios and hold assets over a longer period with the intention of building wealth. Investors benefit from CGT rules, including the 50% CGT discount if assets are held for more than 12 months; and
- crypto traders: those who engage in crypto trading as a business are considered traders. Frequent transactions, buying and selling strategies, and an intention to generate profit from market activity signify a business. Profits from trading are classified as ordinary income, and trading stock rules apply under s 70-10(1) ITAA97. Crypto assets held by traders are treated as trading stock, meaning gains are calculated as income, not capital gains.

The simplified trading stock rules may apply to traders if the stock's year-end value has changed by less than $5,000, relieving the need to conduct a formal stocktake. Estimating stock value, according to ATO guidance, includes using cost, market selling, or replacement value to calculate the stock's year-end figure.

Sale of crypto assets as an investor

For investors, any sale or disposal of crypto assets triggers a CGT event. Common methods of disposal include:

- selling for Australian dollars or other fiat currency: capital gains or losses are determined based on the difference between the asset's cost base and the sale proceeds;
- swapping one crypto assets for another: this constitutes a CGT event, even when no fiat currency is involved. The market value of the crypto assets received forms the basis for calculating gains or losses;
- spending on goods and services: when crypto assets are used for purchases, a CGT event occurs unless it qualifies as a personal use asset; and
- gifting: crypto assets gifted to others triggers a CGT event based on the asset's market value at the time of gifting.

Decentralised finance and wrapping crypto assets

In the world of decentralised finance (DeFi), users can engage in various activities such as lending, borrowing and earning staking rewards. DeFi transactions typically have tax implications based on whether they result in a change of beneficial ownership or income.

Wrapping crypto assets involves converting one type of crypto asset to another that is compatible with a different blockchain. The ATO considers wrapping and unwrapping events as CGT events if they result in a change in beneficial ownership or a change in the characteristics of the crypto assets. Both DeFi and wrapping activities require detailed records to determine CGT or ordinary income liabilities, depending on the specific circumstances.

Staking rewards and airdrops

Staking rewards are payments received for participating in blockchain consensus mechanisms, such as proof-of-stake, and are generally treated as ordinary income at the time of receipt. Additionally, staking rewards are treated as CGT assets, so any disposal of these assets will trigger a CGT event, with gains or losses calculated based on the difference between the market value at receipt and the market value at disposal.

For example, 100 Polkadot (DOT) tokens are purchased for $50 per token, and these are being used to stake. If the estimated staking reward over 12 months is 75, then, on receipt of the staking rewards (75), this is treated as ordinary taxable income which would be the market value at that time. The cost base of the 75 staking rewards also becomes the first element of the cost base for CGT purposes. At the time of selling the 175 DOT tokens, CGT will apply to this whole amount.

Airdrops are a marketing tool that distributes crypto assets through a group of people to build their use and popularity. However, the tax treatment can vary depending on multiple factors.

For example, the value of an established token that you receive by airdrop is ordinary income at the time you receive it, based on its market value. Once again, the airdropped assets become CGT assets from that point on, and the cost base is the market value at the time you receive them. When you dispose of these, it will trigger a CGT event.

There are also airdrops known as initial allocation airdrops. These are where a crypto project makes an initial airdrop of tokens that is the very first distribution of its tokens. They are the first allocation of tokens and would be considered "initial" if there has been no trading in the project's tokens prior to this airdrop. If you receive this initial allocation, they do not derive ordinary income and they are not subject to CGT at the time they are received. Instead, they are treated as a CGT asset with a nil cost base (they have no market value as they have never been previously traded). The CGT gain or loss is calculated based on the market value of the asset at the time of disposal.

If these initial tokens are not free and you have made a payment for them, the cost base of the token is the amount you pay to acquire them.

Chain splits

A chain split occurs when a blockchain is forked, creating a new digital asset. The ATO provides guidance for handling such events:

- the original asset retains its cost base, and no CGT event occurs at the time of the fork; and
- the new asset is allocated a nil cost base, meaning any gains from its disposal are fully subject to CGT.

Documenting the chain split, the initial cost base, and subsequent disposals is essential to comply with ATO requirements, as these records determine the tax implications of any future disposals.

Non-fungible tokens

NFTs represent unique ownership rights over digital items, such as art or collectibles. NFTs are treated as CGT assets in Australia, and any gain or loss from their disposal is subject to CGT.

NFTs acquired and held as personal use assets may, in rare cases, qualify for a CGT exemption on disposal. However, this is uncommon as most NFTs are acquired for investment purposes. The ATO specifies that NFTs held as part of an investment or profit-making scheme do not qualify as personal use assets, and the full amount of any gain on disposal is subject to CGT.

Crypto asset prizes and gambling winnings

Winning crypto assets through competitions, games or gambling activities are generally not considered as ordinary income by the ATO. The tax treatment differs depending on whether the win was obtained as part of a game of chance, a competition, gambling activities, or from a business that conducts these activities.

The amounts that are received through prizes won in a lottery (draws or raffles) and prizes won in game shows (excluding regular appearance fees) are not included as ordinary income so are not assessable to the individual.

However, if you win a crypto asset and hold it as an investment, this may be treated as a CGT asset and the disposal could be subject to a capital gain or loss. If this were the case, the cost base of the asset would be the market value at the time you won it.

Giving a gift or donation in crypto

When gifting or donating crypto assets, the transfer is treated as a CGT event. To determine if there is a gain or loss, you will need to know the market value of the crypto assets at the time of the gift. For donations, only gifts to organisations with deductible gift recipient (DGR) status qualify for a tax deduction, and the recipient must be legally able to accept crypto assets.

Generally, donations of crypto assets to DGRs may be exempt from CGT if:

- they are made under a will (testamentary gifts). However, you cannot claim a tax deduction for these;
- they qualify under the Cultural Gifts Program; or
- the crypto assets is a personal use asset.

If you receive crypto assets as a gift, there are no immediate CGT implications. However, if you later dispose of the crypto assets, a CGT event may apply. Organisations accepting crypto donations must be capable of receiving and managing these assets, ensuring that the crypto asset is legally transferred to their name.

Lost crypto assets

Crypto assets may become irretrievable if, for instance, a private key is lost or a platform goes into administration. Taxpayers can claim a capital loss if they can substantiate the ownership and establish that the asset is indeed unrecoverable. For example, if a private key is lost and cannot be retrieved, the asset is considered permanently lost.

In cases where an exchange or platform enters administration, taxpayers may face a financial loss, but a capital loss cannot be claimed until the administration process concludes. It is essential to retain records to document ownership and efforts made to recover the asset.

Records to keep

For tax compliance, it is essential to keep thorough records for each stage of a crypto transaction:

- buying (acquiring): maintain receipts, transaction records showing the asset, purchase price in Australian dollars, transaction date and purpose, as well as any commission, brokerage or professional fees, and exchange records;
- owning (holding): keep records of software expenses related to managing tax affairs, digital wallet information and keys, and documents showing the date and amount of crypto assets received via staking or airdrop; and
- selling (disposing): record receipts for sales or transfers, transaction details including the asset, sale price in Australian dollars, transaction date and purpose, any commission or brokerage fees, exchange records, and calculations of capital gains or losses.

Conclusion

The tax treatment of crypto assets in Australia is complex, requiring a careful assessment of each transaction. While many began crypto investing and trading as a hobby or a "punt," this article highlights the various tax treatment that applies to digital assets. Keeping comprehensive records is essential to navigate these complexities and to ensure compliance with Australian tax obligations. Tax professionals advising on crypto assets must understand the nuanced application of CGT, trading stock rules, GST, income classification and, of course, the type of crypto asset. You must keep detailed and accurate record-keeping to ensure that you can navigate the evolving tax landscape for crypto assets and ensure compliance.

Troy Smith
Associate Director
HLB Mann Judd

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A rising star in tax

The National Dux of CTA3 Advisory 2023 shares insights on balancing study, work and life while mastering complex tax challenges to excel professionally.

Jeremy Scott
Manager – Taxation and Advisory
Pilot Partners, Brisbane

With nearly seven years of experience, Jeremy provides specialised tax advice to a diverse range of clients, from local businesses to international corporations.

Early career and education

Jeremy's fascination with tax was sparked during his university studies, drawn by its complexity and the opportunities for problem-solving. He holds a Bachelor of Business (International) and a Bachelor of Science (Hons) – Business and Management, completing his studies at Queensland University of Technology and Aston University in the UK. His early career involved various accounting roles that built a solid foundation in practical skills and accounting principles.

The CTA journey

Jeremy pursued the CTA Program to deepen his tax knowledge and improve his ability to communicate complex advice to clients. He found particular value in the discussion sessions with experts. "The real-time feedback was invaluable," he explains. The program also helped him simplify intricate tax topics, such as CGT, for clients.

To balance work, study and life, Jeremy relied on careful planning and a methodical approach. "I'm not a crammer. Breaking things down helped me to stay on track," he says. His advice for those considering the CTA program? "Jump in and embrace the journey. You won't master everything, but you'll come out with a clearer direction for your career."

Professional achievements at Pilot Partners

In his role at Pilot Partners, Jeremy has developed significant expertise in corporate tax, international tax and estate planning. He provides tailored tax solutions to a wide range of clients and thrives on solving complex problems. "It's satisfying to deliver a solution that helps a client and to learn something new in the process," he shares.

One of his standout achievements was leading an international tax restructuring project for a multinational corporation. His efforts were key to identifying risks and opportunities and devising a tax-efficient strategy that delivered a successful outcome for the client.

A focus on continuous learning

Although Jeremy is currently taking a break from formal study, he remains committed to expanding his expertise in areas like international and corporate tax law. His journey exemplifies how continuous learning shapes a successful career in tax.

"Tax changes so rapidly. What you learned during your degree might already be outdated by the time you enter the workforce," Jeremy observes. Subjects like CTA3 Advisory, he believes, help professionals stay ahead by equipping them with practical skills and critical thinking abilities.

Navigating potholes and sinkholes on "vacant" land

by David Krunic, CTA, Principal,
DKP & Co Chartered Accountants

This article discusses the combined impact of a series of changes to negative gearing and rental property deductions available to individual, family trust and self-managed superannuation fund taxpayers. Discussion regarding changes to vacant land, travel and capital allowance measures in relation to residential property now leaves us with a more complex income tax environment. Appropriate treatment of holding cost expenditure during construction, involuntary destruction and sale of residential investment property has been assisted with guidance from the ATO. Some exemptions and exclusions for assets used in business are also discussed, as are some associated income tax and CGT measures. Many individual residential rental property owners will need to consider these issues in order to ensure the appropriate income tax treatment. The new landscape is more complex and sometimes results in inconsistent outcomes. As a result, further reform is recommended.

Introduction

Negative gearing and the ability to deduct various rental property expenditure against salary and wage income has attracted significant media attention and public interest once again.

A common misconception with rental property expenditure is that we have an unlimited negative gearing regime, an ability to deduct all costs in relation to holding a rental property. This is not the case.

Since 2017, we have had a series of restrictions imposed on the ability of an individual taxpayer to deduct a range of costs in relation to a typical residential rental property investment. Further restrictions introduced in 2019 have been followed by TR 2023/3 which has provided welcome guidance on some of the measures relating to "vacant" land.

The article will address restrictions to rental property deductions as they apply to an individual not in business, with a focus on the following issues in the context of rental property expenditure:

- holding costs;
- travel;
- depreciation;
- third element cost base; and
- non-commercial losses.

The article begins with a description of who is subject to the measures and the meaning of "vacant" land contained within s 26-102 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97). It then considers the issues faced at the commencement of the rental property investment cycle – the acquisition.

Who are the target taxpayers?

Recent reforms to residential rental property deductions (ss 26-102, 40-27 and 26-31 ITAA97) specifically target non-business taxpayers, including individuals, family/discretionary trusts, closely held unit trusts, and self-managed superannuation funds not in business.

The following taxpayers are excluded from these measures (s 26-102(5)):

- a corporate tax entity;
- a superannuation plan that is not a self-managed superannuation fund;
- a managed investment trust;
- a public unit trust (within the meaning of s 102P of the *Income Tax Assessment Act 1936* (Cth) (ITAA36); or
- a unit trust or partnership, if each member of the trust or partnership is listed above during the income year.

There are also exclusions for land used in primary production, structures affected by natural disasters, and other exceptional circumstances.

Is "vacant" land only vacant land?

The "vacant" land measures are significantly broader than what we ordinarily consider to be parcels of vacant residential land purchased in a new estate.

Section 26-102 significantly extends this common understanding to encompass situations where the land does not have a substantial and permanent structure that is lawfully able to be occupied and is either leased, hired or licensed, or is available for lease, hire or licence.

The measures include situations where a dwelling is under construction, extended renovations and extended repairs that inhibit rental use, demolition and vacancies during a typical sale process. The acquisition of an "off the plan" investment or "knock-down job" to be rebuilt as a rental property would also be captured.

Many individual rental property owners would likely encounter these situations several times during the life cycle of their property ownership.

House and land deposits – new building, new treatment

Many practitioners are requested to advise on the tax treatment of buying "off the plan" and building a rental property on vacant land.

An example provided in TR 2023/3 clearly articulates that holding costs can only be deducted from the time the property is legally capable of being occupied and is available for lease. TR 2023/3 provides the following example:

> **"Example 5 – new construction**
>
> 23. Harry purchases vacant land on 1 July 2019 and builds a house on the land. He obtains an occupancy certificate on 9 February 2020. Harry lists the property with a real estate agent for lease on 1 March 2020. Any holding costs that Harry would otherwise be entitled to deduct from 1 March 2020 will not be denied by section 26-102, as from this date the house is lawfully able to be occupied and is available for lease."

However, at para 26 of TR 2023/3, the ATO states that a separate loan does not relate to holding land:

> "… we do not consider the costs of repairing, renovating, or constructing a structure on the land, or any interest or borrowing costs (to the extent they are associated with repairs, renovation or construction), to be a loss or outgoing related to holding land."

This opens up an advantageous income tax outcome where an individual obtains another loan to fund construction on the vacant land. Note para 27 of TR 2023/3 which states:

> **"Example 6 – interest expense for multiple purposes**
>
> 27. Giovanna takes out a mortgage to purchase a vacant block of land in September 2019. Giovanna intends to build a house on the land (which she will rent out). Giovanna does not carry on a business. Giovanna takes out a separate loan for the construction of the house. Giovanna will not be able to claim a deduction for her interest expense which relates to acquiring the land until the house is lawfully able to be occupied and leased or available for lease. If a deduction is otherwise available for the construction loan interest expense, Giovanna will not be prevented from deducting the expense by section 26-102."

Taxpayers are now incentivised to obtain separate loans when buying land and then building on that land, contributing to additional administration and borrowing costs.

Demolition, sale of residential rental property

Inevitably, we reach a stage where the property will be demolished or sold. Accordingly, it is necessary to consider the treatment of holding costs during these periods.

In order to claim holding costs, s 26-102 requires that the residential premises:

- are lawfully able to be occupied; *and*
- are leased, hired or licensed; or
- are available for lease, hire of licence.

To explain the outcome of demolishing an established house, refer to para 18 of TR 2023/3:

> **"Example 3 – demolishing an established house**
>
> 18. Arun purchased an established house which he has used as a rental property for several years. On 1 July 2019, he decides to demolish the existing house to build a townhouse. The tenants vacate the property in October 2019. The house is demolished in December 2019. The property was in use or available for use until the date of demolition. Any holding costs that Arun may otherwise be entitled to deduct until the property was demolished would not be limited by section 26-102."

The ATO considers that, during the period *after* the tenants vacate in October 2019 and *before* the demolition occurs in December 2019, the premises will be available for use unless deemed unsafe to occupy by a council, relevant body or relevantly qualified professional (para 16 of TR 2023/3).

> **Practitioner note**
>
> Unless the property is "leased" for 52 weeks during the year, detailed reasoning as to why the property was not generating income during any period of ownership should be maintained.

Meaning of holding costs – apportionment requirement

Although not specifically defined in s 26-102, the ATO has published QC 60628, where it itemises various costs of holding land:

1. ongoing borrowing costs, including interest payments on money borrowed for the acquisition of land;
2. land taxes;
3. council rates; and
4. maintenance costs.

According to both QC 60628 and para 26 of TR 2023/3, repairs and insurance are not holding costs.

Another important note for practitioners is that the concept of "holding costs" is *different* to the third element of the cost base defined in s 110-25(4)(b) ITAA97. Table 1 summarises the key items.

Once again, we encounter a few more "potholes" when considering the appropriate treatment of various items of common rental property expenditure.

Table 1. Differences between holding costs and the third element of the cost base

Expenditure	Holding costs for "vacant land"	Third element of cost base (s 110-25(4))
Interest – land	**Yes**	**Yes**
Interest – construction	No	**Yes**
Borrowing costs	**Yes**	No
Land tax	**Yes**	**Yes**
Council rates	**Yes**	**Yes**
Maintenance	**Yes**	**Yes**
Repairs	No	**Yes**
Insurance	No	**Yes**

Practitioner note

Repairs and insurance are not captured by the meaning of "holding costs". Therefore, s 26-102 should not operate to restrict their deductibility, and those costs should retain their deductibility under s 8-1 ITAA97 during the "vacant" period of a rental property.

Cost base exclusions – watch the date of acquisition

There is considerable discussion among practitioners that any vacant land holding costs that are denied deductibility are automatically included in the third element of the asset's cost base (s 110-25(4)) as some sort of "compensation".

This is not the case. The third element of the cost base relates to the cost of ownership, and this only applies where the asset was acquired after 20 August 1991. Section 110-25 was not changed in 2019, and therefore vacant land holding costs could slip through a pothole and not count towards the cost base.

With respect to travel costs, s 110-38(4A) ITAA97 also specifically excludes travel costs from forming part of the cost base.

Are all holding costs denied when the measures apply?

Once we have a "vacant" period, s 26-102 only seeks to deny the associated holding costs. But not all is lost; here, we have a method which assists the taxpayer in deducting some of these costs.

As each type of holding cost has its own specific features they will be discussed separately.

Council rates – corresponds with the income tax year

In QC 60628, the ATO has further categorised holding costs into those that are "for a period that applies before and after the property is ready for use", and has provided an example where an individual taxpayer incurs council rates and the property was vacant during the income year.

The example requires an apportionment of costs based on the number of days the property was available for use during the year to determine the deductible amount:

> "… Kylie's council rates for the year ended 30 June 2024 are $2,000. Kylie apportions the council rates according to when the property became available for use.
>
> > Holding expense × portion of year property was available = deductible amount
>
> Kylie can claim a deduction against her rental income of:
>
> > $2,000 × (214 ÷ 366) = $1,169."

The costs are not automatically disallowed based on the timing of the expenditure, ie holding costs incurred during a period of "vacancy" are not completely "lost" if the property returns to rental use later in the income tax year.

In most municipalities, council/shire rates are issued at the start of the financial year and cover the same 12-month period as income tax years (ie 1 July through to 30 June), thereby making the apportionment calculation relatively straightforward.

Land tax – differs to the income tax year

With respect to land tax, the land tax notice is typically issued at the start of the calendar year and covers the period 1 January through to 31 December of that year. For example, in Victoria, an annual land tax notice issued in January 2024 typically relates to the period from 1 January 2024 through to 31 December 2024.

As a result, if the period of "vacancy" arises during the period 1 July through to 31 December, it would appear that taxpayers need to consider the land tax notice issued and incurred in the previous income tax year and apportion costs accordingly. This creates complexity when determining the correct amount of land tax to deduct in any one income tax year.

Borrowing costs – upfront and annual charges

With respect to borrowing costs, they are typically incurred at the time finance is obtained when the property is purchased, followed by an annual finance charge during the life of the loan and later if the loan is refinanced.

It would appear reasonable that annual charges could be apportioned based on the use of the property over the preceding 12 months.

With respect to the up-front borrowing costs and refinance costs, s 25-25(5) ITAA97 basically tells us to deduct those costs over a maximum of five years. However, these borrowing costs are tied to the life of the loan, and the property may cease to be available for rent many years after the costs have been deducted even though the loan continues to exist.

When there is a period of "vacancy", it appears reasonable to proportionately reduce the amount deducted relating to that period. Once again, we have complications where the vacant period does not align with the income tax year or the five-year rule in s 25-25.

Practical guidance on the interaction of s 26-102, s 25-25 and an appropriate apportionment methodology would be welcome.

Interest costs – mind the days

In many cases, the most significant holding cost for rental property owners is interest. With the requirement to apportion holding costs now becoming an issue, we need to be aware of how interest is calculated and charged for each loan facility.

Usually, interest accrues on a daily basis, but interest will only be charged by the financier to the borrower in arrears (ie at the end of the month, on the last business day of the month, annually, quarterly, fortnightly or another anniversary date that corresponds with the letter of offer or Div 7A ITAA36 if financed by a related party).

> "... taxpayers now have an incentive to allow items in their rental property to become inoperative ..."

Accordingly, we will inevitably have a situation where the property is "vacant" and the costs will require apportionment. When the "vacancy" happens all within one income tax year, the apportionment calculation can be straightforward.

Interest costs – messy prepayments

We now need to consider the issue of appropriately treating prepaid interest which is otherwise an allowable deduction pursuant to s 82KZM(1)(aa)(ii) ITAA36.

Consider a hypothetical situation where an individual taxpayer prepays 12 months' interest on a $10m rental property loan at 8.00% on 29 June 2021 and deducts $800,000 when submitting their 30 June 2021 income tax return.

If the property was to become "vacant" for six months in the 2022 income year due to extended repairs, or to rectify safety concerns, it seems that the taxpayer would have to amend the 30 June 2021 income tax return to the extent of $400,000, even though the vacancy occurred in the subsequent year.

We could have an unusual situation where the deductions are denied in a period when the property was exclusively available for use (ie 30 June 2021 income year), whereas the deductions for repairs are allowable in the subsequent vacant period (ie 30 June 2022 income year).

It would seem reasonable that any borrowing costs associated with the prepayment would be treated similarly.

This requirement to apportion holding cost expenditure results in significant complications for negative gearing and additional compliance costs.

Maintenance costs – what is the relevant period?

Regular maintenance expenditure also provides its own quirks.

In QC 60628, the ATO states that costs that are for a period before and after the property is ready for use can be apportioned. With respect to maintenance expenditure, it may be difficult to determine the period to which those costs relate. It is suggested that, if the maintenance costs are an annual expenditure, it may be reasonable and consistent to apportion costs over that annual period corresponding to when the property is available for use.

Maintenance expenditure may be required on an annual basis or after an item of plant and equipment is used for a certain number of hours.

Guidance from the ATO on this matter would be welcome.

An important note with respect to maintenance costs is that "maintenance" implies that the item was not inoperative or damaged. This needs to be differentiated from "repairs" which occur when the item was damaged or somehow inoperative. Taxpayers are now obligated to differentiate "repairs" from "maintenance" expenditure.

Further, taxpayers now have an incentive to allow items in their rental property to become inoperative or damaged so that the expenditure qualifies as a repair which is unhindered by s 26-102.

For completeness, at para 59 of TR 2023/3, the ATO has ruled that it will not apply resources to review compliance with s 26-102 during brief periods of vacancy to undertake repairs to a rental property.

Apportionment methods for holding costs

Table 2 summarises possible apportionment methodologies available for various holding costs.

Vacant land – business use exclusion

Although there is a general exemption from the "vacant" land measures for land used in carrying on a business, the coast is not all clear for individual business taxpayers.

Division 35 ITAA97, relating to non-commercial losses, still has residual operation. Section 35-40 ITAA97 could apply where the reduced CGT cost base of the real property is less than $500,000. So, although s 26-102 may not be triggered, if the property has a value of less than $500,000, those costs may nevertheless be deferred if other tests contained within Div 35 are not satisfied.

Table 2. Apportionment methods for various holding costs to determine deductible amount

Holding cost	Apportionment methodology	Note
Interest – in arrears	Days basis	Consider when interest is charged
Interest – in advance (prepayment)	Days basis	May require amendment to prior year deduction if vacant period
Borrowing costs	Days basis over the life of the loan or five years	May require amendment to prior year deduction
Land tax	Days basis – calendar year	Check prior year assessment
Council rates	Days basis – income tax year	Record days in use
Maintenance	Useful life, hours of use or service cycle	Different to repairs

Section 26-102 is not a deduction provision; it is there to *limit* deductions.

The business use test is a carve-out from the "vacant" land measures, not from the non-commercial loss provisions.

Natural disaster and exceptional circumstance exclusions

A sensible exclusion to these restrictions exists when the structure is affected by a natural disaster or other exceptional circumstance (s 26-102(6)). This would cover situations like an earthquake, a sinkhole, substantial building defects or a major building fire.

However, it should be noted that the exclusion only applies for three years, after which the taxpayer must apply to the Commissioner for an extension of time (s 26-102(6)(d)(ii)). Factors taken into account when granting an extension include government and council delays, builder problems and legal disputes.

An inability to rectify the structure and return it to the rental market due to financial constraints or an economic downturn is not considered acceptable.

Written records of the exceptional circumstances must be maintained for five years (s 26-102(7)).

Travel to a rental property

Another significant restriction to rental property deductions relates to travel.

From 1 July 2017, s 26-31 ITAA97 disallows deductions for travel expenditure relating to producing assessable income from the use of residential premises as residential accommodation. Emergency visits to site, construction-related travel, or sale-specific travel are not deductible.

Plant and equipment depreciation deductions

Another measure restricting rental property deductions was announced in the May 2017 Federal Budget. Subject to some transitional and grandfathered provisions, from 1 July 2017, deductions for the decline in value ("depreciation") of a depreciating asset used to generate income from a residential premises ("rental property") is only available for new assets (s 40-27 ITAA97).

Subsequent owners of the rental property are unable to claim deductions for depreciable plant and equipment purchased by a previous owner of the rental property.

Summary

In summary, after almost a decade of changes, we have this very peculiar situation for individual rental property owners that have breached integrity measures.

Provided none of the exclusions in s 26-102 apply to the land (eg exceptional circumstances, business use, short period between tenants), we now have an inconsistent mix of deductible and non-deductible rental property expenses for a single asset in breach of legislated integrity concerns.

Table 3 summarises the typical position for an individual.

Reform undertaken in 2017 and 2019 to rental property and negative gearing deductions has left us in a significantly

Table 3. Summary of income tax treatment when land is "vacant" (eg extensive renovations)

Expenditure	Holding costs for "vacant land"	Deductible
Interest – land loan	**Yes**	No
Interest – separate construction loan	No	**Yes**
Borrowing costs – land loan	**Yes**	No
Borrowing costs – separate construction loan	No	**Yes**
Land tax	**Yes**	No
Council rates	**Yes**	No
Repairs	No	**Yes**
Maintenance	**Yes**	No
Insurance	No	**Yes**
Travel	No	No
Depreciation (used plant and equipment)	No	No

more complicated and somewhat contradictory situation where some costs remain deductible and others lose their deductibility for the same underlying asset.

Conclusion

It is hoped that this article provides clarity to advisers and taxpayers when dealing with the appropriate income tax treatment of various rental property deductions and the issue of negative gearing.

As outlined above, the current tax laws governing negative gearing in Australia are full of potholes, many new complexities and several unanswered issues.

Integrity measures introduced over the last decade don't integrate very well and appear to produce some unintended and confusing outcomes. Although various professional bodies have submitted detailed issues and concerns, many questions remain unresolved.

It is timely that sensible review and reform is undertaken. One that addresses these real issues and integrates the broader income tax system to achieve a fair and consistent outcome that is easier to comprehend and administer, and deals with integrity issues.

Here's to essential tax reform.

David Krunic, CTA
Principal – Taxation Advisory
DKP & Co Chartered Accountants

Australia's hybrid mismatch rules: current issues

by Melanie Earl, CTA, Partner, and Melissa Gile, Director, Deloitte

The Australian hybrid mismatch rules have been in place for over six years and as the implementation by other jurisdictions continues, the focus of the ATO on how taxpayers are applying and interpreting the rules has increased. The ATO's evolving expectations have therefore resulted in the issuance of public advice and guidance, rulings and determinations, and increased scrutiny during risk and assurance reviews. This article aims to highlight the current tax issues and practicalities that are relevant to the application of the Australian hybrid mismatch rules, including its potential interaction with the implementation of the Pillar Two regime. The article also provides an overview of the ATO's insights and findings as documented in its latest publications.

Important note

This article was originally presented at The Tax Institute's International Masterclass on 20 June 2024. Following the presentation, further developments have transpired in relation to the topics discussed and presented at that time. In this regard, this article should be read in conjunction with the Addendum (current as at 15 November 2024).

Introduction

The framework for the hybrid mismatch rules (HMRs) was developed by the Organisation for Economic Co-operation and Development (OECD) as part of action 2 of the OECD/G20 base erosion and profit shifting (BEPS) project which addresses the erosion of the tax base through hybrid mismatch arrangements which reduce or defer income tax of multinational groups. The policy objective of the HMRs is to neutralise the tax advantage for multinational groups due to the differences in the tax treatment of an entity or instrument between two or more jurisdictions.

Australia, along with other OECD members, subsequently introduced the HMRs with an aim of levelling the playing field between multinational and domestic groups by adopting the recommendations from the BEPS action 2 report having regard to the outcome of the Board of Taxation's consultation on implementation. The Australian HMRs in Div 832 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) apply from 1 January 2019, along with the imported HMR applying from 1 January 2020 to non-structured arrangements. The Australian HMRs go beyond the OECD recommendations by including a targeted integrity rule (TIR) which broadly seeks to deny an Australian deduction where an outgoing payment is subject to less than 10% foreign tax (with limited exceptions).

The HMRs have been subject to several technical amendments with retrospective application, accompanied by various ATO advice and guidance to assist with voluntary compliance. However, the HMRs continue to be challenging due to uncertainties with a number of interpretative issues and the high bar of expectations that the ATO has set to demonstrate compliance with the HMRs.

This article seeks to highlight current issues and practicalities that are relevant to the HMRs having regard to the latest developments in Australia and globally, including the following:

- global status and update on implementation of the HMRs in key regions;
- introduction of the Pillar Two regime and potential interaction issues;
- common United States structures that may pose a concern based on recent advice and guidance issued by the ATO, including TD 2024/D1; and
- compliance expectations based on the ATO's latest findings report in respect of assurance programs, as well as recent changes to the 2024 company income tax return schedules.

It should be noted that this article is not intended to provide a technical analysis of the HMRs which ultimately rely on specific facts and circumstances.

Global status of the HMRs

In 2015, the OECD released the report *Neutralising the effects of hybrid mismatch arrangements* to address BEPS through double non-taxation and tax deferral arising from the different tax treatment of an entity or characterisation of a hybrid financial instrument under the tax laws of two or more jurisdictions.

Action 2 of the OECD/G20 BEPS project made recommendations to the Inclusive Framework members to neutralise the effects of hybrid instruments and entities through the implementation of local legislation and modification to the tax treaties. In 2017, the OECD's work on hybrid mismatch arrangements was subsequently expanded through the release of the report *Neutralising the effects of branch mismatch arrangements*. In response to the OECD's recommendations, a number of Inclusive Framework members adopted the HMRs to address a comprehensive range of hybrid and branch mismatches. Alongside Australia, the United Kingdom and New

Zealand enacted HMRs which, according to the OECD, are consistent with the common approach as it relates to action 2.

Several OECD members have since implemented (either in full or in part) similar foreign HMRs. However, there is limited guidance as to whether the foreign HMRs implemented by other jurisdictions corresponds with Australia, which is relevant for the purposes of determining the application of the imported HMR. As mandated by the ATO, taxpayers "should not claim a deduction for a payment unless they are able to obtain sufficient information to support a conclusion that the deduction in respect of the payment is not disallowed under Subdivision 832-H [ITAA97]".

Diagram 1 shows a high-level snapshot of the HMRs implementation status/rules that have been introduced or will be enacted in key regions around the world.

Interaction with the Pillar Two rules

Australia, along with other members of the OECD Inclusive Framework, have agreed to the Pillar Two model rules under the OECD/G20 Inclusive Framework on BEPS. Broadly, Pillar Two applies to in-scope multinational groups with global anti-base erosion (GloBE) revenue of €750m+ and imposes a 15% tax in every jurisdiction where it operates. The GloBE rules are intended to be implemented by each jurisdiction locally, based on the OECD model rules, and operate in a coordinated manner with the local rules of other jurisdictions where a multinational group has a presence. In this regard, the profits of constituent entities derived in a low-tax jurisdiction may nevertheless be subject to the Pillar Two rules in another jurisdiction in which the multinational group operates that is yet to implement Pillar Two.

On 21 March 2024, Treasury released the exposure draft legislation for the implementation of the OECD Pillar Two rules in Australia. The package of exposure draft legislation includes both primary and subordinate legislation (rules), along with accompanying explanatory materials for consultation, which will apply to income years beginning on or after 1 January 2024.

The legislative framework of the announced Pillar Two rules in Australia includes the draft Taxation (Multinational — Global and Domestic Minimum Tax) Imposition Bill 2024 to determine any top-up tax payable under the income inclusion rule, and a domestic top-up tax amount under the domestic minimum tax. A proposed undertaxed profits rule has been deferred for another 12 months.

Under the Pillar Two rules, transitional country-by-country reporting safe harbours (CbCR TSH) may apply to exclude operations in lower-risk jurisdictions from preparing full GloBE calculations during the transitional period. The CbCR TSH apply to income years beginning on or before 31 December 2026. However, the OECD Inclusive Framework has agreed that in-scope multinational groups which entered into "hybrid arbitrage arrangements" after 15 December 2022 could be subject to the anti-avoidance rule and not qualify for the CbCR TSH.

According to the OECD, a hybrid arbitrage arrangement includes:

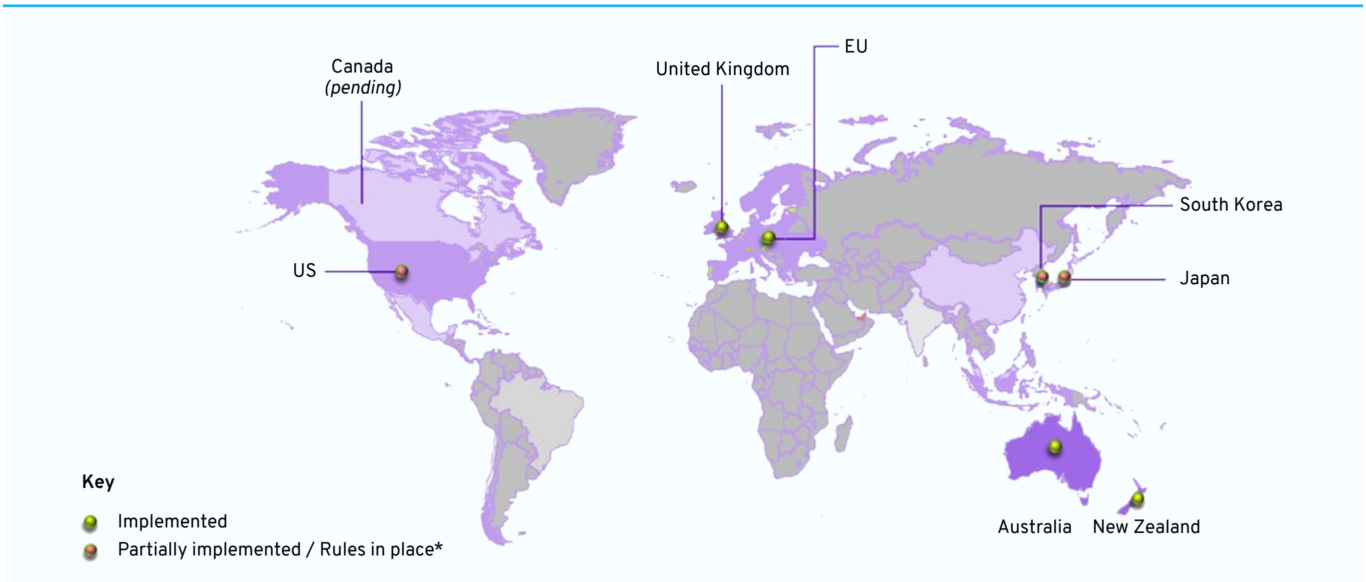
- a deduction/non-inclusion arrangement;
- a duplicate loss arrangement; and
- a duplicate tax recognition arrangement.

In this regard, CbCR TSH calculations must be adjusted by:

- excluding from the profit before tax: any expense/loss arising from either deduction/non-inclusion arrangements or duplicate loss arrangements; and
- excluding from the income tax: expenses arising from duplicate tax recognition arrangements.

Multinational groups must consider the availability of the CbCR TSH which simplify the GloBE computations during the transitional period. Subject to the audit materiality

Diagram 1. Overview of global status



in Australia, separate financial disclosures of Pillar Two exposures will be required when the Australian legislation is substantively enacted as at the reporting date. Local filing obligations will arise in Australia and other jurisdictions in which they operate where Pillar Two is in force (due 18 months after the year-end for the first return and 15 months thereafter).

Based on the consultation paper which accompanied the draft rules, Treasury has taken the view that Australia's HMRs, including the TIR, should continue to operate despite the foreign jurisdiction imposing a global or domestic minimum tax. In this regard, Treasury invited comments on whether amendments are required to the "subject to foreign income tax" definition which is particularly relevant for foreign headquartered groups that could face double taxation if both the HMRs and the Pillar Two rules apply.

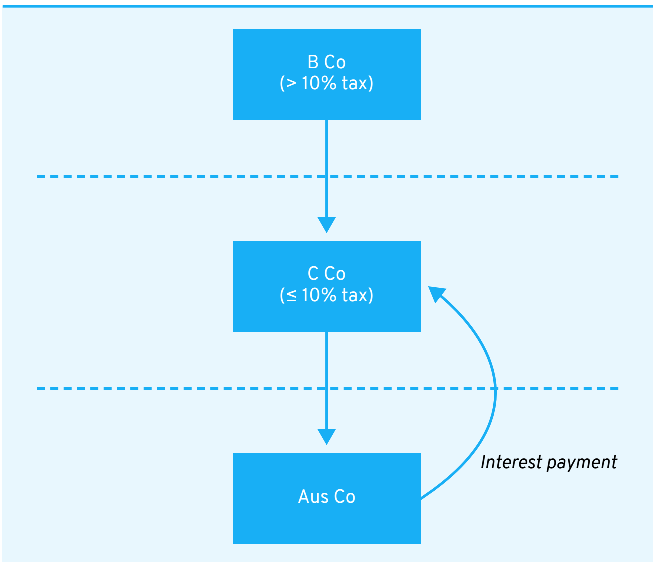
As drafted, s 832-725(4) ITAA97 switches off the TIR where the relevant payment is subject to tax pursuant to a corresponding controlled foreign company (CFC) regime. In this regard, the application of the TIR without regard to the imposition of the global and domestic minimum taxes potentially results in double taxation. This is illustrated in the example below.

Targeted integrity rule example

In the example:

- B Co is located in country B which does not adopt a CFC regime but has implemented Pillar Two;
- Aus Co in Australia is indirectly wholly owned by B Co;
- B Co also wholly owns C Co, a financing entity located in country C with a headline corporate rate of less than 10%;
- C Co enters into a financing arrangement with Aus Co; and
- Aus Co makes interest payments to C Co which is deductible in Australia (see Diagram 2).

Diagram 2. Targeted integrity rule



In this scenario, the TIR may disallow Aus Co's interest deduction in Australia where the threshold conditions of the TIR are met. As contemplated by Treasury, the definition of "subject to foreign income tax" does not include global and domestic minimum taxes in country C when determining whether the payment is subject to foreign income tax that is 10% or less for the purposes of the TIR.

Under Pillar Two, the payment is included in the profit before tax of country C and subject to top-up tax (where the jurisdictional effective tax rate is less than 15%). Double taxation potentially arises in Australia under the TIR (ie denial of the interest deduction giving rise to additional tax liabilities) and in country B under Pillar Two (ie payments are included in the GloBE tax base of B Co). The ATO's targeted consultation on the implementation of a global minimum tax and domestic minimum tax is in progress to obtain feedback on the administrative, compliance and systems impacts relevant to Pillar Two. The consultation was expected to be completed in June 2024.

Latest ATO update

Insights from the ATO's assurance program

Top 100

In September 2023, the ATO published its latest findings on the outcomes of the income tax and GST justified trust assurance reviews undertaken with the Top 100 taxpayers in respect of the year ended 30 June 2023. According to the ATO, a larger proportion has achieved an overall high assurance rating compared to 2022 (29%).

The ATO noted that low assurance ratings and red flags were generally associated with related party or other structured arrangements which circumvent certain anti-avoidance rules, such as the hybrid mismatch integrity rule. To obtain justified trust, the ATO expects adequate evidence has been prepared and obtained by taxpayers to support their HMR self-assessment processes and analysis and to demonstrate compliance with the rules.

Given that the Top 100 taxpayers are subject to annual pre-lodgment compliance reviews, arrangements rated as high-risk would continue to be monitored by the ATO on a regular basis.

Top 1,000

In October 2023, the ATO subsequently released its latest findings on the outcomes of the combined income tax and GST justified trust assurance reviews undertaken in relation to the Top 1,000 taxpayers. The ATO identified and reviewed circumstances where the HMRs apply, having regard to LCR 2019/3 and accompanying PCG 2019/6 and PCG 2018/7. According to the ATO, several taxpayers made category C reportable tax position (RTP) schedule disclosures with regard to hybrid mismatch arrangements in the 2021–22 income year that were mostly "low-risk". Similar to the pre-lodgment compliance reviews for the Top 100, the scope of the Top 1,000 combined assurance review (CAR) covers income tax years where the full scope of the HMRs is in effect. According to the ATO, 28% of taxpayers that were subject to a CAR considered the application of the HMRs to hybrid arrangements (compared to 14% in 2022). The ATO also observed a positive trend where a larger proportion of taxpayers achieved an overall high assurance rating.

Taxpayers that attained medium assurance for HMRs under the CAR was due to inadequate evidence being provided to support the processes and procedures that the taxpayers were taking to ensure compliance with the imported HMR. The ATO reiterated its expectations for taxpayers to self-assess against PCG 2021/5 and maintain sufficient documentary evidence to support its position.

In this regard, multinationals within the Top 100 and Top 1,000 population should ensure that relevant queries, analysis and contemporaneous documentation is prepared to support their HMR positions ahead of any future ATO assurance reviews. This includes revisiting recommendations put forward by the ATO in relation to earlier assurance reviews.

Medium and emerging public and multinational businesses

As part of the ATO's Tax Avoidance Taskforce, there will be an increased focus on taxpayers that are classified as "medium and emerging" public and multinational businesses (medium and emerging). In February 2024, the ATO released the medium and emerging public and multinational business engagement program. The program will include:

- taxpayers that are part of an economic group controlled by a public or multinational entity with a combined Australian turnover of less than $250m; or
- taxpayers where high-priority or emerging tax risks are identified and where they are part of an economic group controlled by a public or multinational entity with a combined turnover of more than $250m and outside the justified trust programs.

> "The ATO expects adequate evidence has been prepared and obtained by taxpayers to support their HMR self-assessment processes and analysis."

According to the ATO, payments that give rise to hybrid mismatch outcomes will be one of its focus areas as part of the engagement program for the medium and emerging market. Taxpayers that have good record-keeping and tax control frameworks are expected to have a streamlined engagement experience. In this regard, taxpayers within the medium and emerging market must ensure that a robust self-assessment is performed against PCG 2021/5 regarding the application of the imported HMR, PCG 2019/6 regarding structured arrangements, and PCG 2018/7 if they are planning to restructure out of hybrid arrangements.

ATO web guidance

As noted throughout this article, Australia's HMRs largely follow the OECD action 2 report, designed to prevent multinational companies from gaining an unfair competitive advantage by avoiding income tax or by obtaining double tax benefits through hybrid mismatch arrangements.

The ATO website was updated on 31 January 2024 to provide a single point of reference for its current guidance regarding the HMRs. The ATO web guidance outlines how the HMRs work in Australia and when they apply. Since enactment, Australia's HMRs have gone through a number of technical amendments. To clarify and improve the operation of the HMRs, the ATO web guidance has summarised these amendments, including the application dates for the amendments.

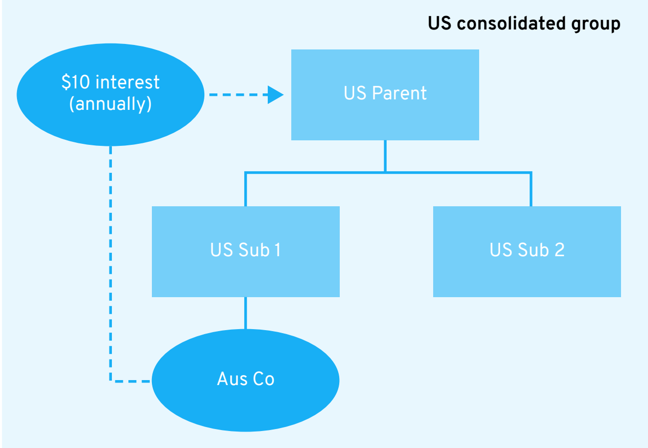
Due to the retrospective effect of the amendments to the HMRs, taxpayers will need to either decide to comply with the law (pre-amendments) or anticipate the amendments (now enacted law) for the purposes of their income tax return lodgments. The ATO recommends that taxpayers review their lodged returns now that the proposed amendments have been enacted. To assist, taxpayers should refer to the ATO's "Administrative treatment of retrospective legislation" and "Lodgment and payment obligations and related interest and penalties" web guidance. PS LA 2007/11 also provides further information on how the ATO administers retrospective changes.

The ATO web guidance includes an example to illustrate the application of the HMRs in respect of payments from an Australian subsidiary to its US parent company which are in a US consolidated group (see Diagram 3).

When determining whether the payment is "subject to foreign income tax", the ATO will consider the extent to which the payment was included in a recipient member's "separate taxable income" during the relevant period. If the subsidiary is "disregarded" by its immediate parent company and deductions are claimed in Australia and the US, the ATO concluded that a deduction/deduction mismatch will arise.

In this regard, US inbounds must be prepared to coordinate with the US counterparts to obtain copies of the US

Diagram 3. ATO web guidance example



consolidated tax return and relevant supporting documents which the ATO may request to determine whether the related party payment has been included in the US recipient member's "separate taxable income".

TD 2024/D1

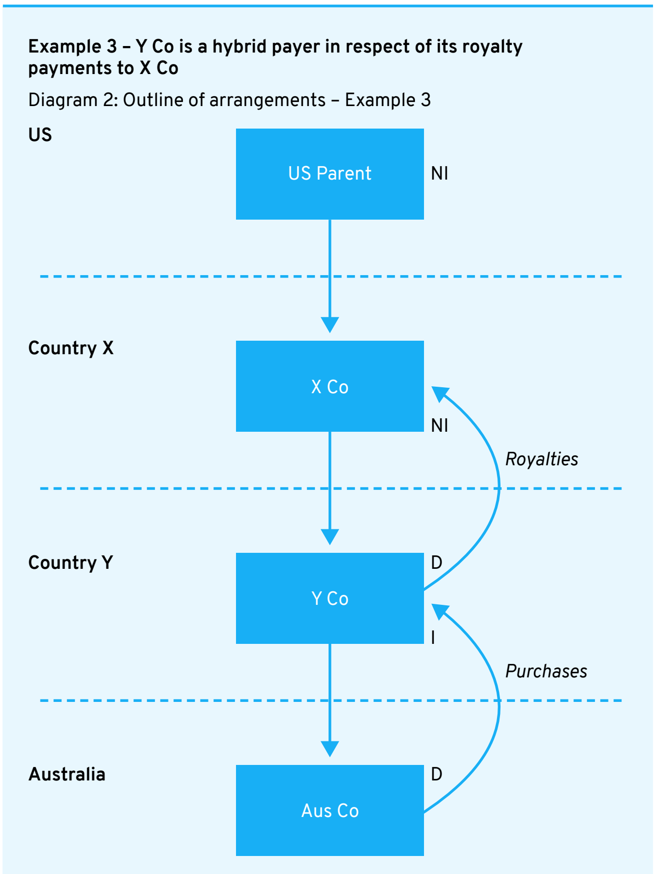
On 13 March 2024, the ATO released TD 2024/D1 Income tax: hybrid mismatch rules – application of certain aspects of the "liable entity" and "hybrid payer" definitions.

The definition of "liable entity" in s 832-325 ITAA97 is a key concept of the HMRs which is relevant when determining whether an entity is a hybrid payer. Broadly, the general test for whether an entity is a liable entity in a jurisdiction in respect of its own or another entity's incomes is whether tax is imposed on the entity. Where no income or profits have been derived in the relevant jurisdiction, the ATO has taken the view that identification of one or more liable entities can be based wholly on hypothetical income or profits.

In relation to the "hybrid payer" definition for the purposes of s 832-320(3) ITAA97, the ATO has also taken the view that a "non-including country" can be a different jurisdiction to where the recipient entity of the payment is located. Therefore, the laws of a country (other than the country where the payee is located or resides) must be considered when determining whether there is a hybrid payer risk.

As such, a "hybrid payer mismatch" could be triggered regardless of the reason for which the payment is not subject to tax in the recipient's jurisdiction as illustrated in example 3 of TD 2024/D1 (see Diagram 4).

Diagram 4. TD 2024/D1 example 3



Based on the examples provided in TD 2024/D1, the ATO's interpretive view may impact US multinationals that have made "check-the-box" elections to disregard non-US subsidiaries. In this regard, US multinationals should consider arrangements that give rise to a deduction/non-inclusion mismatch in respect of a payment between entities in the same group in two different jurisdictions, or where check-the-box elections have been made by the US parent and it does not recognise the payment. According to the ATO, TD 2024/D1 is expected to be finalised in July 2024.

2024 tax return disclosures

2024 RTP schedule

On 4 April 2024, the ATO published the form and instructions for the 2024 RTP schedule which included changes to the questions that are relevant to the application of the HMRs. In particular, question 27 in relation to structured arrangements (as outlined under LCR 2019/3 and PCG 2019/6) has been removed from the 2024 RTP schedule. Minor changes to question 39 were also made in relation to the self-assessed outcome of the application of the imported HMR under PCG 2021/5.

2024 international dealings schedule

On 5 June 2024, the ATO released the form and instructions for the 2024 international dealings schedule (IDS). There were no specific changes in relation to disclosures relevant to the HMRs. However, as noted in the IDS instructions under question 47a, the ATO expects taxpayers to disclose information that may have been obtained from their control group(s) in the course of preparing the HMRs income tax return disclosures. Specifically, this includes information relating to the existence of any offshore hybrid mismatches regardless of whether the information was obtained when determining compliance with Subdiv 832-H, and thus may or may not impact the tax position of the taxpayer (as flagged in the 2022 IDS instructions).

Compliance readiness

Having regard to the latest global tax developments and public advice and guidance from the ATO, going forward, multinationals are encouraged to consider taking the following steps to ensure compliance readiness:

- monitor the global status of the implementation of HMRs (noting any differences with the operation and scope compared to the Australian HMRs), particularly in the context of restructuring and proposed M&A transactions;
- regularly update and carefully examine the global group structure and be aware of any changes or additions to the entities. Coordinate with the offshore parent entity and make the necessary enquiries to identify and confirm the taxation of payments paid and received in the foreign jurisdiction to assess any potential hybrid mismatch exposures in Australia;
- prepare contemporaneous documents which evidence self-assessment against the relevant ATO practical

compliance guidelines and analysis that support the disclosures in the IDS and RTP schedules. Where applicable, revisit and action the ATO's recommendations from earlier assurance reviews;

- conduct an impact assessment and understand the global tax developments which may interact with the application of the HMRs such as the Pillar Two regime which could potentially result in double taxation. The impact assessment should include CbCR TSH modelling for tested jurisdictions which must be adjusted where there is presence of hybrid arbitrage arrangements that may compromise future eligibility for CbCR TSH; and
- monitor ATO advice and guidance to understand any developments of the ATO's interpretive views, compliance expectations and engagement approach in respect of applying the HMRs.

Addendum

This article was originally presented at The Tax Institute's International Masterclass on 20 June 2024. Following the presentation, further developments have transpired and the article should be read in conjunction with this Addendum (current as at 15 November 2024).

Recent global developments

Canada: hybrid financial arrangement legislation enacted

On 20 June 2024, Canada's Bill C-59 received royal assent in respect of hybrid financial arrangements. The Bill comprised various business tax measures that were announced from earlier federal budgets. The Department of Finance indicated that it would be introducing a second package of legislation focused on hybrid entities (including branch mismatches). However, the draft legislation is yet to be released.

TD 2024/4 finalised

On 3 July 2024, TD 2024/4 was finalised by the ATO. As discussed in this article broadly, TD 2024/4 focuses on hybrid mismatch risks related to foreign disregarded entities (US "check-the-box" elections) under the US CFC rules. It is noted that the ATO subsequently launched a letter campaign which seeks to understand how taxpayers have applied the ATO's views as set out in TD 2024/4 since the HMRs first applied to a particular taxpayer. This signals the ATO's continued focus on the HMRs and the need for taxpayers to have a robust assessment in relation to all potential hybrid mismatch arrangements, including the imported HMR in accordance with PCG 2021/5.

US: dual consolidated loss rules proposed regulations

In August 2023, the IRS and the US Treasury proposed regulations to address certain issues which relate to the operation of the dual consolidated loss (DCL) rules, including:

- intercompany transaction rules;
- revisions to the current DCL rules;
- interaction with the Pillar Two GloBE model rules;
- new rules for disregarded payments that give rise to foreign tax deductions; and
- new anti-abuse rules.

The amending DCL regulations are proposed to apply to taxpayers with respect to taxable income years for which the original federal income tax return is due (without extensions) *after* the date on which the final regulations are published in the US Federal Register. In this regard, the potential interaction with TD 2024/4 should be monitored by US multinationals that have made "check-the-box" elections to disregard non-US subsidiaries or that make disregarded payments that give rise to foreign losses.

Australian implementation status of the Pillar Two regime

In August 2024, the outcome of the ATO's targeted consultation on Pillar Two to obtain feedback on the administrative, compliance and systems impacts was published on the ATO's website. It acknowledged the challenges, including capturing data points for the GloBE information return, as well as specific administrative and interpretative issues. The supporting activities being undertaken by advisers were also outlined, including the development staff capability, in-house modelling tools, early guidance to taxpayers on impact assessments, and data requirements. Finally, the ATO anticipated that further guidance will be required to support taxpayers in complying with future obligations, including the administrative and interpretive issues.

In September 2024, the ATO established a Pillar Two Global and Domestic Minimum Tax Working Group, which includes members from Australian headquartered multinationals in various sectors, advisers and corporate industry groups. The purpose of the working group is to focus on the administrative aspects of implementing the Pillar Two rules. In particular, the resourcing, systems and processes website. It acknowledged the challenges, including in preparation for compliance, including any necessary guidance. As at the date of drafting this article, the Bill for the Pillar Two primary legislation is still before the Senate, noting that the final sitting days for the year are from 18 to 28 November 2024.

ATO public groups findings report published

In September 2024, the ATO published the public groups findings report as at 30 June 2024 on the outcomes of the income tax and GST justified trust assurance reviews undertaken with the Top 100 taxpayers, and CARs in respect of the Top 1,000 taxpayers.

In relation to the Top 100, the ATO continued to review circumstances where the HMRs apply, having regard to LCR 2019/3, along with accompanying PCG 2019/6 and PCG 2018/7. According to the ATO, almost two-thirds of the arrangements reviewed were rated high or medium assurance.

In relation to the Top 1,000, the assurance ratings improved incrementally. The ATO reiterated that taxpayers that attained medium assurance for HMRs was due to inadequate evidence to support the processes and procedures undertaken to ensure compliance with the imported HMR. A common reason for medium or low assurance ratings in respect of the HMRs continued to be the lack of evidence to demonstrate compliance, in particular in relation to the imported HMR.

The ATO also reiterated that its compliance approach is based on PCG 2021/5. In this regard, it is important that taxpayers continue to retain evidence to support their filing positions. Notably, the ATO has stated that it continues to identify structured transactions, including contrived arrangements designed to obtain deductions or avoid assessable income that circumvent the HMRs.

Melanie Earl, CTA
Partner
Deloitte

Melissa Gile
Director
Deloitte

This article is an edited version of "Australia's hybrid mismatch rules – current tax issues" presented at The Tax Institute's International Masterclass held in Sydney on 20 June 2024.

Case Note

by Mira Brewster, CTA, State Tax Specialist, and Liam Telford, National Tax Technical Director, RSM Australia

Director's appointment triggers landholder duty

A recent decision of the Victorian Civil and Administrative Tribunal whereunder landholder duty was triggered absent any change in beneficial ownership has shed light on the operation of the "acquisition of control" duty provisions in Victoria.

On 11 July 2024, Senior Member Tang of the Victorian Civil and Administrative Tribunal (VCAT) delivered a potential landmark decision in *Tao v Commissioner of State Revenue* (*Tao*).[1]

The decision in *Tao*, which represents the first time that the operation of s 82 of the *Duties Act 2000* (Vic) (the Act) has been considered by a tribunal or court, is significant for various reasons, including (inter alia) the peculiarity of landholder duty applying absent any change in beneficial ownership, as well as the novelty of Senior Member Tang's construction and application of the Commissioner of State Revenue's (the Commissioner's) "unfettered discretion" under s 82(1)(b) of the Act.

Background: change in control of the trustee

The key background facts in *Tao* were:

- in 2011, a special purpose vehicle (SPV) was established by three individuals (Messrs Constantinou, Tao and Wiemer) to carry on a joint venture to conduct property development in Melbourne. Establishment of the SPV involved:
  - incorporation of 66WR Pty Ltd (66WR), with Mr Constantinou as its sole shareholder, director and secretary;
  - entry by 66WR into a deed (with a third party as settlor) to establish the WCT Unit Trust (the trust); and
  - issuance of units in the trust at a price of $1 per unit as follows:[2]
    - 50 units to Maclaw No. 547 Pty Ltd (Maclaw) as trustee for The Mountain Highway Unit Trust;
    - Fredco Incorporated Ltd (Fredco) as trustee for Nomsec No. 1 Ltd; and
    - Amber Investments Pty Ltd (Amber);
- later in 2011, 66WR entered into a contract to purchase a development site in Lynbrook, Victoria (the relevant property), of which it took possession in February 2012. To fund the acquisition of the relevant property and meet development costs, a $2.79m loan was obtained by 66WR from Southern Finance (the loan). Southern Finance's loan book, including the loan, was acquired by Bendigo and Adelaide Bank (Bendigo Bank) in March 2013 pursuant to an unrelated transaction;
- subsequent events, including allegations of "serious mismanagement" as director of 66WR being levelled against Mr Constantinou, and the loan owing to Bendigo Bank by 66WR falling into arrears, led to Mr Tao replacing Mr Constantinou as the sole director and shareholder of 66WR, without any change to the ownership of the trust;
- in 2019, more than five years after Mr Tao replaced Mr Constantinou as the sole director and shareholder of 66WR and following a forced sale of the relevant property and deregistration of 66WR, the Commissioner issued a notice of assessment to Mr Tao whereunder ad valorem duty of $199,650 (plus penalties and interest of $49,912.50 and $22,383.51, respectively) were imposed. The landholder duty assessment was predicated on the foregoing events constituting a "relevant acquisition" by Mr Tao in the trust because of either:
  - acquiring a "significant interest" in the trust pursuant to s 78 of the Act; or
  - "control" of the trust pursuant to s 82 of the Act; and
- the first ground was dropped by the Commissioner before the matter reached VCAT, meaning that only the application of s 82 was at issue in *Tao*.

Legislation

Broadly, s 82 provides that where a person acquires, directly or indirectly, "control" over a private landholder other than by a "relevant acquisition", they will be deemed to have made a "relevant acquisition" in the landholder of:

- 100%; or
- a lesser percentage determined by the Commissioner to be appropriate in the circumstances.

According to the conjunctive operation of ss 3 and 71(1) of the Act, s 82 extends to trusts that have landholdings in Victoria with a total unencumbered value of at least $1,000,000.

Relevantly, s 82(2) provides as follows:

> "(2) For the purposes of subsection (1), a person acquires control over a private landholder if the persons acquires the capacity to determine or influence the outcome of decisions about the private landholder's financial and operating policies, taking into account –

(a) the practical influence the person can exert in addition to any rights the person can enforce; and

(b) any practice or behaviour affecting the private landholder's financial or operating policies (even if that practice or pattern of behaviour involves the breach of an agreement or a breach of trust)."

Section 82 operates discretely from s 81 of the Act, which deals with the acquisition of economic entitlements.

Decision

In *Tao*, Senior Member Tang determined that:

- when Mr Tao became the sole director and shareholder of 66WR, he obtained "control" over the trust for the purposes of s 82;
- having regard to the text, context and purpose of the provisions, it was not necessary for Mr Tao to have also obtained a beneficial interest in the trust for s 82 to be engaged; and
- it was appropriate for the "relevant acquisition" that was deemed to have occurred under s 82 to be reduced to account for Mr Tao's pre-existing economic interest in the trust.

The bases for each of the preceding determinations are considered in further detail below.

Obtaining control

Regarding whether Mr Tao obtained "control" over the trust on becoming the sole director and shareholder thereof, Senior Member Tang found that Mr Tao was, from that point, responsible for making strategic decisions concerning the trust as the sole director and shareholder thereof (eg in relation to the loan that was in arrears and had become an existential threat to the trust), notwithstanding his consultation of Messrs Constantinou and Wiemer on relevant matters, and the direct involvement of the former in negotiations pertaining to the loan.

Accepting that the concept of control over "financial and operating policies" envisaged by s 82 is focused on the strategic direction of a landholder, as opposed to its day-to-day management, Senior Member Tang held that, contrary to submissions by Mr Tao's counsel that Mr Tao was simply executing policy decisions that had already been initially determined by the unitholders of the trust, Mr Tao had acquired the capacity to determine or influence the outcome of decisions about the trust's financial and operating policies and that this constituted control thereover. It appears that the fact that the status of the loan had become an existential threat to the trust, causing relevant decision-making to take on a strategic character, was a relevant consideration of Senior Member Tang in arriving at his view.

No incremental beneficial interest

Despite conceding that, having regard to material extrinsic to s 82 and predecessor provisions,[3] "it may seem incongruous that duty is imposed under section 82 on a change in control of a trustee that is not also accompanied by a change in the beneficial ownership of the land held by that trustee",[4] Senior Member Tang ultimately rejected submissions by the applicant, calling for a purposive approach to the interpretation of the provision. Senior Member Tang instead accepted the Commissioner's submission that the words that would need to be read into the provision would be "enormous", which, per the majority decision of the High Court in *Taylor v The Owners – Strata Plan No. 11564*,[5] would materially transcend what can be achieved through an exercise of statutory interpretation.

Commissioner's discretion

In response to contentions by Mr Tao's counsel that that an adjustment to reduce the percentage of the deemed "relevant acquisition" to reflect Mr Tao's pre-existing economic interest in the trust via Amber, and despite submissions made on behalf of the Commissioner that such an adjustment would be erroneous, Senior Member Tang held in favour of Mr Tao on the basis of his view that the Commissioner's discretion under s 82(1)(b) was in place to counteract the potential for the default presumption of 100% to give rise to inappropriate outcomes (eg where a person who has obtained control has only incrementally increased an existing interest).

Notably, it was held that the appropriate reduction would *not* be the full 25% interest held in the trust by Amber (as contended by Mr Tao's counsel), but rather 15% (ie 60% of 25%, to reflect that Mr Tao personally held six of the 10 shares that Amber had on issue and therefore stood to receive 60% of any distributions Amber received from the trust).

Pursuant to the decision, the penalty was required to be correspondingly reduced, and interest recalculated by applying the market rate to the reduced amount of landholder duty.

Key implications

In addition to providing valuable edification on the task of statutory interpretation, *Tao* has several significant implications for Victorian landholder duty. Issues to consider include:

- the imprudence of relying on statements or undertakings on the State Revenue Office (SRO) website. In *Tao*, it was observed that the Commissioner's approach in the relevant circumstances was contrary to an undertaking on the SRO website. However, it was implicitly affirmed that, according to the earlier VCAT decision in *Winnett v Commissioner of State Revenue*,[6] the Commissioner was not estopped;
- the need for caution when acquiring shares and becoming the sole director of a corporate trustee of a trust that directly holds land in Victoria, specifically the need to consider whether the acquisition gives the holder the capacity to determine or influence the outcome of decisions about the landholder's financial and operating policies; and

- if "control" in a trustee is acquired, the need to confirm the value of Victorian landholdings, and whether the acquirer holds any pre-existing interest(s) in the landholder, even where those interests are *not* held directly to determine whether (1) the provisions are attracted, and if so, (2), if the quantum of the "relevant acquisition" can be reduced.

The implications of *Tao* are *not* expected to transcend Victoria due to the lack of similar provisions in other jurisdictions. The economic entitlement and acquisition of control provisions are only contained in the Victorian *Duties Act 2000*.

The taxpayer has lodged an appeal from VCAT, and the hearing date of the appeal will be on 25 March 2025.

Mira Brewster, CTA
State Tax Specialist
RSM Australia

Liam Telford
National Tax Technical Director
RSM Australia

References

1 [2024] VCAT 637.

2 Maclaw is an entity associated with Mr Constantinou, whereas Fredco and Amber are associated with Messrs Wiemer and Tao, respectively.

3 Former s 79(5) to (7) of the Act.

4 [2024] VCAT 637 at [102].

5 [2014] HCA 9.

6 [2019] VCAT 403.

A Matter of Trusts

by Meera Pillai, Associate, Sladen Legal

VRLT holiday home exemption extended to trusts

The application of vacant residential land tax to holiday homes has caused much anxiety recently, particularly where that holiday home is held in a trust.

It's the festive season, which for many involves staying at a holiday home. Grinch-like, the Victorian Government's recent expansion of the vacant residential land tax (VRLT) rules could potentially have subjected these properties to VRLT where they were held by a trust or company. Happily (for some), an exemption from VRLT for holiday homes has recently been extended to land held by trusts and companies continuously since 28 November 2023. An early Christmas present has also arrived by way of further refinements to the exemption.

Original VRLT regime

VRLT was introduced by the Victorian Government from 1 January 2018 to address a lack of housing supply in Melbourne. The owner of a vacant property is assessed at 1% of the capital improved value (ie the rates value) of the land. It can be imposed in addition to standard land tax (currently chargeable at rates up to 2.65%).

VRLT applies to residential land where it has not been used and occupied for more than six months (continuously or in aggregate) in the preceding calendar year by the owner, their permitted occupant, or a natural person under a lease or short-term letting arrangement.

Original holiday home exemption

In contrast, holiday homes[1] only have a four-week (continuous or aggregate) occupation requirement (the holiday home exemption) under s 88A of the *Land Tax Act 2005* (Vic) (the Land Tax Act). This did not initially include properties held by companies which were subject to the more onerous six-months test, however.

In relation to trusts, there was a limited exemption for vested beneficiaries. A "vested beneficiary" is defined in s 3 of the Land Tax Act as a natural person who has a vested beneficial interest in possession in land, ie a bare trust, or who is a principal beneficiary of a special disability trust.

However, this does not include a beneficiary of a discretionary trust as they do not have a vested interest even when they have a present entitlement for income tax purposes. To qualify for the original holiday home exemption, a trustee had to ensure that the holiday home held by a trust was occupied for over six months (rather than four weeks).

There have been three tranches of changes to the VRLT regime in the last 12 months, including an extension of the holiday home exemption to trusts and companies irrespective of whether qualifying persons have a direct or indirect interest.

2023 changes to the VRLT regime

The *State Taxation Acts and Other Acts Amendment Act 2023* (Vic) was enacted on 12 December 2023 and contains numerous changes to the VRLT regime.

Changes from 1 January 2025

From 1 January 2025, VRLT will apply to all residential land across Victoria, including regional areas (not just those in 16 select inner and middle suburbs of Melbourne).

The use of holidays homes by relatives may now be included in the four-week usage test. "Relative" is defined in s 3 of the Land Tax Act as a partner of the landowner, grandparents, grandchildren or siblings of the landowner or their partner (or the children of the siblings), the partner of the landowner's child, or the partner of the landowner's sibling.

A progressive rate will also apply based on the number of consecutive tax years that land has been liable for VRLT – 1% for the first year, 2% for the second year, and 3% for the third and subsequent years.

Changes from 1 January 2026

Unimproved land was previously not caught by VRLT. From 1 January 2026, land in metropolitan Melbourne that is capable of residential development but has remained unimproved for at least five years will be liable for VRLT. Unimproved residential land that is either contiguous to an owner's principal place of residence (PPR) or is incapable of being developed for residential purposes will be exempt. Land that is contiguous with a holiday home, and enhances it, is also exempt.

June 2024 changes to the VRLT regime

On 4 June 2024, the *State Taxation Amendment Act 2024* (Vic) (the June 2024 amendments) was enacted and introduced a new subs 88A(1A) of the Land Tax Act that extends the holiday home "grandfathered" exemption to properties directly held in trusts and companies (as well as to the relatives of exempt shareholders and beneficiaries) from 1 January 2025, if certain conditions are all met. The conditions are set out below.

Condition 1: continuous ownership since 28 November 2023

The owner of the property, ie a company or trustee of a trust (other than a trust with a vested beneficiary), must have continuously owned the home since 28 November 2023 or the property must have been under a contract of purchase from this date.[2]

Condition 2: no change in beneficial ownership

There have been no changes from 28 November 2023 in shareholdings (for companies), unit holdings (for unit trusts), beneficial interests (for fixed trusts), or specified beneficiaries (for discretionary trusts) unless the change has been between persons who are relatives.

Condition 3: principal place of residence elsewhere

There is an ownership interest requirement contained in new s 88A(5) that has been inserted into the Land Tax Act (the PPR requirement).

In the case of companies, unit trusts and fixed trusts, there must be a minimum ownership interest of at least 50% in the landowner held by one or more natural persons who have used and occupied land other than the holiday home in Australia as a PPR in the year preceding the tax year.

For discretionary trusts, a specified beneficiary of the discretionary trust who is a natural person or a relative of that person must have used and occupied other land in Australia as a PPR in the year preceding the tax year.

Condition 4: use and occupation as a holiday home

In the year preceding the tax year, the land must have been used and occupied as a holiday home for a period of at least four weeks (continuous or aggregate) by a specified person. Specified persons are the shareholders, unitholders, beneficiaries or specified beneficiaries of companies, unit trusts, fixed trusts and discretionary trusts, respectively, or their relatives as defined in s 88A(5) of the Land Tax Act.

Condition 5: Commissioner satisfied land used as a holiday home

The Commissioner of State Revenue must be satisfied that the land was used and occupied as a holiday home with regard to:

- the location of the land;
- the distance between the location of the land and the PPR of a shareholder, unitholder, beneficiary or specified beneficiary; and
- the nature and frequency of the use of the land.

October 2024 changes to the VRLT regime

Under the June 2024 amendments, the holiday home exemption only applies if interests in the land-owning entity are held directly by a natural person or persons with an Australian PPR elsewhere.

On 29 October 2024, the State Taxation Further Amendment Bill 2024 (Vic)[3] (October 2024 amendments) was introduced with additional changes so that a relevant natural person with an Australian PPR may now directly or indirectly hold at least 50% of the shares or beneficial interests in the company or trustee owner to qualify for the grandfathered holiday home exemption. The Bill passed both Houses of the Victorian Parliament on 28 November 2024.

Corporations, fixed trusts and unit trusts

Corporations and trustees of fixed and unit trusts may satisfy the PPR requirement if a natural person directly *or indirectly* holds at least 50% of the shares in the company, beneficial interest in the fixed trust, or units in the unit trust, that owns the holiday home land.

This is an example from page 38 of the explanatory memorandum:

> "… vacant residential land is owned by Company A, the sole shareholder of which is Company B acting in the capacity as trustee for a unit trust. The sole unitholder of the unit trust has an Australian principal place of residence. As the unitholder indirectly owns the shares in the Company A, the principal place of residence requirement will be satisfied."

Discretionary trusts

A new subs 88A(6) will be inserted into the Land Tax Act so that where shares in a corporation, beneficial interest in a fixed trust or units in a unit trust are held by a trustee of a discretionary trust, they will be deemed to be held by a natural person who is a specified beneficiary.

This is an example from page 39 of the EM:

> "… vacant residential land is owned by Company A, the sole shareholder of which is Company B acting in the capacity as trustee for a discretionary trust. The sole specified beneficiary of the discretionary trust has an Australian PPR. As the specified beneficiary is taken to own or hold the shares in the landholding company (Company A) for the purposes of this provision, the PPR requirement will be satisfied notwithstanding that the shares are held under a discretionary trust."

Summary of the PPR requirement[4]

In the year preceding the tax year, natural persons must have used another property in Australia as their PPR and occupied a holiday home for at least four weeks (in aggregate, but not concurrently) as shown in Table 1.

Other changes

The October 2024 amendments including various other changes to the VRLT regime, including the holiday home exemption and more generally.

Table 1. Summary of the PPR requirement

Owner of land	Natural persons who must have a PPR in Australia	Natural persons who must occupy a holiday home
Company	Shareholders who directly or indirectly owned at least 50% of the shares in the company	The shareholders or their relatives
Trustee of a unit trust	Unitholders who directly or indirectly owned at least 50% of the units in the scheme	The unitholders or their relatives
Trustee of a fixed trust	Beneficiaries who directly or indirectly held at least 50% of the beneficial interest in the trust property	The beneficiaries or their relatives
Trustee of a discretionary trust	Specified beneficiaries of the trust or their relatives	The specified beneficiaries or their relatives

Holiday home exemption applies despite change of trustee

Land that is subject to a trust remains eligible for the holiday home exemption despite a change of trustee, provided the land has been subject to the same trust continuously since 28 November 2023.

Holiday home exemption after death of owner

The holiday home exemption may also continue for three years after the death of the landowner or the sole shareholder of a company owner.

Further exemptions

Newly developed residential land will be exempt for up to three tax years, after which a 1% concessionary rate will apply each subsequent tax year until the land changes ownership.

Victoria's alpine resort areas will also be excluded from the VRLT regime from 1 January 2025.

Changes to unimproved residential land regime

There is clarification that residential land that has remained unimproved for at least five years and is liable for VRLT from 1 January 2026, includes the five years preceding 2026 (ie 2021).

The VRLT exemption from 1 January 2026 for unimproved residential land contiguous to an owner's PPR will also now include the PPR of a qualifying person with a disability or their permitted occupant.

Remaining issues with the holiday home exemption

Limited grandfathering of measures

The holiday home exemption extension to trusts and companies will not apply to new acquisitions or holiday homes inherited via a testamentary trust structure under a deceased owner's will, where the landowner died after 28 November 2023.

Lack of specified beneficiaries

Sometimes trust deeds may not include specified beneficiaries or the specified beneficiary may have died. A trust deed may be amended to overcome this. However, if the terms have been varied outside its scope, this may constitute a resettlement which can result in stamp duty. Any changes to the specified beneficiaries of a trust may also cause the holiday home exemption to be lost if those people are not relatives of the original specified beneficiary.

Self-managed superannuation funds

Self-managed superannuation funds (SMSFs) are precluded from leasing residential premises to their members and can only conduct arm's length commercial dealings. An SMSF may therefore struggle to qualify for the holiday home exemption unless land is leased to an arm's length tenant.

State Revenue Office compliance activity

Landowners who are liable for VRLT, or who believe that they qualify for one of the several exemptions from VRLT (in addition to the holiday home exemption), must notify the SRO of Victoria through an online VRLT portal by 15 January each year.

Land is exempt from VRLT if in the prior calendar year it:

- is exempt from land tax, ie as a PPR or as primary production land;
- changes ownership;
- becomes residential land, which includes newly constructed homes (if ownership remains unchanged, the land will be exempt for two years and, from 1 January 2025, if there are efforts to sell the land, this extends to three years);
- is used by the owner or vested beneficiary for work for at least 140 days; or
- qualifies for the holiday home exemption.

On 24 May 2024, the Victorian Government confirmed[5] that the SRO has been undertaking a compliance investigation into VRLT that started with apartment towers. The investigation will expand to houses in the inner and middle suburbs of Melbourne in 2025.

Failure to comply with VRLT obligations may result in penalty tax. The standard rate applied is 25% of the VRLT. Penalty tax can range from 5% if a voluntary disclosure is made before an investigation to 90% if there is an intentional disregard of the law and/or the investigation is hindered. An objection to VRLT may be lodged if a landowner believes that it has been assessed in error.

What should affected landowners do?

Holidays home owners who hold their properties in trusts and companies should ensure that the qualifying conditions for the holiday home exemption are closely adhered to. Variations to trust deeds should also be carefully made to ensure that the holiday home exemption is not lost.

It is also recommended that those who intend to claim an exemption document usage with evidence such as log books, utility bills and receipts. These records should be maintained for five years which is the SRO's general retrospective period of review.

The only question left is … will Victorian holiday home owners ever be able to ask themselves, "How's the serenity?",[6] again.

Meera Pillai
Associate
Sladen Legal

References

1 The term "holiday home" is not defined in the *Land Tax Act 2005* (Vic). The State Revenue Office (SRO) of Victoria webpage "Vacant Residential Land Tax Definitions" defines "holiday home" as: "A property which is used by the owner or vested beneficiary as a second home for at least four weeks in the calendar year."

2 The holiday home extension to companies and trusts has been grandfathered from 28 November 2023 as, on this date, the Victorian Government secured a deal with the Victorian Greens to pass reforms to the VRLT regime. See Victorian Greens, "Greens secure relief for renters: stronger tax on empty homes means up to 5,000 could be made available as rentals", media release, 28 November 2023.

3 At the time of writing, the State Taxation Further Amendment Bill 2024 (Vic) had passed both Houses of the Victorian Parliament on 28 November 2024 and was awaiting enactment.

4 Table 1 has been reproduced from the SRO of Victoria webpage "Holiday home exemption – eligibility requirements for companies and trusts" and updated for the changes in the *State Taxation Amendment Act 2024* (Vic).

5 The Hon. Jacinta Allan MP, Premier of Victoria, "Making more homes available for Victorians", media release, 24 May 2024.

6 Quote from the 1997 Australian film, *The Castle*.

Superannuation

by Daniel Butler, CTA, and
Fraser Stead, DBA Lawyers

NALI/E: urgent fix still needed

The NALI/E provisions can easily expose SMSFs to a 45% tax rate for comparatively minor oversights, resulting in unfair and disproportionate outcomes. Urgent legislative reform is required.

The non-arm's length income (NALI) provisions contained in s 295-550 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) continue to be a divisive topic, with recent non-arm's length expense (NALE) changes providing some welcome relief while also highlighting the urgent need for further legislative change for specific NALI and the CGT interaction.

In this article, we provide an overview of some of the recent NALI/E developments with a particular focus on general NALE.

General expense upper cap

The *Treasury Laws Amendment (Support for Small Business and Charities and Other Measures) Act 2023* (Cth) brought a welcome change in relation to the NALE exposure for a lower or nil general expense incurred by a self-managed superannuation fund (SMSF). A general expense is an expense that is not related to gaining or producing income from a particular asset (eg general accounting expenses for an SMSF).

These changes have effect from 1 July 2018 and impose an upper cap on the amount that is taxed as NALI under s 295-550(1)(b) and (c) in the form of a two-times multiplier of the amount of the lower (or nil) general expense for an SMSF or a small APRA fund. Further, under the recent changes, larger funds are no longer subject to the general or specific NALE rules.

However, the recent changes did not contain any relief in relation to specific expenses (ie any expense other than a general expense, such as an expense that relates to gaining or producing income in relation to a particular asset). Thus, the usual NALI rules apply, and a lower specific expense in relation to acquiring an asset can potentially taint that asset for life, with a 45% tax rate on the asset's ordinary income as well as on the capital gain when the asset is finally realised (this could be 20+ years later).

CGT and NALI interaction

The ATO recently released TD 2024/5 which outlines the interaction between the NALI and CGT provisions of the ITAA97. This determination states that the NALI provisions apply where:

- the amount of the capital gain is more than the amount that the fund might have been expected to derive if the parties had been acting at arm's length in relation to the scheme; or
- for SMSFs or small APRA funds — when gaining or producing the capital gain, NALE is incurred (including nil expenditure) in respect of a CGT asset that is less than the amount of a loss, outgoing or expenditure that the fund might have been expected to incur if those parties had been dealing with each other at arm's length in relation to the scheme.

Example 3 of TD 2024/5 considers where a $1m arm's length capital gain was tainted and taxed at 45%. The example demonstrates that a non-arm's length gain effectively taints an arm's length gain if derived in the same income year. This outcome would appear to be unintended as, based on the ATO's interpretation of the legislation, a $100 tainted gain would taint a $1m arm's length capital gain. Urgent legislative action is needed to correct this disproportionate and, most likely, unintended outcome.

Further serious defects with NALI/E

What activities can a trustee safely undertake?

In addition to the above defects, there is still considerable uncertainty regarding what SMSF trustees and members can and cannot do with respect to their SMSF. For example, if an accountant maintains the books and records of their own fund using more than minor, irregular or infrequent use of business resources, the fund can be rendered subject to the general, or potentially the specific, NALI provisions, resulting in significant tax and penalties.

The ATO has provided limited guidance in LCR 2021/2 to help identify in what capacity an SMSF trustee/director may be operating, noting that it "is necessary to carefully weigh up all the relevant facts, circumstances and factors in deciding whether the individual is acting in a capacity other than as trustee, or as a director of a corporate trustee, of an SMSF".

Broadly, an SMSF trustee/director is precluded from being remunerated by an SMSF in relation to performing trustee functions on behalf of the fund under s 17A of the *Superannuation Industry (Supervision) Act 1993* (Cth) (SISA). However, an SMSF trustee/director may be remunerated in accordance with s 17B SISA. Broadly, s 17B provides for an exception to the prohibition on SMSF trustee/director remuneration contained in s 17A where a trustee/director performs non-trustee duties or services in a capacity other than as an SMSF trustee (or director of a corporate trustee). Remuneration can be paid by an SMSF for non-trustee type services provided the four criteria in that section are complied with (for example, providing services that are similar to what you do in business and being covered by an insurance policy).

Example 9 in LCR 2021/2 involves Trang, an astute plumber, who completes a bathroom/kitchen renovation on a rental property owned by her SMSF. This act means that she has forever tainted all of the rental income and future capital gain derived by her SMSF from that property, even if the property is disposed of in 20 years' time. Being a registered plumber who carries on a business serving the public and who is licensed and qualified, Trang would be required to charge an arm's length fee to "avoid" specific NALE (resulting in NALI) unless the service was minor, infrequent and irregular.

These types of issues give rise to considerable additional work and grey areas for advisers and clients to deal with, and are likely to increase costs on all funds where advisers will need to spend more time considering the practical application of these rules. Take, for example, the current ASIC fee of $310 for a corporate trustee that acts for an SMSF and in some other capacity, such as a trustee of a family trust. Consideration will need to be given as to whether:

- the fee should be split 50/50;
- the fee should be split $63 to the SMSF trustee and $247 in respect of the family trust; or
- this is a minor benefit that should not be an issue in practice.

However, there is no de minimis rule. The ATO's LCR 2021/2 gives rise to issues unless the item is minor, infrequent and irregular, and in an FBT context, an occasional benefit less than $300 that is minor, infrequent and irregular is exempt from FBT. Advisers must consider NALI/E exposures even if they are trivial and minor as they must comply with the law.

Contributions and NALE

There is significant uncertainty in relation to knowing the dividing line between what counts as a contribution and what counts as NALE. On 28 July 2021, the ATO issued for consultation TR 2010/1DC that outlines its initial thinking in this regard where part of an asset such as property was given to an SMSF as a contribution and the balance of the property was purchased by the fund.

Traditionally, if an expense was paid on behalf of a fund, or an asset was acquired by a fund for less than market value, the ATO would treat the "discount" or lower cost as a non-concessional contribution. This position was reflected in the ATO's comprehensive ruling on what is a contribution that it issued in 2010, ie TR 2010/1, which the superannuation industry and the ATO have relied on for many (14+) years as the main guide on this important topic.

However, the ATO seems to be adopting the view in the revised draft TR 2010/1DC that NALI/E now prevails. Discounts on employee share ownership plans (ESOPs) where the shares are nominated by the employee to their SMSF would seem tainted and in "troubled waters" given this view. This is certainly a limit to many ESOPs.

Since TR 2010/1DC is still in draft form and has had limited consultation due to the industry waiting on the passage of the NALE legislation and for the "dust to settle" on this important topic, the divide between a contribution and NALI/E remains a real and disturbing one. Giving clear advice has become far more complex and is becoming beyond the reach of many accountants and tax advisers.

The complexity and the uncertainty relating to NALI/E are also giving rise to considerable additional costs and work, as advisers need to analyse how to apply these rules. Returning to the example of the ASIC fee for an SMSF corporate trustee that also acts as trustee of a family trust, how should the fee be split between the fund and the family trust? If the cost is not split, that would likely result in a general NALE exposure to the fund unless it should indeed be treated as a contribution. There is conflicting ATO material on this point. Until TR 2010/1DC is finalised and further ATO information released, advisers should obtain expert advice if there is any doubt.

Mistakes and forgiveness

Humans are prone to making mistakes, and a particularly concerning aspect of NALI/E is that the Commissioner has no discretion to disregard honest mistakes and inadvertent oversights.

Conclusion

Advisers and SMSF trustees/members must be aware that the complex nature of the NALI/E provisions can easily expose SMSFs to a 45% tax rate for comparatively minor oversights, resulting in unfair and disproportionate outcomes. Although the recent NALE changes are welcome, the NALI/E provisions remain in need of further legislative change.

On 27 November 2024, the ATO released revised draft rulings LCR 2021/2DC on NALI/E and TR 2010/2DC with updated changes on NALI/E requesting submissions by 24 January 2025. The ATO also withdrew TR 2010/1DC on contributions. The above article was prepared prior to these revised ATO materials being issued and the authors intend to prepare an update on these materials in a future issue of this journal.

Daniel Butler, CTA
Director
DBA Lawyers

Fraser Stead
Lawyer
DBA Lawyers

Events Calendar

Upcoming month

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Thu–Fri

QLD | Online

Private Business Tax Retreat

12 CPD hours

MARCH
6
Thu

NSW | Online

Tax Disputes Masterclass

7 CPD hours

MARCH
13–14
Thu–Fri

WA

WA Tax Forum

12 CPD hours

MARCH
20–21
Thu–Fri

VIC

VIC Tax Forum

12 CPD hours

MARCH
27–28
Thu–Fri

NSW

Financial Services Taxation Conference

11 CPD hours

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

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Giving back to the profession

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Contacts

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National Office

CEO: Scott Treatt, CTA

Level 21, 60 Margaret Street
Sydney, NSW 2000

T 1300 829 338
E tti@taxinstitute.com.au

State Offices

New South Wales and ACT
Chair: Alison Stevenson, CTA
Vice Chair: Hannah Soh, CTA

Level 21, 60 Margaret Street
Sydney, NSW 2000

T 02 8223 0000
E nsw@taxinstitute.com.au

Victoria
Chair: Dioni Perera, FTI
Vice Chair: Frank Hinoporos, CTA

Level 3, 530 Collins Street
Melbourne, VIC 3000

T 03 9603 2000
E vic@taxinstitute.com.au

Queensland
Chair: Kim Reynolds, CTA
Vice Chair: John Middleton, CTA

310 Edward Street
Brisbane, QLD 4000

T 07 3225 5200
E qld@taxinstitute.com.au

Western Australia
Chair: Ross Forrester, CTA
Vice Chair: Billy-Jo Famlonga, FTI

152 St Georges Terrace
Perth, WA 6000

T 08 6165 6600
E wa@taxinstitute.com.au

South Australia and Northern Territory
Chair: Nicole Peterson, CTA
Vice Chair: George Hodson, CTA

75–77 Dale Street
Port Adelaide, SA 5015

T 1300 829 338
E sa@taxinstitute.com.au

Tasmania
Chair: Simon Clark, CTA
Vice Chair: Ron Jorgensen, CTA

E tas@taxinstitute.com.au

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Publishing House
The Tax Institute
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Level 21, 60 Margaret Street
Sydney, NSW 2000

Content Marketing Executive
Chantel Fekete

Editorial Adviser
Professor Bob Deutsch, CTA

Managing Editor
Deborah Powell

Graphic Designers
Mei Lam, Claudio Palma and Jack Miller

Typesetter
Midland Typesetters, Australia

Advertising
Business Relationship Manager
Paul Camus 02 8223 0003

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