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The Tax Institute

Taxation in Australia

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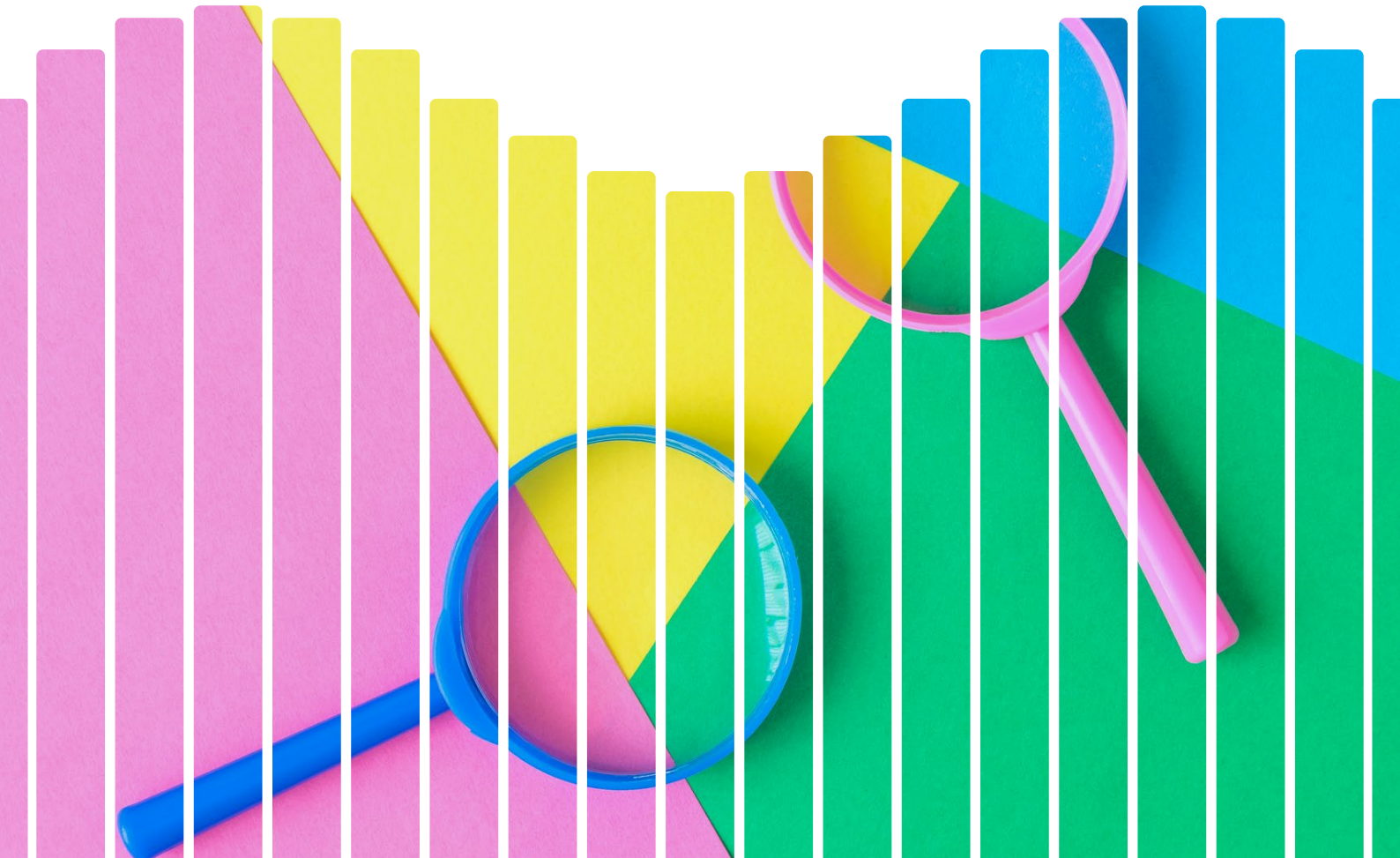

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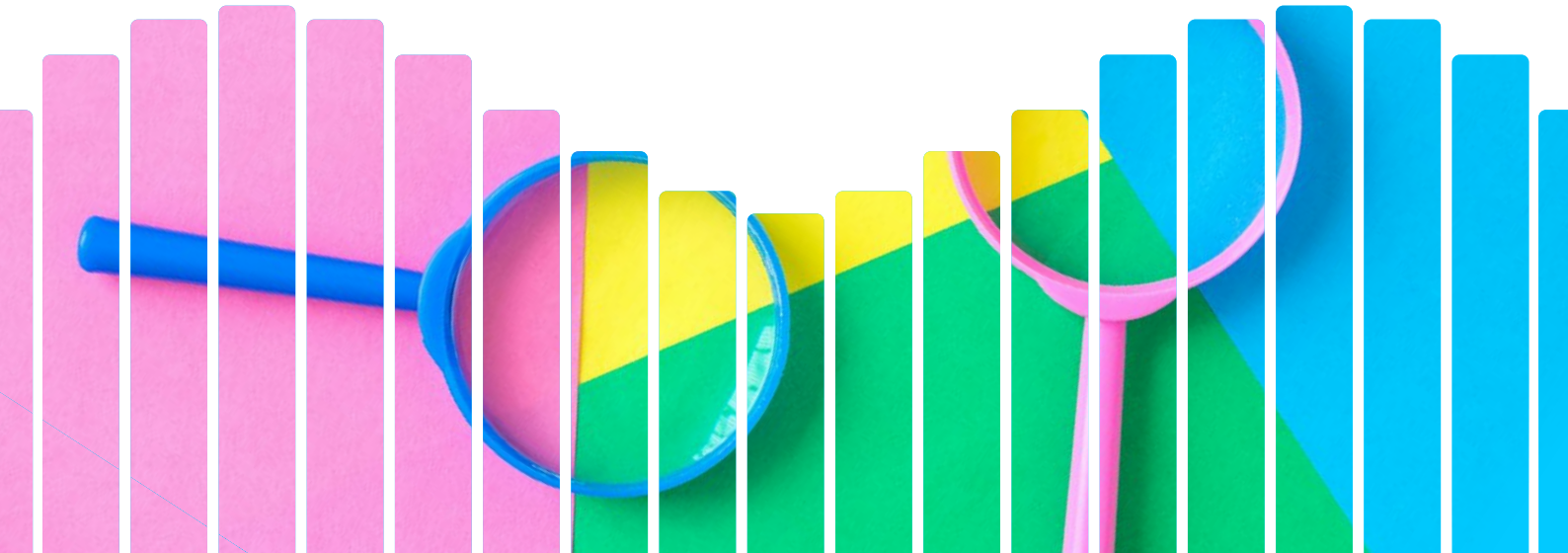

Tax News – at a glance

by TaxCounsel Pty Ltd

December – what happened in tax?

The following points highlight important federal tax developments that occurred during December 2023. A selection of the developments is considered in more detail in the "Tax News – the details" column on page 368 (at the item number indicated).

2023–24 mid-year economic and fiscal outlook

The Treasurer released the *2023–24 mid-year economic and fiscal outlook* on 13 December 2023 and several new measures that are of interest were announced. **See item 1.**

TPB sanctions regime

On 9 December 2023, the Assistant Treasurer and Minister for Financial Services announced the release of a consultation paper in relation to the government's proposed next stage of the reforms in response to the PwC tax leaks matter. **See item 2.**

Franking credits: in specie distributions

The Commissioner has released a taxpayer alert in relation to arrangements involving franked distributions in the form of property other than money (in specie distributions) that are made to income tax exempt entities, including registered charities, deductible gift recipients, scientific institutions and public educational institutions (TA 2023/3). **See item 3.**

Taxpayer alerts: R&D activities

The Commissioner has released two taxpayer alerts in relation to R&D activities, with one of the taxpayer alerts dealing with activities delivered by an associated entity (TA 2023/4) and the other dealing with activities conducted overseas (TA 2023/5). **See item 4.**

Early stage investors: "expense" that is "incurred"

The Commissioner has released a final determination which considers the early stage test that is relevant for the purposes of the early stage innovation company regime which is intended to encourage new investment in small Australian innovation companies with high-growth potential, by providing a tax offset and modified CGT treatment to qualifying investors (TD 2023/6). **See item 5.**

Employee or independent contractor

The Commissioner has released a taxation ruling and a practical compliance guideline in relation to the question of whether an individual is an "employee" of an entity for the purposes of the PAYG withholding provisions of the *Taxation Administration Act 1953* (Cth) (TR 2023/4; PCG 2023/2). **See item 6.**

Unregistered entity: penalties

The Federal Court (Banks-Smith J) has imposed a pecuniary penalty of $230,000 on an individual (Ms Van Stroe) who contravened s 50-5(1) of the *Tax Agent Services Act 2009* (Cth) (TASA) on 531 separate occasions by preparing and lodging income tax returns for taxpayers, being the provision of a tax agent service for a fee or other reward, while not a registered tax agent (*Tax Practitioners Board v Van Stroe (No. 2)* [2023] FCA 1533). **See item 7.**

Beneficiaries assessable on amounts received by trust

The AAT has held that two presently entitled beneficiaries of a property discretionary trust had not discharged the onus of establishing that certain amounts received by the trust during the income years in question were not income (and, so, were assessable to them) and also that the Commissioner had rightly assessed them to penalties on the ground of recklessness (*CVMW and FCT* [2023] AATA 4039). **See item 8.**

Transfer to army reserve: genuine redundancy

The AAT has held that a payment received by a regular full-time member of the army as a result of being transferred to the army reserve was a genuine redundancy payment for the purposes of the genuine redundancy payments and early retirement scheme payment provisions in Subdiv 83-C of the *Income Tax Assessment Act 1997* (Cth) (*Fidge and FCT* [2023] AATA 4245). **See item 9.**

New Commissioner of Taxation

Mr Rob Heferen is to be appointed as the Commissioner of Taxation for a period of seven years from 1 March 2024 to replace Mr Chris Jordan whose term ends on 29 February 2024.

Goods taken from stock

The Commissioner has released a determination that sets out the amounts that he will accept as estimates of the value of goods taken from trading stock for private use by taxpayers in named industries in the 2023–24 income year (TD 2023/7).

President's Report

by Todd Want, CTA

The Institute is what we make it

President Todd Want on shaping The Tax Institute of the future.

As we kick off the new year at the Institute, a warm welcome to 2024 to all members. I hope you got the chance for some downtime over the holiday period and that you've started the year refreshed and ready for what will no doubt be another interesting year in the world of tax.

I'm thrilled and honoured to be writing to you as President of The Tax Institute. My thanks go to you, the members, for putting your trust in me to lead The Institute this year. I also wanted to thank members of the National Council for their support and to Marg Marshall for her wonderful work as President last year. I look forward to working closely with the National Council (Tim Sandow, CTA, as Vice President; Clare Mazzetti, our independent Chair; and Scott Treatt, CTA, our CEO) and the rest of the team at the Institute over the course of 2024 to deliver great outcomes for the Institute, the profession, and for you, the members.

This year, I'm excited to get back to the core of what we do at the Institute. A big part of this is educating the tax profession. A lifelong desire to continue learning, developing and growing is the thread that connects all our members, no matter where or what you practice.

The Institute has historically been known for providing high-quality, relevant and highly tailored tax education, whether it be through structured education programs or through learning at conferences and events.

One of my favourite Institute events — and a favourite of many others — is the Noosa Tax Convention. It is always a wonderful experience, full of robust tax discussions and opportunities to gather new knowledge and skills from the best in the business. And that's not to mention the great socialising and connecting with fellow tax practitioners that occurs at this event and others like it.

These days, the tax conversation at Noosa is as robust as ever and it's often the only opportunity I have to catch up with certain colleagues from around the country. It's also wonderful to see that community expand and develop to include a new generation of tax practitioners from every walk of life.

The tax profession is growing and evolving, and I'm proud to see the Institute grow and evolve alongside it. The members who I meet at events these days represent a broad cross-section of tax professionals from diverse backgrounds and specialties. Although our core purpose is the same — educating and supporting the tax profession — and our membership is still made up of passionate, talented tax practitioners, the Institute has a different face and a different heartbeat these days.

It's The Tax Institute of the future. And I am excited to help shape that future-focused Institute, while remaining true to our core values and purpose.

This year, we're building on the legacy of high-quality tax education with our new Tax Academy offering, which enables practitioners to add to their skill set with bite-sized chunks of micro-credential learning.

Our focus with Tax Academy is on making tax education accessible to all. That means practitioners from diverse backgrounds, small firms, regional areas, and all specialties and levels of experience across the industry. It also opens up education to a new generation of tax practitioners who are busy building careers and lives, and who want to learn online at a time and place that suits them. Helping to bring through a new generation of highly skilled tax practitioners is crucial to the future success of our profession.

Importantly, while we create these new opportunities for tailored learning and new career pathways, we're staying true to who we are at our heart — a tax educator that prides itself on practical, collaborative learning.

As a final word, I encourage you to be actively engaged in our tax community this year. We are making a concerted effort to reach out and open up further opportunities for your voice to be heard. I encourage you to seize these opportunities. The Institute is what we make it, now more than ever.

CEO's Report

by Scott Treatt, CTA

Have your say on our future plans

CEO Scott Treatt invites members to raise their voice in deciding how the Institute supports them in 2024.

Welcome to 2024! I hope your year has started well, and that you're feeling energised and ready to tackle new challenges and celebrate new successes this year.

Personally, I can say that the three months I have served as CEO of the Institute so far have been busy, challenging and, above all, incredibly rewarding. The commitment that our volunteers, staff and, indeed, members have shown to our organisation as we navigated our way through a period of fairly significant change has been impressive and inspiring.

On that note, I'd like to thank Marg Marshall for her work as President last year, and to extend a warm welcome to Todd Want as he takes on the mantle of President, and to Tim Sandow as Vice President. Todd is one of our youngest Presidents in many years – or perhaps ever – and I am excited to have a fresh new voice representing our members and leading the Institute.

Todd's message in this month's journal, about the changing face of the Institute, is a vital factor in how we consider our long-term strategic goals and plans. We aren't the Institute we were 50 years ago, 20 years ago, or even 10 years ago. Instead, we are a more vibrant, inclusive, diverse and enriched community.

A new year is a new chance for us to evaluate how we do things at the Institute and the direction we want to travel in the future. We have just celebrated our 80th year, and the plans we make today will put us on a course for the next 80 years.

As I said at the end of last year, my focus while making plans in 2024 is on ensuring that our members' voices are at the centre of the conversation. Part of this is working to reflect member priorities and diverse opinions in the advocacy work we do for the tax system. We have the best interests of the tax system at heart and we work to ensure that our tax system is administered without excessive burden on the tax profession and broader community.

Just as importantly, I am dedicated to making sure that member voices are heard when it comes to the priorities, direction and vision of the Institute itself. Our members are our first priority – always.

Early this year, we will be asking you to complete a member survey. I encourage you to do so as this is a key tool in helping us understand how to better serve you with the resources, events and support we offer during the year. Our volunteer councils and committees do a wonderful job representing their fellow members throughout the year but, as our membership develops and changes, tools like this offer a vital insight into what *all* of our members are thinking. It is an opportunity for us to hear directly from the "horse's mouth", and for you to have your say about how we develop the Institute into the future.

The survey will by no means be the last chance for you to have your say. I am looking forward to engaging with you in various forums throughout the year. I'm especially looking forward to seeing you in person at events and future engagement opportunities, which are yet to come.

Whatever your journey throughout 2024, whether it is starting a new position, undergoing further education, or continuing to serve your clients to the best of your ability, The Tax Institute is here to support you.

Senior Tax Counsel's Report

by Julie Abdalla, FTI

Retrospective tax legislation

We reflect on and remind taxpayers and tax practitioners of the ATO's approach to announced but unenacted retrospective tax legislation to alleviate uncertainty.

A basic legislative principle of common law presumes that, unless a contrary intention appears, parliament intends to enact legislation prospectively and not retrospectively.

With parliament's first sitting date for the year scheduled on 6 February 2024, the uncertainty created by announced but unenacted measures (such as the Multinational Tax Integrity Package, including the thin cap amendments and the implementation of the OECD's two-pillar solution) continues. The proposed effective start date of the thin cap amendments is 1 July 2023 (except for the debt deduction creation rules which are now proposed to be effective from 1 July 2024) and the proposed effective start date for the implementation of Pillar Two is 1 January 2024.

It is not entirely unheard of for parliament to enact retrospective tax legislation. However, it is subject to checks and bounds. The Senate procedural orders of continuing effect, standing order 45, which deals specifically with the retrospectivity of taxation Bills, provides that, where taxation legislation has been announced by press release more than six months before the introduction of the relevant legislation into parliament (or publication of a draft Bill), that legislation will be amended to provide for a commencement date after the date of introduction (or publication).

The implementation of the Pillar Two rules was announced in the 2023–24 Federal Budget (on 9 May 2023), as foreshadowed in the government's election commitments. Still, exposure draft legislation is yet to be published or introduced in the parliament (over eight months from the date of announcement). Consequently, we could see a change in the effective start date of the Pillar Two rules based on the Senate's standing order 45.

Considering more than six months have passed since the start of the current financial year and the announced measures have not been enacted, taxpayers may intend, or already have started, to manage their tax affairs for the year. In this regard, the ATO's PS LA 2007/11 (on its administrative approach to unenacted retrospective legislative measures) assists and provides some clarity to affected taxpayers.

Unenacted retrospective legislation

Based on the guidance provided in PS LA 2007/11 and the ATO webpage, where announced measures are not enacted but have retrospective operation, taxpayers can lodge their tax return based on the existing law or the proposed law. Generally, the ATO will advise taxpayers to organise their tax affairs in accordance with existing law.

Increases in taxpayers' liabilities

Generally, if taxpayers take reasonable care and follow the existing law, the ATO will not levy shortfall penalties and general interest charges (GIC) or shortfall interest charges (SIC) up to the date of enactment of the legislation change or up to the reasonable period provided by the ATO to correct the taxpayer's affairs after the enactment of the legislation.

If the taxpayer does not lodge an amendment request or revise their activity statement within a reasonable time, full interest will apply from the date of enactment.

When taxpayers anticipate their tax liability based on the proposed retrospective law but the proposed measures are not enacted, they may be liable for GIC and SIC at the base interest rate. Otherwise, the same consequences follow when the proposed law is enacted but the taxpayer has understated their liability.

Reductions in taxpayers' liabilities

If a proposed law change is expected to reduce the taxpayer's liabilities, the taxpayer is encouraged to self-assess under the existing law. If the taxpayer chooses to self-assess by anticipating an announced law change, the ATO may not enforce compliance with the existing law. However, the ATO will act to prevent incorrect refunds.

Where a taxpayer has overstated their liability in general or if the newly enacted retrospective legislation reduces their tax liability, the taxpayer would usually be entitled to interest on overpayment of tax.

More information on the ATO's approach to penalties and interest in relation to changes in legislation with retrospective effect can also be found in PS LA 2006/8.

Conclusion

Retrospective legislation may be justified only when it is beneficial, curative or clarificatory in nature, and should be used in limited circumstances. While PS LA 2007/11 and the ATO website guidance provide some clarity to taxpayers affected by unenacted retrospective measures, we consider that retrospective legislation should remain the exception and that prospective operation should be preferred in most cases. This provides greater certainty to taxpayers and their advisers and can be achieved through good consultation.

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The Tax Institute

24-003EVT_02/24

Tax News – the details

by TaxCounsel Pty Ltd

December – what happened in tax?

The following points highlight important federal tax developments that occurred during December 2023.

Government initiatives

1. 2023–24 mid-year economic and fiscal outlook

The Treasurer released the *2023–24 mid-year economic and fiscal outlook* on 13 December 2023. The following are new measures that were announced and are of interest.

Commonwealth penalty unit increase

The amount of the Commonwealth penalty unit is to be increased from $313 to $330, commencing four weeks after passage of the relevant legislation. The increase will apply to offences committed after the commencement of the legislative amendment.

Denying deductions for ATO interest charges

Deductions are not to be allowable for ATO interest charges (specifically, the general interest charge and the shortfall interest charge) incurred in income years starting on or after 1 July 2025.

Lower fees for build-to-rent projects

The government will apply the lower commercial foreign investment application fee to foreign investments in build-to-rent projects where investors are proposing to acquire residential land or agricultural land. This is intended to encourage investment in build-to-rent projects, increase Australia's housing stock, and expand access to affordable housing.

Raising fees for established dwellings

The following action is to be taken to ensure that foreign investment in housing is consistent with the government's agenda to boost Australia's housing supply:

- tripling foreign investment fees for foreign investors who apply to purchase established dwellings from the day after the date of royal assent of the enabling legislation;
- doubling vacancy fees for foreign investors who have purchased residential dwellings (new and established) since 9 May 2017; and
- providing $3.5m to enhance the ATO's compliance regime to ensure that foreign investors comply with fee, notification and other regulatory requirements such as selling their residence when required.

Foreign resident capital gains withholding

The foreign resident capital gains withholding tax rate is to be increased from 12.5% to 15%, and the withholding threshold is to be reduced from $750,000 to $0, with effect in relation to real property disposals under contracts entered into on or after 1 January 2025.

2. TPB sanctions regime

On 9 December 2023, the Assistant Treasurer and Minister for Financial Services announced the release of a consultation paper in relation to the government's proposed next stage of the reforms in response to the PwC tax leaks matter.

The consultation paper seeks feedback on measures to expand on the sanctions available to the Tax Practitioners Board (TPB) to respond to tax agent misconduct, including:

- reintroducing criminal penalties for unregistered tax practitioners;
- broadening and increasing civil penalties; and
- introducing infringement notices.

The government has also released for consultation an exposure draft of a legislative instrument that would expand the obligations under the TPB Code of Professional Conduct. These proposed obligations would include:

- managing conflicts of interest;
- preventing unauthorised disclosure of confidential government information;
- advising clients of relevant matters, such as if they are being investigated or sanctioned for misconduct; and
- having adequate supervision and quality assurance arrangements in place.

The Commissioner's perspective

3. Franking credits: in specie distributions

The Commissioner has released a taxpayer alert in relation to arrangements involving franked distributions in the form of property other than money (in specie distributions) that are made to income tax exempt entities, including registered charities, deductible gift recipients, scientific institutions and public educational institutions (TA 2023/3).

Under the arrangements:

- an in specie franked distribution is made (or flows indirectly) to an income tax exempt entity; and
- there are restrictions on the ordinary incidents of ownership of the distributed property that are imposed as part of the terms and conditions for the making of the franked distribution and prevent the income tax exempt entity from receiving immediate custody and control of that property.

The ATO is concerned that income tax exempt entities may be entering into the arrangements without being aware that

these restrictions may make them ineligible for a refund of the franking credits attached to the franked distribution.

By virtue of s 207-122(b)(i) of the *Income Tax Assessment Act 1997* (Cth) (ITAA97), an entity that receives a franked distribution in the form of property other than money will not be eligible for a refund of franking credits where the terms and conditions on which the franked distribution is made are such that the entity "does not receive immediate custody and control of the property".

The ATO's position is that this requires the recipient entity to receive, from the moment of distribution, control of the distributed property to the same extent as an absolute owner. In this context, ownership control commensurate with being the absolute owner involves having unrestricted authority over the ordinary incidents of ownership of that property.

TA 2023/3 gives several examples of arrangements where s 207-122(b)(i) may apply, including the following:

Example

The distributing entity makes an in specie distribution of shares held by it in the company (the company shares) to the recipient entity. The distribution is fully franked.

Prior to the in specie distribution being made, the distributing entity and the recipient entity enter into a formal agreement that prohibits the recipient entity from selling, transferring or disposing of the company shares to another entity for a period of time, without the consent of the distributing entity.

The restrictions set out in the formal agreement mean that the recipient entity does not have the required immediate custody and control of the company shares and is not eligible for a refund of franking credits.

The ATO is monitoring applications for franking credit refunds by income tax exempt entities where the claim is in respect of an in specie franked distribution.

4. Taxpayer alerts: R&D activities

The Commissioner has released two taxpayer alerts in relation to R&D activities, with one of the taxpayer alerts dealing with activities delivered by an associated entity (TA 2023/4) and the other dealing with activities conducted overseas (TA 2023/5).

TA 2023/4 states that the ATO is currently reviewing claims made by R&D entities for a tax offset under the R&D tax incentive (R&DTI) for expenditure incurred under an agreement with an associate of the R&D entity (the service provider) that itself conducts the R&D activities. More particularly, the ATO is concerned with arrangements that:

- incorrectly purport the R&D entity as having incurred or paid (or both) the relevant expenditure under an agreement with the service provider; or
- have the effect of obtaining for the R&D entity a tax offset for expenditure on R&D activities purportedly conducted for the R&D entity's own benefit but are instead in substance being conducted for (or to a significant extent for) the service provider.

The service provider is usually an entity that has historically conducted the group's trading and research activities. The service provider, however, is not itself an entity that would be entitled to claim an offset were it to conduct the activities for its own benefit or, if entitled, only entitled to a lesser benefit under the R&DTI.

TA 2023/5 states that the ATO is currently reviewing arrangements where R&D entities claim a tax offset under the R&DTI rules for expenditure incurred on R&D activities conducted overseas. The ATO has seen instances where an R&D entity has purported that the R&D activities were conducted for the R&D entity's own benefit, but those activities were instead being conducted for (or to a significant extent for) a foreign entity that is "connected with" or is an "affiliate" of the R&D entity (foreign related entity).

The ATO's concern is that R&D entities might be incorrectly claiming the R&D tax offset irrespective of whether:

- the R&D entity has an overseas finding (issued under s 28C(1)(a) of the *Industry Research and Development Act 1986* (Cth)) covering the R&D activities being conducted; or
- under the contractual arrangements between the R&D entity and the foreign related entity, the R&D entity purportedly has an interest in any developed intellectual property, know-how or other results from the R&D entity's expenditure on the R&D activities.

5. Early stage investors: "expense" that is "incurred"

The Commissioner has released a final determination which considers the early stage test that is relevant for the purposes of the early stage innovation company (ESIC) regime which is intended to encourage new investment in small Australian innovation companies with high-growth potential, by providing a tax offset and modified CGT treatment to qualifying investors (TD 2023/6).

To be entitled to a tax offset, the investor must be issued with shares in a company that satisfies the tests in s 360-40(1) ITAA97 immediately after the shares are issued. Those tests are an early stage test and an innovation test. The early stage test includes a requirement that the company issuing the shares, and any of its 100% subsidiaries, incurred total expenses of $1m or less in the income year preceding the issue of the shares. The company may need to satisfy an additional expense test, depending on when it was incorporated in Australia or registered with the Australian Business Register.

TD 2023/6 states that, for the purposes of these provisions:

- "expenses" are amounts recognised as expenses under general accounting concepts;
- "incurred" has the same meaning as it has for the purposes of the general deduction provision (s 8-1 ITAA97); and

- "test time" means the time immediately after the company has issued shares to the investor.

As a practical matter, the Commissioner considers that there is low compliance risk in a company and its investors relying on the amount reported as "total expenses" in the company tax return, without separately identifying whether those expenses have been "incurred" in the tax sense. Accordingly, the Commissioner would not devote compliance resources to query or adjust the company's incurred total expenses that use the reported amount of total expenses in the company's tax return. However, compliance action may be taken to verify that the amount of total expenses reported in the tax return is correct.

For the avoidance of doubt, this compliance approach does not prevent a company and its investors from using an amount worked out to be the correct amount of incurred expenses when determining if the relevant early stage expense tests are met.

Also, if the Commissioner is asked to amend an assessment, or is required to state a view (for example, in a private ruling or in submissions in a litigation matter), the Commissioner will act consistently with the views set out in TD 2023/6.

6. Employee or independent contractor

The Commissioner has released a taxation ruling and a practical compliance guideline in relation to the question of whether an individual is an "employee" of an entity for the purposes of the PAYG withholding provisions of the *Taxation Administration Act 1953* (TAA53) (Cth) (TR 2023/4; PCG 2023/2).[1]

Under the withholding provisions, an obligation is imposed on a paying entity to withhold an amount from the salary, wages, commission, bonuses or allowances it pays to an employee, whether or not the paying entity is the employer. Some points from TR 2023/4 and PCG 2023/2 are set out below.

TR 2023/4 points out that, to ascertain the relevant legal rights and obligations between the worker and the engaging entity, the contract of employment must be construed in accordance with the established principles of contractual interpretation. The task is to construe and characterise the contract at the time it was entered into it. For the purposes of that exercise of construction, recourse may be had to events, circumstances and things external to the contract which are objective, known to the parties at the time of contracting, and assist in identifying the purpose or object of the contract.

A useful approach for establishing whether or not a worker is an employee of an engaging entity when analysing and weighing up each of the indicia of employment identified in the case law is to consider whether the worker is working in the business of the engaging entity, based on the construction of the terms of the contract. This evaluative exercise should not be approached on the basis that there is a checklist against which ticks and crosses may be placed to produce the answer. Rather, the terms of the contract between the parties must be considered holistically to determine whether, on balance, the worker is an employee or an independent contractor. It requires an approach which involves standing back and viewing the contract from a distance, such that an informed, considered, qualitative appreciation of the whole can be undertaken. Further, not all details are of equal weight or importance in any given situation. The details may also vary in importance from one situation to another.

The fact that a worker may be conducting their own business, including having an Australian business number, is not determinative. A person conducting their own business may separately be an employee in the business of another.

The "label" which parties choose to describe their relationship, whether within a written contract or otherwise, is not determinative of, or even relevant to, that characterisation. It is the legal rights and obligations which constitute their relationship which are relevant, and "labels" used to describe the relationship which are inconsistent with those rights and duties have no meaning.

An arrangement between parties that is structured in a way that does not give rise to a payment for services rendered but rather a payment for something entirely different, such as a lease or a bailment, does not give rise to an employment relationship for the purposes of the TAA53.

PCG 2023/2 outlines the Commissioner's compliance approach for businesses that engage workers and classify them as either employees or independent contractors. It sets out how the ATO allocates its compliance resources, based on the risks associated with the classification.

It is the substance of a contractual arrangement that will dictate a worker's classification, rather than the labels used in it. Sometimes, for example, an entity that is carrying on a business will engage a worker with a written contract that describes the worker as an independent contractor, but when all rights and obligations in the totality of the contractual arrangement are considered, the arrangement is actually one of employment.

Further to the ordinary meaning of "employee", being its meaning under common law, the *Superannuation Guarantee (Administration) Act 1992* (Cth) (SGAA92) contains an extended definition of "employee" for superannuation guarantee purposes. This extends beyond traditional employment relationships to take into account some independent contractors. Most relevantly, s 12(3) SGAA92 provides that, if a person works under a contract that is wholly or principally for the labour of the person, the person is an employee for superannuation purposes. The Commissioner's view of who is an employee under the extended definition is outlined in SGR 2005/1.

PCG 2023/2 applies in situations where an entity that carries on a business (the engaging entity) engages a worker, and describes how and when the ATO will allocate compliance resources to cases investigating the worker's classification. PCG 2023/2 is relevant for a variety of tax and superannuation obligations for both the engaging entity and the worker, where the worker contracts directly with the engaging entity.

PCG 2023/2 outlines the ATO's risk framework for worker classification arrangements, based on the actions taken by the parties when entering into the arrangement. Parties can self-assess against this risk framework to understand the likelihood of the ATO applying compliance resources to review their arrangement.

The review of an arrangement by the ATO may be the result of proactive case selection where particular risk factors and information known to the ATO warrants a review. A review may also be the result of an unpaid superannuation query received from a worker where they believe that they were entitled to superannuation because they should have been classified as an employee and not an independent contractor or they satisfy the extended definition of "employee" for superannuation purposes.

The risk framework is made up of four zones. When the ATO reviews an arrangement on either of the occasions referred to, the ATO will apply compliance resources initially to determine which risk zone the arrangement falls into. Once the risk zone has been determined, whether the ATO has cause to apply compliance resources will depend on the zone in line with Table 3 of PCG 2023/2.

Recent case decisions

7. Unregistered entity: penalties

The Federal Court (Banks-Smith J) has imposed a pecuniary penalty of $230,000 on an individual (Ms Van Stroe) who contravened s 50-5(1) of the *Tax Agent Services Act 2009* (Cth) (TASA) on 531 separate occasions by preparing and lodging income tax returns for taxpayers, being the provision of a tax agent service for a fee or other reward, while not a registered tax agent (*Tax Practitioners Board v Van Stroe (No. 2)*[2]).

A number of taxpayers provided affidavit evidence as to their dealings with Ms Van Stroe, and Banks-Smith J accepted the submission of the Tax Practitioners Board (the Board) that those taxpayer affidavits evinced a pattern of behaviour indicative of a deliberate attempt to engage in a profit-making scheme in circumstances where Ms Van Stroe was operating outside the regulatory framework for a number of years. Her usual practice was to meet with a taxpayer who had heard of her services through word of mouth and came to meet with her at a specified address.

Ms Van Stroe would access the taxpayers' MyGov accounts with them, and then complete details for their tax return. She did not take steps to confirm that information included in the tax returns was supported or substantiated by reliable documentary evidence. She generally charged $180 for her services. The affidavits provided examples where false income tax deductions were not brought to the attention of the relevant taxpayer. Further, the evidence indicated that at least seven of the deponents of taxpayer affidavits were subject to an audit by the ATO, with an administrative penalty being imposed on six of those taxpayers.

The 531 contraventions all occurred after the Board had sent a warning letter on 8 March 2018 to Ms Van Stroe informing her that the Board was concerned with her conduct as an unregistered tax agent. They occurred during the period 1 July 2020 to 16 August 2021. The Board's investigation revealed that Ms Van Stroe earned some $99,590 from taxpayers in relation to the conduct.

As Ms Van Stroe did not participate in the proceedings brought by the Board in the Federal Court, the court had no relevant information from her as to the circumstances of the contraventions, her financial position or any mitigating factors.

Banks-Smith J said that the purpose of a civil penalty is to protect the public interest by deterring future contraventions of the TASA by the contravener and by others. This includes both specific and general deterrence. The principles of retribution, denunciation and rehabilitation that govern criminal sentencing have no part to play in imposing civil penalties.

Her Honour said that the task of determining an appropriate penalty is sometimes said to involve an "instinctive synthesis" involving the evaluation of a multitude of factors, rather than by starting with a fixed figure and making arithmetical adjustments attributable to each factor. Other principles which guide the court in this approach are:

- the penalty should be proportionate, in the sense of setting a reasonable balance between deterrence and oppressive severity;
- there must be regard to totality when conducting a "final check" of the penalties imposed to ensure that the overall penalty is just and appropriate;
- it must be recognised that the statutory maximum is but one yardstick to be considered with other relevant factors;
- the circumstances of both the contravention and the contravenor are relevant to the assessment. Any of those circumstances may have a bearing on the need for deterrence in the particular case. They may overlap, particularly in cases where the contravening conduct is accompanied by a deliberate or strategic state of mind. The seriousness of a contravention and the associated need for deterrence may be assessed not merely by reference to the nature of the physical acts constituting the contravention, but by circumstances such as the deliberation with which the respondent has contravened;
- penalties imposed in comparable cases may provide guidance on assessing the appropriateness of a penalty, as there should be consistency in the penalties imposed for similar contraventions. This may not necessarily be numerical consistency but rather consistency in the application of the relevant principles; and
- finally, for present purposes, the notion of a course of conduct, particularly where there is repetition of similar conduct, is also an important analytical tool. Ordinarily, separate contraventions arising from separate acts should attract separate penalties. However, where separate acts give rise to separate contraventions that are inextricably interrelated or of the same or similar character, they may be regarded as a "course of conduct"

for penalty purposes. Whether the contraventions should be treated as a single course of conduct is fact-specific, having regard to all of the circumstances of the case.

Banks-Smith J said that she accepted that Ms Van Stroe's contraventions were serious. Of particular concern was the vulnerability of taxpayers to exploitation in circumstances where they may have deliberately sought to obtain genuine advice as to their taxation obligations and have paid for that advice. This was not a case of casual advice given from time to time, or of "helping out" a few people. It was a steady, deliberate and repetitive course of conduct.

In this case, having regard to the large number of contraventions, and the concept of the one course of conduct, care had to be taken with setting an amount based on what might apply with respect to each contravention. For example, even assessing a penalty on the basis of $500 per contravention would lead to a penalty of $265,500, an amount her Honour considered to be excessive. Other decisions had similarly noted such calculations, but the resulting range per contravention did little to assist.

Banks-Smith J said that, in the end, and having regard to principles of totality, it was her view that an appropriate fine was $230,000. That remained a significant sum for an individual. It also seemed to be sufficient to provide a meaningful general deterrent, taking into account that Ms Van Stroe received some $99,590 by way of benefits from her conduct and the apparent ease with which she was able to provide her services for a fee. It should be apparent to others from the fine imposed that the benefit by way of a fee or payment is significantly outweighed by the fine imposed.

8. Beneficiaries assessable on amounts received by trust

The AAT has held that two presently entitled beneficiaries of a property discretionary trust had not discharged the onus of establishing that certain amounts received by the trust during the income years in question were not income (and, so, were assessable to them) and also that the Commissioner had rightly assessed them to penalties on the ground of recklessness (*CVMW and FCT*[3]).

The taxpayers, who were husband and wife, conducted restaurant and take-away businesses at different locations in Victoria through two discretionary trusts. They also conducted property investment activities through another discretionary trust (the property trust). The taxpayers were the controlling minds and beneficiaries of the three trusts.

In the 2017 and 2018 income years, the property trust received into the bank accounts of its corporate trustee (the property trustee company) seven deposits of cash and/or bank cheques totalling $735,825 (collectively, the deposits). The property trustee company made a number of acquisitions of property in those income years.

The Commissioner assessed the deposits as ordinary income of the property trust, with a consequential increase to the property trust's net income for the purposes of applying s 97 of the *Income Tax Assessment Act 1936* (Cth).

The Commissioner then increased the assessable income of each of the taxpayers as presently entitled beneficiaries of the income of the property trust. The Commissioner also imposed penalties on each of the taxpayers at the rate of 50% on the basis of recklessness as to the operation of the income tax laws. The Commissioner did not exercise his discretion to remit the applicable penalties to any extent.

The taxpayers objected to the assessments. In broad terms, they argued that the deposits did not constitute income of the property trust but rather were a mix of debt and equity contributions to the property trust, all of which were provided by their parents (who were secondary beneficiaries). In addition to their evidence and the evidence of their tax agent, the taxpayers also relied on the fact that the deposits were variously described as either a "loan from related party" or a "beneficiary contribution" in the general ledgers and financial statements of the property trustee company.

The AAT was not persuaded that the taxpayers had discharged their burden of proving, on the balance of probabilities, that the assessments issued to them were excessive and what the assessments should be. The AAT was also not persuaded that the administrative penalties imposed by the Commissioner for recklessness should be disturbed.

In summarising the position with respect to the evidence, the AAT said that the vagueness and the numerous inconsistencies of the evidence of the taxpayers led the tribunal to the position that it could not accept their evidence as being sufficiently reliable, despite the fact that the evidence of each taxpayer was sometimes virtually identical. This was because their interests in the disputes were aligned and their statements consequently self-serving. Their evidence, in the absence of any independent contemporaneous documentation or records, was not credible in all of the circumstances.

The taxpayers also submitted that the books and records comprising the general ledgers, balance sheets and profit and loss statements of the property trustee company were prima facie evidence of the matters they recorded as a consequence of the operation of s 1305 of the *Corporations Act 2001* (Cth). The AAT said that the difficulty in the present case was that the reliability of the financial records was suspect. The financial records were prepared by the tax agent based on instructions from one of the taxpayers and her evidence was problematic because of numerous inconsistencies and ambiguities. Therefore, the presumption about the records being prima facie evidence was displaced.

Regarding the safe harbour exception to the imposition of administrative penalties, the AAT said that the taxpayers had not proved that they provided their tax agent with all relevant taxation information.

The hearing of the case was in private and, therefore, the AAT made an order that the identities of the taxpayers were to be anonymised in the AAT's reasons for decision. An application was made that a confidentiality order should also be made by the AAT with respect to the name of the tax

agent acting on behalf of the taxpayers. The AAT refused this application.

9. Transfer to army reserve: genuine redundancy

The AAT has held that a payment received by a regular full-time member of the army as a result of being transferred to the army reserve was a genuine redundancy payment for the purposes of the genuine redundancy payments and early retirement scheme payment provisions in Subdiv 83-C ITAA97 (*Fidge and FCT*[4]).

The taxpayer became a member of the Australian Army on 16 January 1987 and advanced to the rank of colonel in 2010. In March 2016, the taxpayer commenced a posting as Defence Attaché-Ankara, International Policy. On 31 July 2018, the then Chief of Army wrote to the taxpayer advising that he was being considered for Command Initiated Transfer to the Reserves. This letter went on to say:

> "You have provided exemplary service to the Australian Regular Army throughout your service, which has spanned 31 years, with seven years as a colonel. Every effort is being made to find you further employment; however, it is unlikely there will be a full-time position for you following your appointment as Defence Attaché-Ankara, International Policy."

The taxpayer's assignment as Defence Attaché-Ankara came to an end in February 2019. Between February 2019 and 6 June 2019, the taxpayer continued to render, and was remunerated for, full-time service. During this period, he was posted to Canberra to a position designated as "senior officer awaiting repost".

On 5 June 2019, the Chief of Army wrote to the taxpayer advising that, while all efforts had been made to identify further employment, continued workforce planning deliberations had confirmed that there would not be a full-time position available for the taxpayer following his current role. As a result, it had been determined that the taxpayer's transfer to the army reserves would occur on 7 June 2019.

This letter went on state that, as the taxpayer would be compulsorily transferred from the permanent force to the reserves for reasons of workforce planning within 30 days of receipt of the decision, the taxpayer would be eligible for a special benefit payment pursuant to a determination under s 58B of the *Defence Act 1903* (Cth).

The issue for decision was whether the special benefit payment received by the taxpayer was a genuine redundancy payment as defined in s 83-175(1) ITAA97 which provides:

> "A ***genuine redundancy payment*** is so much of a payment received by an employee[5] who is dismissed from employment because the employee's position is genuinely redundant as exceeds the amount that could reasonably be expected to be received by the employee in consequence of the voluntary termination of his or her employment at the time of dismissal."

The AAT held that the correct characterisation of the circumstances was that there was previously a position for a colonel in the regular army that the taxpayer held for some seven years, carrying out duties as and where directed. Due to workforce planning considerations, a decision was taken that his position as a colonel was no longer required. The taxpayer's former position as a colonel in the regular army was therefore properly described as redundant in the sense that the position was excess to the army's requirements.

The taxpayer's dismissal was given effect by the compulsory transfer out of his full-time position and into the reserves. The redundancy caused the compulsory transfer to occur; it would not have occurred but for the redundancy. Thus, the dismissal was because of the redundancy.

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References

1 See s 12-35 of Sch 1 TAA53.

2 [2023] FCA 1533.

3 [2023] AATA 4039.

4 [2023] AATA 4245.

5 If a person holds (or has held) an office, the relevant provisions (Pt 2-40 ITAA97) apply to the person in the same way as they would apply if the person were (or had been) employed.

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Tax Tips

by TaxCounsel Pty Ltd

Code breaches: new notification obligations

Recent legislative amendments impose obligations on registered tax agents to notify the TPB of certain breaches of the Code of Professional Conduct.

Background

The regulatory regime that applies to tax agents is in the course of undergoing substantial change. Not only are the government's responses to the recommendations made in the Tax Practitioners Board (TPB) 2019 review in the course of being legislated, but the emergence of the PwC matter is also driving legislative action.

The recently enacted *Treasury Laws Amendment (2023 Measures No. 1) Act 2023*[1] contains amendments that implement a number of measures recommended by the TPB review, including in relation to employing or using "disqualified entities", and the change of the registration cycle from three years to one year.

This amending Act, however, also made important amendments to the *Tax Agent Services Act 2009* (TASA) that can be traced to the PwC matter and which require (in the circumstances provided for) a registered tax agent to notify the TPB of significant breaches of the Code of Professional Conduct (the Code) that the agent or another registered tax agent has committed on or after 1 July 2024.

These notification obligations (which are referred to for convenience as the "Code breach notification rules") were not proposed by the government (and, so, were not included in the amending Bill as introduced into parliament) but were included in the Bill as a result of amendments moved by the Australian Greens in the Senate.

The Code breach notification rules are clearly important and will require tax agents to be alert to the need to notify the TPB of Code breaches in particular circumstances. This article considers some aspects of the new notification obligations.

The Code breach notification rules also apply to a registered BAS agent. For the sake of simplicity, this article refers to the position of a registered tax agent.

Code breaches by agent

The circumstances in which a registered tax agent has an obligation to notify the TPB of something have been extended by the amending Act to the situation where the tax agent has reasonable grounds to believe that the agent has breached the Code, and that the breach is a significant breach (as defined) of the Code.[2]

This notification obligation applies in relation to breaches of the Code that occur on or after 1 July 2024, this being the date of the commencement of Pt 5 of Sch 3 of the amending Act.[3]

Such a notification must be made in writing within 30 days of the day on which the notifying agent first had, or ought to have had, reasonable grounds to believe that they had breached the Code, and that the breach is a significant breach of the Code (s 30-35(4)(b) TASA).[4]

Code breaches by another tax agent

Importantly, a registered tax agent is obliged to notify the TPB in writing of a significant breach of the Code by another registered tax agent. This notification obligation arises where a registered tax agent has reasonable grounds to believe that another registered tax agent has breached the Code, and that the breach is a significant breach of the Code (s 30-40(1) and (3) TASA).

The time within which such a notification must be made is within 30 days of the day on which the notifying tax agent first had, or ought to have had, reasonable grounds to believe that the other agent breached the Code, and that the breach is a significant breach of the Code (s 30-40(3) TASA). This notification obligation applies in relation to breaches of the Code that occur on or after 1 July 2024.[5]

Further, if, at the time the notifying tax agent has reasonable grounds to believe that the other agent has breached the Code, the other agent is a member of a professional association accredited by the TPB and the notifying tax agent is aware of the other agent's membership, the notifying tax agent must also notify the association, in writing, of the breach within the same 30-day period (s 30-40(2) and (3) TASA).

Failure to notify

Where a registered tax agent fails to notify the TPB of a breach of the Code as required, this would mean that an offence under s 8C of the *Taxation Administration Act 1953* (TAA53) would be committed (failure to comply with requirements under taxation law). In addition, if the failure to notify is in respect of a Code breach by the registered agent that is under a duty to notify, this failure would itself be a breach of the Code (failure to comply with the taxation laws in the conduct of the agent's personal affairs).[6]

No explanatory memorandum

As mentioned, the amending Bill as introduced into parliament did not contain the Code breach notification rules. The rules were included in the amending Bill as a result of non-government amendments moved in the

Senate. One consequence of this is that there is no explanatory memorandum that deals with the Code breach notification rules. That means that what could otherwise have been a potentially useful aid to the interpretation of the Code breach notification rules is not available.[7]

Significant breach of the Code

The Code breach notification rules apply in relation to a breach of the Code by a registered tax agent that is a significant breach of the Code.

The concept of a significant breach of the Code for this purpose is defined in the dictionary to the TASA (s 90-1(1)). That definition is as follows:

> "***'significant breach of the Code'*** means a breach of the Code of Professional Conduct by a registered tax agent or BAS agent if the breach:
>
> (a) constitutes an indictable offence, or an offence involving dishonesty, under an Australian law;[8] or
>
> (b) results, or is likely to result, in material loss or damage to another entity (including the Commonwealth); or
>
> (c) is otherwise significant, including taking into account any one or more of the following:
>
> (i) the number or frequency of similar breaches by the agent;
>
> (ii) the impact of the breach on the agent's ability to provide tax agent services;
>
> (iii) the extent to which the breach indicates that the agent's arrangements to ensure compliance with the Code are inadequate; or
>
> (d) is a breach of a kind prescribed by the regulations for the purposes of this paragraph."

The use of the expression "means" in the definition has the consequence that the definition is exhaustive.

A further point is that, as a matter of construction, a component of a defined term (for example, the word "significant" in the term "significant breach of the Code") cannot govern the construction of the definition. In this regard, in *Owners of the Ship "Shin Kobe Maru" v Empire Shipping Company Inc*,[9] the High Court, in a joint judgment, said:

> "26. The Act's description of a claim falling within s. 4(2) as a 'proprietary maritime claim' is of no assistance in construing the expression 'a claim … relating to … ownership'. The use of the word 'proprietary' in the term to be defined does not colour the meaning to be given to the definition which follows it. It would be quite circular to construe the words of a definition by reference to the term defined …"

This means that the word "significant" in the term defined (significant breach of the Code) does not influence the construction of the definition. It will be noted that the definition itself acknowledges this in that the word "significant" is used in para (c) ("is otherwise significant …").

Indictable offence

Whether an offence is an indictable offence for the purposes of para (a) of the definition of "significant breach of the Code" is governed by the law of the relevant jurisdiction.

For example, for Commonwealth purposes, s 4G of the *Crimes Act 1914* (Cth) provides that offences against a law of the Commonwealth punishable by imprisonment for a period exceeding 12 months are indictable offences, unless the contrary intention appears. And by way of further example in New South Wales, the dictionary in Sch 4 of the *Interpretation Act 1987* (NSW) provides that the expression "indictable offence" means an offence for which proceedings may be taken on indictment, whether or not proceedings for the offence may also be taken otherwise than on indictment.

Offence involving dishonesty

Paragraph (a) of the definition of "significant breach of the Code" also includes a breach of the Code that constitutes an offence involving dishonesty under an Australian law. It would not be relevant whether or not the offence is an indictable offence.

Relevantly, the *Macquarie Dictionary* defines "dishonesty" as "not honest" and the adjective "honest" as "1. honourable in principles, intentions, and actions; upright …".

It is submitted that the meaning to be attached to the expression "an offence involving dishonesty" is that described by Bell J in *Barber v Law Society of New South Wales (No. 2)*.[10] Bell J said:

> "32 The conviction of which s 79A(2)(a) [of the *Legal Profession Act 1987* (NSW)] speaks is one for a crime or offence involving dishonesty. It seems to me that the crime or offence the subject of the conviction must be one which answers that description without further inquiry. Offences involving dishonesty embrace those such as stealing and robbery in which the property of another is taken with the intention thereby of permanently depriving the rightful owner of it and offences where property or some advantage is gained through indirect means such as false pretences, conspiracy to defraud and the like. Glanville Williams notes that while the great majority of offences of dishonesty relate to property it is not true to say that all do; *Textbook of Criminal Law*, 2nd Ed, Stevens, Lond. 1983, at p 699. He cites as an illustration of an offence of dishonesty not involving property the commission of perjury in order to avoid going to prison.
>
> 33 I am not persuaded that on a generous interpretation of the concept of a crime or offence involving dishonesty that a conviction for the offence of taking part in the manufacture of a prohibited drug (or conspiring to produce) contrary to s 32(1)(b) of the *Controlled Substances* Act 1984 (SA) might properly come within the terms of s 79A(2)(a) of the Act."

It would seem that any breach of the Code that constituted an offence involving dishonesty, no matter what its seriousness may be, would, if para (a) of the definition of "significant breach of the Code" is applied literally, constitute a significant breach of the Code. Thus, it would not matter whether the dishonesty involved $100, $100,000 or $1,000,000.

Material loss or damage

Paragraph (b) of the definition of "significant breach of the Code" includes a breach that results, or is likely to result, in material loss or damage to another entity (including the Commonwealth). Presumably, this would cover the circumstances such as arose in the PwC matter. It would seem that this category may overlap with para (a).

Otherwise significant

Paragraph (c) of the definition of "significant breach of the Code" includes a breach of the Code that is otherwise significant, including taking into account any one or more of the matters listed. This category of a significant breach of the Code does call for a meaning to be given to the word "significant". The *Macquarie Dictionary* defines "significant" as "1. important; of consequence".

In the context of para (c), the meaning of the word "significant" is affected by paras (a) and (b) of the definition because of the opening words of para (c) ("is otherwise significant") and also by the subparagraphs of para (c).

Reasonable grounds to believe

For the Code breach notification rules to apply, the registered agent for whom a notification obligation may potentially arise must have "reasonable grounds to believe" that there has been a breach of the Code and that the breach is a significant breach of the Code.

In *Civil Aviation Safety Authority v Alligator Airways Pty Ltd (No. 3)*,[11] Murphy J considered the concept of "reasonable grounds to believe" in the context of the *Civil Aviation Act 1988* (Cth).

Under s 30DE(2) of that Act, if the court is satisfied that there are reasonable grounds to believe that the holder of a civil aviation authorisation has engaged in, is engaging in, or is likely to engage in conduct that constitutes, contributes to or results in a serious and imminent risk to air safety, the court *must* make a prohibition order.

Murphy J said:

> "28. The requirement to establish reasonable grounds precludes the arbitrary exercise of many statutory powers. When a statute requires there must be 'reasonable grounds' for belief it requires the existence of facts which are sufficient to induce that state of mind in a reasonable person: *George v Rockett* [1990] HCA 26; (1990) 170 CLR 104 ('*George v Rockett*') at 112. At 116 in that case the High Court explained:
>
> > The objective circumstances sufficient to show a reason to believe something need to point more clearly to the subject matter of the belief, but that is not to say that the objective circumstances must establish on the balance of probabilities that the subject matter in fact occurred or exists: the assent of belief is given on more slender evidence than proof. Belief is an inclination of the mind towards assenting to, rather than rejecting, a proposition and the grounds which can reasonably induce that inclination of the mind may, depending on the circumstances, leave something to surmise or conjecture."

Murphy J also referred to the decision of the Appeal Division of the Supreme Court of Victoria in *Loughnan v Magistrate's Court of Victoria Sitting at Melbourne*[12] in which the court said that reasonable grounds to believe that a suspect had committed an offence meant that:

> "… the court is not required to be satisfied, even to some prima facie stage, that the suspect has committed the offence; the court need be satisfied only that there are reasonable grounds to believe that the suspect has committed the offence."

Murphy J also referred to the court's observation in that case:

> "That reasonable grounds exist for believing that the suspect has committed the offence is not necessarily inconsistent with the fact that other possibilities exist too, based upon further and different material."

Code principles

The Code principles which, if breached, could potentially call for a notification being made to the TPB under the Code breach notification rules include:

- acting honestly and with integrity;
- accounting to a client for money or other property held on trust; and
- acting lawfully in the best interests of a client.

Examples of offences

Putting to one side an indictable offence, it must be kept in mind that para (a) of the definition of "significant breach of the Code" requires that the offence involve dishonesty. This means, for example, that the fact that a false or misleading statement offence provided for by s 8K TAA53 may have been committed will not be a relevant offence because absolute liability applies to the circumstance that the statement is false or misleading in a material particular.[13]

Also, if the circumstances are such that an offence under s 8N TAA53 (recklessly making false or misleading statements) may have been committed, this will not be a relevant offence because "recklessly" is a different concept to dishonesty.

On the other hand, an offence under s 8T TAA53 (incorrectly keeping records with intention of deceiving or misleading etc) or s 8U TAA53 (falsifying or concealing identity with intention of deceiving or misleading etc) would be relevant offences as they each require some action or actions which would involve dishonesty.

It may be noted that the penalty for an offence under s 8T or 8U TAA53 is a fine not exceeding 50 penalty units or imprisonment for a period not exceeding 12 months, or both (s 8V(1) TAA53). However, if the court before which the person is convicted is satisfied that the person has previously been convicted of a relevant offence, the penalty that the court may impose is a fine not exceeding 100 penalty units or imprisonment for a period

not exceeding two years, or both (s 8V(2) TAA53). It is submitted that the possibility that the offence may, in the circumstances defined, be punishable by imprisonment for more than 12 months would not mean that the offence was an indictable offence.

There are also a range of offences in the various jurisdictions that may be relevant if there has been a breach of trust in relation to moneys held on trust for a client.

Some scenarios

A Code breach notification obligation could arise in a range of circumstances. For example, a taxpayer may be changing tax agents and the accounting and other records that the taxpayer brings to the new tax agent may evidence a notifiable Code breach committed by the taxpayer's former tax agent.

Further, where it is necessary to conduct a due diligence exercise in relation to an accounting practice, such as where the accounting practice is being sold, there would be the possibility that this may expose a notifiable Code breach committed by the selling tax agent.

Where a tax practice is being carried on by a partnership, each partner who is a registered tax agent would need to be alert to any circumstance that may trigger an obligation to make a Code breach notification to the TPB.

And, very basically, an employed tax agent may come across a situation that may trigger an obligation to make a Code breach notification to the TPB.

Observations

It will be seen that the Code breach notification rules raise a number of issues. It is important to keep in mind that it is only breaches of the Code that occur on or after 1 July 2024 that are subject to the notification rules. It is to be hoped that the TPB issues guidance materials in relation to the rules before that date.

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References

1 Act No. 101 of 2023 (date of assent 27 November 2023). It is referred to in this article as "the amending Act".
2 S 30-35(1)(ba) TASA (individuals), s 30-35(2)(ba) TASA (partnerships) and s 30-35(3)(ba) TASA (companies).
3 S 28(1) of the amending Act.
4 Although the form of expression "within 30 days of the day" is not expressly covered by the time reckoning provision of the *Acts Interpretation Act 1901* (Cth) (s 37), it would seem that, on the ordinary meaning of the words used, the 30-day period would commence on the day following the day on which the agent first had, or ought to have had, reasonable grounds to believe. This view is confirmed by analogy with the expressions which s 37 of that Act provide for.
5 S 28(2) of the amending Act.
6 S 30-10(2) TASA.
7 See s 15AB of the *Acts Interpretation Act 1901*.
8 The expression "Australian law" takes the defined meaning that it has for the purposes of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) (see s 3-5 TASA). The effect of the definition in the ITAA97 is that "Australian law" means a Commonwealth law, a state law or a territory law.
9 [1994] HCA 54. For recent tax cases in which this proposition was applied, see *B&F Investments Pty Ltd as trustee for the Illuka Park Trust v FCT* [2023] FCAFC 89 and *Sunlite Australia Pty Ltd v FCT* [2023] FCAFC 43.
10 [2001] NSWSC 861. See also *Diesel Holdings Pty Ltd v Waters* [2023] VSC 455.
11 [2012] FCA 601.
12 [1993] 1 VR 685 at 692.
13 S 8K(1) TAA53.

Higher Education

From intern to dux: strategies for success

The Dux of CTA1 Foundations in Study Period 2, 2023 shares strategies for juggling his studies with work and undergraduate degree commitments.

Daksh Aggarwal
Intern Accountant
Fortuna Advisory Group, Western Australia

Tell us about yourself

I am currently in my first year of university studying finance and data science, and have been working as an intern tax accountant for the last five months. I have worked primarily on taxation for individuals, small businesses and companies. I enjoyed working progressively through more complex scenarios as I gained more experience in the role.

Why did you undertake the CTA1 Foundations subject?

I wanted foundational knowledge in tax which I could apply during my internship. CTA1 Foundations introduced me to Australian taxation laws and provided an important insight into the fundamentals that are applied across various aspects of day-to-day tax accounting.

CTA1 Foundations is an extremely well-thought-out and structured subject that really immersed me in tax from the get-go. It covers topics from assessable income, deductions, CGT, GST and FBT, which are essential topics in any tax role. An understanding of these different areas, as well as how they interplay and relate with each other, allowed me to handle many situations, from the easy to the more complex, in my job.

Did the new knowledge assist you in your work?

I have been able to apply this new knowledge in my work. It was my first insight into tax education and underpins the majority of the work I do in my internship.

What's your experience of studying at The Tax Institute Higher Education?

CTA1 Foundations was set out well and the learning platform made it easy to access all of the required resources. I also appreciated the clarity of the unit's structure, indicating the breadth and level of knowledge needed. The study materials were both comprehensive and presented in a clear and concise manner.

How did you balance studying at two different institutions and working at the same time?

Balancing almost full-time work (4.5 days a week), full-time university study and CTA1 Foundations study was quite tough. During school, I was always busy juggling many different things, so I developed strong time management skills then and I learnt to be efficient while studying. These skills help me to complete large tasks in short amounts of time.

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

Given I have three years left in my undergraduate degree in finance and data science, as well as a lot more to learn in my formal tax education, there are many different career paths I could take and I am still undecided. However, given my current position in a tax role and desire to continue my tax education, this field is definitely near the top of my list and career paths to choose.

What advice do you have for other tax professionals considering studying?

For those looking to get into the tax industry, I recommend this subject as a great foundation that can be directly implemented in your daily job from the moment you begin working in taxation.

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Member Spotlight

Tax and Australian musicians

Kylie Thompson
Sorrento Strategic

With over 1,400 music professionals managed by Sorrento Strategic, the company's owner, Kylie Thompson, has been busy managing the tax needs of Australian music professionals for over 25 years.

Spending five years at a practice specialising in the arts, Kylie found herself working with bands and took a strong interest in the field, so she set up her own practice and 2023 marked her 25th year in business. Her passion for working in this niche is inspiring, with her clients at the heart of it all. Kylie had a huge 2023, being awarded Accounting Consultant of the Year at both the Women in Finance Awards and the Australian Accounting Awards.

A fact worth noting is that Kylie's first client at Sorrento Strategic was a gentleman by the name of John Butler who at the time was a busker in Fremantle! Fast forward to today, and Kylie is still working with him.

Kylie works with organisations to help support the grassroots level of music, including her role as Treasurer of West Australian Music and the WA Strings Attached Guitar Festival. She has also recently been appointed to the Board for the Australian Live Music Business Council. Kylie also contributes to the AIR Women in Music Mentorship Program and provides financial literacy workshops and is an assessor and mentor for the program. You'll also find Kylie doing tax-time workshops for music professionals.

Covid-19 was an interesting time for musical professionals, which is one of the reasons Kylie became a member of The Tax Institute. During the pandemic, Sorrento Strategic was processing 150 JobKeeper registrations and found the Institute's tax updates very helpful.

"When we added it up, we distributed $5.3m in stimulus payments during that time. We were flat out, but the positive outcome, while being in lockdown with no performance opportunities or revenues, was that I saw musicians put their mental health and energy into writing songs, with Perth-based recording studios being booked up to six months in advance. The $750 JobKeeper payment gave musicians a stable income, and it's a lot of money to them", Kylie said.

"My clients are continually working on their craft, their passions, but it can be a tough gig that comes with highs and lows in income. Ideally, we could follow some European countries, where musicians receive some form of supplemental payment to stabilise their income. My clients work hard to contribute, and although they aren't unemployed, being a creative and doing what you love, means they struggle to pay the bills sometimes. I have had difficulty working with the ATO to build on its understanding of these issues and helping to explain artist averaging, ensuring that the ATO understands the importance of its correct application when it comes to the ebbs and flows of musician's incomes specifically."

"I love working with creatives, my motto is, 'relax, it's just tax', and we're able to provide support with their taxes, while understanding how their income works", Kylie said.

"Things have also changed a lot since I started working with bands — with record sales, you had physical sales of records, and artists would earn more. Every time you sold a cassette or physical merchandise you'd receive, $20 or $30. However, Spotify currently pays $4,000 for a million streams", Kylie reflects.

"If you want to make it big in music, you need to tour America. When I was starting, I reached out to my network to provide specialist tax advice on US foreign tax credits and the double tax agreement, and what to claim in Australia to help when working with Aussies who started to make it in America. Max Hendriks, CTA, is now at MAST Advisers, and was able to provide me with advice, and I finally met Max in person this year at the Australian Accounting Awards, and he remembered helping me some 15 years earlier. Our tax community is great", Kylie said.

Kylie also works with charities, including Support Act, which is a charity for the music industry to deliver crisis relief services to musicians, managers, crew and music workers who are unable to work due to injury or mental health problems. The charity offers a variety of services, including tax assistance, which can often be stressful to deal with. Sorrento Strategic is one of two tax agents that Support Act recommends. As an annual fundraiser, this charity runs Ausmusic T-Shirt Day on 30 November each year, where you can wear an Aussie band t-shirt and make a donation or buy a t-shirt to contribute to this cause.

"I enjoy working on various industry boards to make a positive difference at the grassroots. I see the day-to-day details at a micro level, which provides valuable insights to decision-makers in the industry that make a difference at the entry-level of the industry", Kylie said.

Kylie and her team proudly supporting Ausmusic T-Shirt Day

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Default assessments: the "all or nothing approach"

by Norman Hanna, Barrister, Lilley Chambers

This article considers some of the practical issues that a taxpayer faces in discharging the onus of proof in a "tax appeal" to prove that their assessment is excessive and what the assessment should have been. The focus is on a potential divergence of opinion that has arisen in recent Federal Court decisions as to whether the "all or nothing" approach to discharging the onus in default assessment cases is still valid, or whether a taxpayer can succeed to the extent that they can "chip away" at such assessment. This issue is considered in the context of default assessments issued under s 167 of the *Income Tax Assessment Act 1936* (Cth) which adopt the asset betterment approach.

Introduction

A taxpayer bears the onus of proof in an appeal to the Federal Court or on review in the Administrative Appeals Tribunal (AAT) to prove that the assessment is excessive and what the assessment should have been.[1] The standard of proof is the civil standard, being the balance of probabilities.[2]

The courts have repeatedly stressed that there is no undue hardship in imposing the onus of proof on a taxpayer. The rationale is that the facts relating to a taxpayer's income are peculiarly within the taxpayer's knowledge.[3] Accordingly, a taxpayer must be taken to know what their items of income are and how such income was derived.[4] A taxpayer has first-hand knowledge of the taxable events, in contrast to the Commissioner who is really a stranger to those events.[5]

An interesting issue has arisen in the Federal Court as to whether the "all or nothing" approach to discharging the onus in default assessment cases is still valid. That is, whether a taxpayer can succeed to the extent that they can chip away at a default assessment, or whether the taxpayer must positively prove their actual taxable income to be successful (and if they do not, their entire case will fail).

This article explores this issue in the context of default assessments issued under s 167 of the *Income Tax Assessment Act 1936* (Cth) (ITAA36) which adopt the asset betterment approach.

Key principles

The ultimate issue in Pt IVC TAA53 proceedings in respect of a default assessment under s 167 is whether the amount of the assessment is excessive.[6] When undertaking that task, a taxpayer must positively prove the actual amount of their taxable income and therefore must show that the amount of money for which tax is levied by the assessment exceeds their actual substantive liability.[7] This does not mean that the taxpayer must prove their taxable income down to the last cent, but it would be sufficient to prove it to "what is right or more nearly right".[8]

It has also been repeatedly emphasised that the manner in which a taxpayer discharges that burden is not defined or specified but "varies with the circumstances".[9] One thing is clear, a "taxpayer must show that the unexplained accumulated wealth was from non-income sources".[10] A constant theme running through the authorities is that the discharge of the onus requires more than just a critique of that approach.[11]

The difficulty faced by the taxpayer is that the Commissioner is "entitled to rely upon any deficiency in the taxpayer's proof of the excessiveness of the amount assessed in seeking to uphold the assessment".[12]

When explaining how the burden may be discharged, the Full Federal Court in *Gashi v FCT* (*Gashi*)[13] cited with approval the following passage from Burchett J in *Ma v FCT*:[14]

> "9. … if a taxpayer denies any undisclosed source of income, provides acceptable evidence of how he spends his time, and demonstrates a reasonable explanation for any appearance of the possession of assets, he will generally discharge his burden of proof unless some positive reason is shown why he is to be disbelieved."

The Full Court in *Gashi* went on to provide an extremely useful elaboration of this passage as follows:

> "65. Justice Burchett identified a number of steps – identification of sources of income, explanation of a taxpayer's activities and an explanation of the source or sources of a taxpayer's assets. The steps identified by Burchett J are not surprising. In addressing a s 167 assessment based upon an asset betterment statement, a taxpayer must account for an unexplained increase in assets. *The taxpayer must explain the source or sources of those assets and then identify whether that source, or those sources, are taxable. Put another way, if the disclosed 'actual' taxable income does not explain the increase in assets, then the taxpayer is unlikely to have discharged the burden of establishing the assessment is excessive.* And, of course, that unexplained increase in assets cannot be viewed in isolation – it must also take into account the expenditure during that period.

66. Consistent with that view, even if a taxpayer was able to prove that an item in the asset betterment statement was wrong or should not have been included, *but did not adequately explain the source or sources for the otherwise unexplained increase in wealth, the taxpayer would not discharge the onus* under s 14ZZO of the TAA." (emphasis added)

In a similar vein, it has been noted that a taxpayer is required to identify their contended actual taxable income, and to prove that the amount contended for was the full extent of their assessable income.[15] This requires a taxpayer to provide acceptable explanations and evidence to the effect that their monetary receipts and increases in wealth during the income year were from non-taxable sources.[16] Where a taxpayer is able to do this, and the court accepts the evidence to the requisite standard, then the onus would be discharged.[17]

There are two further types of cases that are worth emphasising that bear on the principles stated above. Namely, those cases where the underlying taxable events are uncontroversial and those cases where the parties have agreed to confine the issues for determination.

> "The manner in which a taxpayer discharges that burden is not defined but varies with the circumstances."

In the former type of case, the onus of proof can be discharged "by showing that the Commissioner has erred in his construction and application of the taxation legislation to those events".[18] In those circumstances, a "taxpayer may succeed by demonstrating on the balance of probabilities that the amount in question does not bear that legal complexion".[19]

In the latter type of case, it may be possible for there to be an agreement with the Commissioner to confine the issues for determination in a Pt IVC proceeding "to a specific point of law or fact on which the amount of the assessment depends".[20] In circumstances where that occurs, a taxpayer may succeed on the identified issue to indicate that the assessment is excessive.[21] It follows that the issue of whether there is in fact an agreement may become a live issue in the proceeding.[22]

Divergence of opinion

Support for a possible rejection of the "all or nothing approach" comes from the Full Federal Court decision of *Haritos v FCT* (*Haritos*). In that case, the court observed that:

"235. The third way in which the appellants put their argument that the Tribunal had misused the burden of proof section is related to the second. The appellants submitted that even if Mr Haritos' evidence was correctly rejected, they had nevertheless established subcontractor expenses of at least a certain amount. The Tribunal was not entitled to adopt what the appellants described as an 'all or nothing' approach. If an 'at least' figure was established on the evidence, then the Tribunal should have made a finding in accordance with that evidence.

236. We think that proposition is correct. If a taxpayer claims his or her expenses were $10, but fails to prove that fact because their evidence is rejected, this does not prevent the Tribunal from finding that the expenses were $5 where there is other satisfactory evidence establishing expenses of at least that amount. In our opinion, the burden of proof section does not dictate a different conclusion."

In *Le*, Logan J referred to the above passages from *Haritos* in support of the proposition that a taxpayer is entitled to succeed in having shown that an assessment is excessive even if they have not succeeded to the fullest extent.[23] In other words, a taxpayer could chip away at the transactions referred to in an asset betterment calculation and succeed to that extent. As his Honour observed:

"53. Against this background, particularly the emphasised parts of the observations in *Haritos*, the applicants' allegation that the *Tribunal failed to advert to one of their central arguments as to why in each year the amount of the assessment was excessive does not just have force, it should be accepted.* The flow of funds into and out of bank accounts was in evidence, as was an explanation as to why outgoings from accounts were not income. The applicants gave precision in their tabulations as to the resultant excess in the amount of each assessment. A failure to consider that explanation is, truly, a failure to undertake the statutory review function. Further, the impact of that failure is not explicable by findings as to credit, because those findings themselves were made without considering the explanation.

54. The observations made by the Full Court in *Haritos* offer, with respect, elucidation about the operation of the statutory onus of proof in practice. *If the material before, and accepted by, the Tribunal shows that the assessment is excessive in a particular amount, it is nothing to the point that an applicant contends that it is excessive to an even greater extent.* Section 14ZZK does not have the effect that, because that contention fails, the applicant has not shown the assessment to be excessive or, related to that, that the Tribunal is thereby relieved from concluding, based on the material it has accepted, that the assessment is excessive to the extent revealed by that material." (emphasis added)

It is interesting to note that his Honour drew a distinction between a *critique* of an asset betterment calculation versus actual *evidence* that a taxpayer adduces to prove that an assessment is wrong by a particular amount.[24] In that regard, after referring to various passages from the reasons of Latham CJ in *Trautwein*, his Honour stated:

"56. … However, it is also the effect of what Latham CJ stated in this passage from *Trautwein*, and the importance

> of *Haritos* is in the elucidation of this, that if, in addition to such a critique, the applicant introduces evidence, which is accepted and which shows that the assessment is wrong by a particular amount, that applicant will have discharged the statutory onus of proof."

It is critical to note that Logan J emphasised that this approach did not "gainsay" what was said in *Gashi*.[25] Unsurprisingly, the decision of *Gashi*, along with *Trautwein* and *Dalco*, were emphasised by the Commissioner in *Le*.

Logan J was satisfied that there was an error of law in "not considering the explanation as to why the debits in the bank account statements should not be equated with income".[26] The statutory onus was "no panacea for illogicality of reasoning".[27] The tribunal's decision was set aside and the matter was remitted to be heard afresh.

Derrington J has also considered whether the observations in *Haritos* reflect the approach taken by Logan J in *Le*. The first occasion was in Ross and the second occasion was in Condon. In both cases, Derrington J decided that the "all or nothing approach" was still the correct approach for a taxpayer to discharge the onus when dealing with default assessments.

The taxpayer in *Ross* submitted that the observations in *Haritos* had the consequence that, "in attempting to discharge the burden imposed by s 14ZZK(b)(i) TAA53, it was sufficient to identify that elements of the Commissioner's assessment were incorrect or partially incorrect and, to the extent error is shown, the taxpayer's taxable income is revealed by the remaining amount".[28]

Derrington J rejected this submission in the following terms:

> "57. … With respect, although the Full Court in *Haritos* may have intended to overturn the earlier decisions of the Full Court in *Gashi*, *Rigoli* and *Bosanac* (FC) by a side-wind, it is probably unlikely. As the Commissioner submitted, Haritos concerned circumstances where the taxpayers and the Commissioner had reduced the scope of the hearing to a number of particular disputed amounts which, depending upon the manner in which they were resolved, would increase or decrease the amount which the parties had otherwise agreed represented the taxpayers' taxable income. In other words, the underlying circumstances in relation to the taxpayers' taxable income were generally agreed with the remaining disputed items to be determined by the Tribunal, with the results of those determinations altering the otherwise accepted amount of taxable income. *Haritos* was not a case where, before the Tribunal, the taxpayers' were still required to fully and completely establish the actual amount of their taxable income. Given the context in which the Court was discussing the effect of the taxpayer establishing some portion of its expenses, there is nothing exceptional about its comments at [235] to [236] and no reason to think the Court was departing from the orthodox principles described earlier."

His Honour emphasised that, in *Haritos*, the parties had effectively accepted that the taxpayers' taxable income in particular years was a certain amount, except that it might be increased or decreased depending on the manner in which various disputed items were resolved.[29]

His Honour held that the observations by Logan J in *Le* "should not be accepted in relation to circumstances where the Commissioner has made a default assessment based on the asset betterment method and the taxpayer is faced with having to establish what their actual income is and that it is less than that assessed by the Commissioner".[30] This is on the basis that what was "in issue is whether the taxpayer is able to establish both what their actual taxable income was and that it was less than the Commissioner's assessment (which gives rise to the conclusion that the latter is excessive)".[31]

His Honour held that neither *Haritos* nor *Le* altered the statement of the relevant principles concerning the operation of s 14ZZK(b)(i) TAA53. In the event that *Le* required a different approach, his Honour would not follow it because, in his view, it was inconsistent with the established Full Court authorities such as *Gashi* which his Honour was bound to apply.[32]

Derrington J addressed this issue again in Condon and comprehensively rejected the submission that a taxpayer could "chip away" at the transactions referred to in an asset betterment statement. Derrington J provided a number of reasons why the taxpayer's reliance on *Haritos* was misplaced.[33]

The point was made that the Full Court's observations in *Haritos* were obiter.[34] His Honour then repeated his reasoning in *Ross*[35] that *Haritos* "should not be accepted in relation to circumstances where the Commissioner has made a default assessment based on the asset betterment method and the taxpayer is faced with having to establish what their actual income is and that it is less than that assessed by the Commissioner".[36] There was no agreement between the parties so the taxpayer was required to prove his actual taxable income, and to "prove that the amount contended for was the full extent of his assessable income".[37]

Derrington J went on to note that *Haritos* was concerned with the statutory obligations of the tribunal when conducting a review under s 43 of the *Administrative Appeals Tribunal Act 1975* (Cth) as modified by s 14ZZJ TAA53, and the application of the onus set by s 14ZZK TAA53.[38] His Honour rejected the submission that the observations in *Haritos* applied to an "appeal" to the Federal Court from a decision of the Commissioner, and the application of the onus set by s 14ZZO TAA53.[39] There was nothing to suggest any equivalence between those two regimes.[40]

Additionally, *Haritos* "did not go so far as to say that where the evidence before the Tribunal … shows that one or more of the disputed receipts of a taxpayer are not income, the Tribunal must necessarily allow the appeal before it".[41]

Derrington J also addressed *Le* in the following terms:[42]

> "The passages in the judgment in *Le*, on which reliance was placed by Mr Condon, do not assist him. In the

first place, notwithstanding the fact that the decision in *Haritos* seemed to underpin Logan J's decision in *Le*, for the reasons expressed above, it is not clear that it can properly be understood as capable of doing so. The Full Court was most clearly concerned with the Tribunal's obligations to make findings in relation to contested transactions. In any event, it does not appear that the decision in *Le* has the effect attributed to it by Mr Condon. There, Logan J postulated a situation in which the assessment in question was shown to be 'excessive in a particular amount'. In the context of an assessment under s 167 of ITAA36, and the application of the asset betterment method, such a scenario could only realistically arise where the material before the Tribunal had established the amount of the taxpayer's assessable income and demonstrated that other receipts of money or transactions that may have occurred in the relevant years and that might have suggested a greater level of income were adequately explained. That is clearly different from the situation where the taxpayer has failed to satisfy the Tribunal that all of the receipts, and unexplained expenditures or increases in wealth, were not referable to assessable income, such that the taxpayer had failed to establish what their assessable income was. The point being made by Logan J in *Le* can, in this way, be understood as a practical one, and not an observation as to the proper application of the onus of proof."

Concluding remarks

As can be observed, the differing views in the Federal Court raise some complex issues. It will be interesting to see which approach the Full Federal Court might adopt if the matter were to be raised on appeal in a future case.

It is timely that the tribunal in *QQRK and FCT*[43] commenced its reasons by providing some useful and practical comments about discharging the onus.[44] In particular, the tribunal noted that:

"9. As a model litigant, the Commissioner is expected to make concessions where possible, and certainly where there is no real dispute over particular transactions or deductions. The parties should not waste the Tribunal's time (and their own resources) by arguing over transactions or deductions that are not genuinely in dispute. But even where the Commissioner makes concessions about individual transactions or deductions or classes of transactions or deductions, it will remain incumbent on the taxpayer to provide evidence which positively establishes each of the integers of taxable income. It does not inevitably follow that the Tribunal is permitted to reduce the assessment by the amounts associated with a concession if there remains doubt over other components."

It is apt to conclude with the comments by Nettle J in *Bosanac* where his Honour drew a clear distinction between cases where all of the material facts are known and cases where they are not all known. In the latter case, it was observed that:[45]

"30. … But where, as here, an appeal proceeds on the basis that not all of the material facts are known, either because the taxpayer has been less than forthcoming in making disclosures to the Commissioner or for some other reason, the taxpayer cannot succeed by showing only that the basis of the Commissioner's assessment was in some respect erroneous; since for all that can be told, unless and until the taxpayer proves to the contrary, there may be other income of which the Commissioner was not aware and which the Commissioner has not taken into account. In order to succeed in such a case, the taxpayer must discharge the burden of demonstrating on the balance of probabilities the true amount of the taxpayer's taxable income and thus that the amount determined by the objection decision is excessive …"

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Complications with trustee duties

by Peter Speed, Director, Speed and Stracey Lawyers

A trustee's duties to avoid conflicts, to not engage in self-dealings, to provide beneficiaries with documents of the trust, and to otherwise act in the best interests of the beneficiaries of the trust can cause substantial and unintended issues for the trustees of family trusts. This is particularly case where there are dealings between the trust and other companies and entitles of the same family, and where there has been a breakdown of relations between the trustee and one or more of the beneficiaries. Many of these issues can be avoided or minimised at the outset by the careful drafting of the trust deed and by the other means discussed in this article.

Introduction

This article discusses a number of the issues that may arise for the trustees of family trusts where there are other companies and entitles of the same family involved. It then sets out some of the potential means of avoiding these issues. It has been written by a lawyer who specialises in commercial litigation and who has spent a substantial amount of his time over the last decade acting for trustees in rather large and unfortunate family disputes.

No conflict rule

The trustees of a trust are generally prohibited from placing themselves in a position which "involves a real or sensible possibility of a conflict" between the duties that they owe as trustees to the beneficiaries of that trust and their own interests, or the duties that they might owe to others.[1]

In the context of a family trust, trustees can unwittingly breach this fiduciary duty simply by being the trustee while also being a director of a family company or being a trustee of a different trust. The problem typically arises when, say, the family accountant suggests that mum or dad, who is the trustee of the family trust, also sets up a family company and that they become one of the company directors of that company. It will then likely be expected that this family trust and this family company will have inter-dealings in terms of loans and shareholdings and may be in competition with each other for access to the same pool of funding and the terms on which any such funding is proffered. As such, there often exists, from that point on, a real possibility of conflict between the duties that the trustee owes to the one trust and the duties that same person or entity owes to a family company or another family trust.[2]

Interposing a company as the trustee of the family trust does not necessarily avoid the issue. A corporate trustee, like any other trustee, owes its duty of loyalty in the administration of that trust to the beneficiaries of the trust. A director of that corporate trustee must then act in the interests of that corporate trustee (which interests in this context are typically aligned with it fulfilling the duty of loyalty that it owes to the beneficiaries of the trust).[3] This director can therefore be in breach of their duty to avoid conflicts of interest (and potentially be liable as such) by being both a director of a corporate trustee and a director of another family company or of another corporate trustee of another family trust with which the first-mentioned trust has dealings (or acts in competition with).[4]

It is not a defence to the strict no-conflict rule for a trustee to establish that they were acting honestly or bona fide in what they considered to be the best interests of the trust at the time.[5] A trustee may also be liable personally even if the beneficiaries may have suffered no loss by reason of the trustee's breach of this duty (and as such are seeking to make a windfall gain through their suit).[6] An account of profits and constructive trusts may be imposed in equity to strip the defaulting trustee (and other knowing recipients) of the entirety of their gains made when in a position of conflict and not simply to compensate the beneficiaries for their loss.[7]

Potential solutions

One means of potentially buttressing a trustee from a suit for a breach of the duty to avoid conflicts is for the settlor of the trust to expressly identify in the applicable trust deed, at the outset, those other specific roles that the trustee is envisaged to perform while acting as the trustee, and to make it clear that it is both permissible and expected for the trustee to perform these other roles.[8] Otherwise, the appointed trustee might be left struggling to find evidence (perhaps decades down the track) which establishes what was envisaged by, and as such "authorised" by, the settlor when the trust was created.[9] In addition, to capture roles not in existence or specifically envisaged at the time of the creation of the trust, the trust deed might make it clear that the trustee is entitled to perform other roles (listed by, say, type) into the future without breaching the no-conflict rule. Such a catch-all provision, however, may only provide relatively limited protection by reason of the trustee's other continuing obligations (as discussed below) to still act in the best interest of the trust and its beneficiaries.

Another means of protecting a trustee from the application of the strict no-conflict rule is to get the fully informed consent of the beneficiaries of the trust to the trustee serving the potentially conflicting role after the creation of the trust deed.[10] Getting the "fully informed consent" of all beneficiaries is, however, problematic where the existing and potential areas of conflict are complex, unknown and/or

difficult to explain (including because the range of roles for which consent is being sought is not concrete and fixed). It is particularly problematic to get "fully informed consent" where the class of beneficiaries includes children or where the trustee is in a familial/parental relationship with one or more of the beneficiaries (who tend to trust and rely on the trustee) such that any consent obtained might subsequently be challenged as being invalid on the grounds of undue influence and duress.

Rule against self-dealing

The trustees of a trust are generally prohibited from making a profit, receiving a benefit or exploiting an opportunity arising out of their position as trustee of that trust.[11] In the context a family trust, trustees may breach this fiduciary duty by making loans to or from the trust to (or otherwise dealing with) entities in which they have an interest in or to whom they owe conflicting duties, such as other family companies or other family trusts.[12]

Again, interposing a company as the recipient of the benefit does not avoid the issue, including where the interposed company might properly be regarded as the alter ego of one or more of its directors (who is, say, a family member who in some way benefits from the relevant transaction).[13] Typically, the recipient of the profit, benefit or opportunity will be a knowing recipient liable under the *Barnes v Addy*[14] first limb.

> "A few moments of foresight spent redefining a trustee's obligations can resolve months of subsequent anguish."

It is not a defence to this strict rule against self-dealings for a trustee to show that the deal done was a commercial deal that was in the best interests of the trust at the time.[15] Years down the track, that trustee may thus find that they are liable to personally account for the profits made on (and any increase in the value of) an asset or speculative opportunity which they (or a related entity of theirs) acquired from the trust and may have invested in and developed at considerable personal risk and expense. It likely does not matter that the trust itself was not in a commercial position to have similarly invested in that asset and exploited that opportunity.[16]

Potential solutions

Again, one means of potentially buttressing a trustee from a suit for a breach of the rule against self-dealings is for the settlor of the trust to expressly identify in the applicable trust deed, at the outset, the range of dealings (with entities in which the trustee is envisaged to have an interest in) that are specifically envisaged to take place, and to make it clear that this range of self-dealings is both permissible and expected.[17] Again, it can also be helpful for a trust deed to contain a catch-all provision that says generically that the trustee is not prohibited from engaging in self-dealings of particular types with particular other family entities. The comments made above concerning subsequently getting the "fully informed consent" of all beneficiaries equally apply here.

Duty to act in best interests of beneficiaries

The trustees of a trust are typically under a duty to act in the best interests of the beneficiaries of the trust.[18] Even where, say, the trust deed makes it clear that the trustee can act in a position of conflict or engage in a self-dealing (or the trustee gets the fully informed consent of the beneficiaries to do so), the trustee must typically still exercise any powers, rights or influence that they hold as the trustee of that trust with due care and in good faith in the best interests of the beneficiaries of that trust.[19] A trustee may therefore breach the duties that they owe to a trust by having the trust enter into a purchase, sale or other dealing which is not on commercial arm's length terms. This is irrespective of whether or not it was per se permissible for the trustee to have had the trust enter into the applicable deal with the applicable counterparty (such as another family company or family trust).[20]

Arguably, the duty on a trustee to act in the best interests of the beneficiaries of the trust forms part of the irreducible core of what it means to be a trustee and is not a duty that can be excluded by the terms of the trust deed (if what is sought to be established is a valid trust that is recognised as such).[21]

Potential solutions

To avoid it being left unclear to the trustee (and open to the vagaries of the courts to interpret) how the trustee ought to act and what responsibilities the trustee still bears when acting in permissible positions of conflict and when involved in permissible self-dealings, the trust deed might make it clear that, in such circumstances and when entering into such dealings, the trustee must exercise any powers, rights or influence held as the trustee of that trust with due care and in good faith in the best interests of the beneficiaries of that trust. The trust deed might then make it clear that the trustee nevertheless remains free to exercise any other rights, powers and influence that they hold on their own behalf or on behalf of others in the best interests of themselves or those others. With a view to avoiding liability and having adverse claims being made, the trustee should then ensure (and be in a position to establish) that any dealing they (or an entity in which they have an interest) have with the trust is a dealing that commercial arm's length parties acting reasonably in the circumstances might have entered into.

Consideration may also be given to making it clear in the trust deed that the trustee, when exercising their powers, rights and influence as the trustee of that trust in good faith in the best interests of the beneficiaries of that trust, they may (in their absolute discretion) have regard to those

beneficiaries' wider best interests outside of the particular trust in question (perhaps as shareholders in nominated family companies etc), as well as their more limited financial interests in the assets of the trust. Otherwise, a trustee may be hamstrung from entering into or permitting a proposed dealing which would be beneficial to the family group as a whole (and as such to the benefit of the same beneficiaries of the trust overall), but where it is detrimental to the value of the assets of the trust considered in isolation.[22] Such a provision in the trust deed may only be helpful where you have the same shareholders and beneficiaries across the various companies and trusts within the family group.

Beneficiaries rights to trust documents

The trustees of a trust almost invariably have a duty to administer the trust with due care and for proper purposes.[23] To ensure that the beneficiaries of that trust are capable of making an assessment of whether the trust is properly being administered in their interests (and, if not, so that they are in a position to challenge the administration of that trust),[24] courts habitually order trustees to produce documents of the trust to beneficiaries. The beneficiaries of a trust are entitled to see the accounts of the trust and many, if not all, of the "documents of the trust".[25] What constitutes a "document of the trust" can be a matter of controversy.[26] The range of documents which beneficiaries may see and have access to depends on the trust and the approach taken by the courts.[27]

Typically, even the remotest of beneficiaries, who might only have been intended to benefit from the trust in the remotest of circumstances, have the right to enforce the due administration of the trust. Consequently, courts will often give such beneficiaries access to trust documents (which may represent the commercially confidential accounts and bank statements of a family business), notwithstanding that those beneficiaries are remote discretionary beneficiaries who were never likely to benefit from the trust (including, for example, a former spouse of a child of the settlor who themselves, in seeking such documents in, say, divorce proceedings, might not be acting in the best interests of the trust).

Potential solutions

To lessen the chances of the trustee having to hand over commercially sensitive family documents, the list of potential beneficiaries of a trust might be kept as tight as possible in the trust deed (while still being sufficiently wide as to achieve its intended objectives). Further, the trust deed might make it clear that only certain classes of beneficiaries are to have broad rights of access to trust documents and to otherwise ensure the proper administration of the trust (being perhaps those persons who are primarily expected to benefit from that trust). The trust deed might then provide for limited rights of access for more distant beneficiaries to documents which might pertain directly and in a material way to those distant beneficiaries (including any exercise of a trust power to remove them as a discretionary beneficiary of the trust).

Conclusion

Where there are dealings between a family trust and other companies and entitles of the same family, and where there has been a breakdown of relations between the trustee and one or more of the beneficiaries, a trustee's duties to avoid conflicts, to not engage in self-dealings, to provide beneficiaries with documents of the trust, and to otherwise act in the best interests of the beneficiaries of the trust can cause substantial and unintended issues for the trustee of that family trust. Many of these issues, however, can be avoided or minimised at the outset by the careful drafting of the trust deed and by the other means discussed above in this article.

Certainly, it is preferable to pre-empt these potential issues rather than waiting for the same to arise in the hope that they do not. A few moments of foresight spent redefining a trustee's obligations can resolve months of subsequent anguish. Remember that it is notoriously difficult for a trustee of a family trust to safely, and with any certainty, obtain the assent or waiver of the beneficiaries to (or a court's forgiveness for) the actions of a trustee that might otherwise be (or have been) in breach of their duties owed to the trust.[28] Even where a trustee gets the beneficiaries' assent, there is always the possibility of one or more of those beneficiaries subsequently turning around and saying that their consent was not fully informed and that the trustee did not perform a sufficient mea culpa to be entitled to maintain and rely on the release and waiver that the beneficiaries signed.[29] The onus of proof then falls on the trustee to show that the beneficiary had full knowledge of all of the circumstances and of their rights.[30]

What potential solutions work will depend on the terms of the specific trust deed in question and the circumstances pertaining to that trust, and should be the subject of specific legal advice.

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Superannuation

by Daniel Butler, CTA, DBA Lawyers

Pending NALE changes place SMSFs at risk

Under the current NALE provisions, lower expenses taint taxable income at 45%. Until proposed NALE changes are finalised, there is substantial exposure for superannuation funds, both large and small.

The non-arm's length expense (NALE) provisions have proved controversial since they were introduced with effect from 1 July 2018. Perhaps the most controversial aspect has been the fact that small discounts on services, such as an adviser fee of $1.00, can give rise to substantial extra tax.

For instance, under the current law, a NALE breach will render all of an SMSF's ordinary and statutory income tainted, including net capital gains and assessable contributions, resulting in a 45% tax rate instead of the usual 15%.

The amending legislation to reduce some of this substantial tax impact, namely, the Treasury Laws Amendment (Support for Small Business and Charities and Other Measures) Bill 2023 (Cth) (the Bill), was introduced into parliament on 13 September 2023 but has not yet been passed as law. This Bill will, when it becomes law, reduce the tax impact where a lower or nil general expense is incurred by an SMSF by imposing an upper cap (discussed below) on the amount that is taxed as non-arm's length income (NALI). The upper cap applies to changes to NALE introduced in s 295-550(1)(b) and (c) of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) where the NALE relates to a general expense. However, there is no relief for SMSFs for specific expenses which will be subject to the usual NALI rules in s 295-550.

Did the Senate Economics Legislation Committee report add anything?

In November 2023, the Senate Economics Legislation Committee issued its feedback in respect of the Bill recommending that it proceed in its current form. One comment made by a Treasury official to this inquiry was that providing an opportunity to rectify for honest or inadvertent mistakes would be contrary to an anti-avoidance provision. The following is extracted from this report:

> "2.60 Mr Hawkins of the Department of the Treasury explained why there was no option for remediation either in the Bill or the wider NALE rules:
>
> > These provisions are anti-avoidance provisions. They are intended to disincentivise the behaviour or the mischief that they're designed to prevent. If a trustee had the ability to rectify any non-arms-length expenditure then there would be, in effect, no disincentive for that behaviour."

However, the author disagrees with Mr Hawkins comments for a number of reasons, including (but not limited to):

- under the general anti-avoidance provision, Pt IVA of the *Income Tax Assessment Act 1936* (Cth), the Commissioner must make a determination that the anti-avoidance provision applies. In contrast, under NALI/E, the provision is automatically invoked. There are many situations where taxpayers and SMSF trustees will not even be aware of the technicalities or the nuances of the NALI/E law;
- most anti-avoidance provisions only apply to particular FYs. In contrast, NALI, including specific NALE, taints an asset for the rest of its life and provides no ability to rectify, for example, technically, a $1.00 lower expense could result in an asset that is held for 20+ years being exposed to 45% tax;
- this is not a "black and white" area of the law as there are potential arguments as to whether NALI/E applies depending on the facts and circumstances involved, for example, as noted above, technically, the ATO could argue that as little as a $1.00 discount invokes NALE. Moreover, Australia has one of the most complex tax systems in the world and generally rates second in complexity behind only the United States; and
- many professional and industry bodies, including those that represent large APRA funds (that represent many millions of members) and SMSFs, requested the ability to rectify for NALI/E adjustments for honest or inadvertent oversights. This request was not just made by the SMSF sector.

In short, there is a pressing need for flexibility to rectify for honest or inadvertent oversights.

When will the new NALE rules apply?

The Bill still has to be passed by parliament and will likely commence from the next 1 April, 1 July, 1 October or 1 January to occur after the day the Bill receives the royal assent. For example, if the Bill receives royal assent in March 2024, the changes will commence from 1 April 2024. Once passed as law, the NALE provisions in Sch 7 of the Bill will have retroactive application from 1 July 2018.

What were the NALE changes in mid-2018?

Broadly, under the current NALE provisions (see s 295-550(1)(b) and (c)), where the parties are not dealing at arm's length and a lower or nil expense is incurred, all of

the ordinary and statutory income of a superannuation fund for a FY (including assessable contributions) will be taxed at 45%. In other words, NALE results in substantial NALI exposure.

Moreover, NALE currently applies to all superannuation funds, both APRA funds and SMSFs. Note, however, that the ATO provided an administrative solution by way of PCG 2020/5 where it did not apply its compliance resources for the 2019 to 2023 FYs to enforce a general expense NALE in relation to large and small funds.

However, a specific NALE exposure was not covered by PCG 2020/5 and therefore can result in NALI from 1 July 2018.

Will PCG 2020/5 be extended for FY2024?

There are sound grounds for the ATO to extend its administrative relief in PCG 2020/5 up to the time the Bill takes effect as law. Given that the Bill may not become law until 1 March 2024 or possibly later, eg 1 July 2024, it is hoped that the ATO will consider extending its administrative relief of not applying its compliance resources towards general NALE breaches for the year ending 30 June 2024. However, while certain professional bodies have requested an extension, there has been no indication that the ATO will provide one.

Upper cap on general expense NALE

The Bill proposes a cap on the amount of income that will constitute NALI from a non-arm's length scheme involving a lower or nil general fund expense for a small fund. This cap is in the form of a two times (ie 2 x) multiple of the amount of the lower general expense for an SMSF or a small APRA fund. The example below outlines how this cap is to apply.

As noted above, the proposed changes do not apply in relation to expenses relating to "gaining or producing income in relation to any particular asset or assets of the fund" (ie a specific expense). This is unfortunate as specific expenses can result in tainting the asset for life as outlined in the Sam and Trang examples discussed below.

The difference between a specific and a general expense is discussed further below.

Example applying a 2 x multiple

If an SMSF trustee uses their brother's accounting firm's services, which would usually cost $8,000 under an arm's length relationship but is not charged any fee, this is considered NALE as the parties were not dealing at arm's length. Therefore, the tax payable would be calculated as follows:

- 2 x $8,000 = $16,000 NALE
- $16,000 x 45% = $7,200 tax payable by the fund.

Note that, where the product of 2 x the NALE is greater than the fund's actual taxable income, an "upper cap" will be the SMSF's taxable income for the FY (not including any assessable contributions or any deductions against those assessable contributions).

Referring to the above example of the SMSF trustee's brother's firm providing accounting services valued at $8,000 for free, where the amount of NALI under a 2 x $8,000 is $16,000 but the fund's actual taxable income is, say, only $6,000, the upper cap would result in total NALI being $6,000 for that FY.

Other proposed changes

Clarification on non-arm's length and internal arrangements

The explanatory memorandum (EM) to the Bill discusses the capacity in which an SMSF trustee/member acts and whether those actions will give rise to non-arm's length risks or will be an internal arrangement not giving rise to NALI/E risks. Broadly, this distinction depends on the capacity in which the trustee undertakes those activities based on the particular facts and circumstances. This is not always clear and can prove difficult in practice to distinguish between which capacity a person is acting in.

The EM notes that, if a trustee is not acting as a trustee but is instead providing services that are procured as a third party, the NALI rules are intended to apply. The EM also recognises that, in such cases, an SMSF trustee may be prevented from charging any more than the arm's length price because of s 17B of the *Superannuation Industry (Supervision) Act 1993* (Cth), which permits a trustee to charge in limited circumstances.

The EM uses different language to that used by the ATO in LCR 2021/2, and further clarification by the ATO on the Bill in this regard would be welcome.

Specific versus general expense

The EM states:

> "7.5 Any [NALE] will be either a specific expense or a general expense. A general expense will be an expense that is not related to gaining or producing income from a particular asset … of the fund. A specific expense will be any other expense …
>
> 7.6 For specific expenses the previous treatment continues to apply, and the amount of income that will be taxed as [NALI] is the amount of income derived from the scheme in which the parties were not dealing at arm's length."

Example 7.4 of the EM is relevant to SMSFs utilising the services of related members and party parties as the example, among other matters, states:

> "[Sam is a related party of an SMSF, whose assets include a rental property.]
>
> … Sam is a licensed builder and blocks time out of his work calendar to conduct renovations on the SMSF's rental property worth $3,000 for which nothing is charged … The renovations were an expense incurred in deriving income from a particular asset, the asset

being the rental property. The renovations are a specific [NALE] …"

Thus, given the lower $3,000 specific expense, the net rental income from the SMSF's rental property in example 7.4 is taxed at 45%. The ATO's LCR 2021/2 suggests that Sam's $3,000 of work taints the property with a 45% tax rate for the remainder of its life, including on any net capital gain realised on the disposal of that property in the future.

Example 9 in LCR 2021/2 involved Trang, a plumber, who renovated the kitchen and bathroom to her SMSF's second rental property — this exposed the net rental income and future capital gain forever to NALI.

As noted above, unfortunately, there is no express discretion for the Commissioner to disregard honest or inadvertent oversights despite numerous professional bodies requesting this type of flexibility.

Contributions to be excluded

The Bill proposes to exclude contributions assessable under Subdiv 295-C ITAA97 from NALI. Note that, under current legislation, general expenditure NALE results in assessable contributions being taxed as NALI at 45%. However, specific NALI relates to a particular asset and therefore should not capture contributions. This is one factor as to why the ATO view on general expense NALE gave rise to so much controversary over many years (ie the general expense NALE included compulsory superannuation guarantee contributions).

The exclusion of assessable contributions from NALI makes sense given that there are a range of other taxes impacting concessional contributions, including the 15% income tax on contributions, the Div 293 ITAA97 tax, and excess contribution taxes. There is, under current law, the prospect of taxes on contributions already exceeding 120%.

Pre-1 July 2018 expenditure to be excluded

The Bill proposes that expenditure incurred prior to 1 July 2018 will be excluded from NALI. Note that, under current legislation, NALE can apply retroactively and can also catch schemes entered into prior to 1 July 2018.

Large APRA funds exempt from NALE

Large APRA funds will be exempt from NALE in relation to both general and specific expenses. Large APRA funds remain subject to NALI where the income derived is derived from a non-arm's length arrangement. This could arise, for example, where a large APRA fund receives more income from a non-arm's length dealing.

A staff discount policy minimises NALI risk for SMSFs

Given that many firms and businesses offer discounted services to staff, an appropriately documented staff discount policy should be in place.

Firms and businesses providing discounted services to staff (including to partners, shareholders and officeholders) must ensure that an appropriate discount policy is in place to minimise the risk of NALI to a staff member's SMSF.

If an appropriate staff discount policy is not in place, discounted services may expose SMSFs to a 45% tax rate.

The key points to implement include:

- there must be a policy framework in place (ie a formal policy document outlining the terms of the discount);
- the discount must be consistent with normal commercial practice (ie based on appropriate benchmark evidence); and
- the same discount must be provided to others of the same class (ie the eligibility rules should have a class-based application, eg all staff or all directors).

Conclusion

Many SMSF trustees are not aware of the breadth of the NALI/E provisions and advisers should ensure that there is ongoing education and monitoring for NALI/E risks in their client base.

In particular, the general expense NALE risk is substantial until the Bill is finalised as law.

Specific NALE also gives rise to significant risk and can expose all ordinary and statutory income (less deductions) in relevant FYs to a 45% tax rate, including a future net capital gain on disposal of the asset.

Despite ongoing and extensive submissions to the government, Treasury and the ATO over the past five years by numerous professional and industry bodies, this area of law remains in need of urgent change. The changes requested included a discretion to forgive honest or inadvertent oversights for a more proportionate tax liability for NALI that does not taint an asset for the rest of its life.

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FEBRUARY
15–16
Thu–Fri

QLD

Private Business Tax Retreat

12 CPD hours

FEBRUARY
28
Wed

NSW

Women in Tax Congress

7 CPD hours

MARCH
7–8
Thu–Fri

WA

WA Tax Forum

12 CPD hours

MARCH
13
Wed

VIC

Not-for-Profit Tax Intensive

6 CPD hours

MARCH
14–15
Thu–Fri

NSW

Financial Services Taxation Conference

11 CPD hours

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