LawPM

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22 July 2026

Assistant Secretary
Individuals and Indirect Tax and Superannuation Division
The Treasury
Langton Crescent
PARKES ACT 2600

By Email Only: mintaxtrusts@treasury.gov.au

Dear Assistant Secretary,

Minimum Tax on Discretionary Trusts
Consultation Paper Response

We write to you to set out our submission to the consultation paper published by your office. The consultation paper is dated 8 July 2026 and titled 'Minimum tax on discretionary trusts' (**Consultation Paper**). Our submission is structured in numbered paragraphs with an appendix that sets out more technical analysis. The primary question we address from Consultation Paper is as follows:

> *"Are there any other implementation matters not addressed in this paper that should be considered in designing the minimum tax on discretionary trusts?"*

We summarise these matters in the form of recommendations with the balance of this submission expanding on these.

Recommendations

1. We consider that the implementation matters that should be considered that are not set out in the Consultation paper are:

   a. An explicit and detailed articulation of the policy objectives in introducing this measure;

   b. The mismatch of characterisation of receipts as capital or revenue in nature for trust law and tax purposes;

   c. The complexity and uncertainty in application of tax liabilities to trusts currently; and

   d. The consideration of anti-avoidance measures designed to apply to groups of taxpayers rather than entity specific measures.

2. While Consultation Paper asks other questions, this is the primary one we have addressed. The balance of our letter sets out discussion in relation to these points.

Policy Objectives

3. The Consultation Paper makes an initial point that less than 15% of small businesses are run from discretionary trusts with less than 90% of these businesses being impacted by this.[1] The aim of the proposed tax contemplated by Consultation Paper is to better align the tax on trust income with that paid by workers.[2]

4. The Consultation Paper also refers to the decision in *Commissioner of Taxation v Bendel* [2026] HCA 18 (***Bendel Case***). Briefly, that decision confirmed that an unpaid present entitlement is not a loan for Division 7A purposes, a position I put forward in two articles being:

   a. one from 13 years ago in 2013; and

   b. one from 9 years ago in 2017.

5. I enclose both these articles at the back of this submission.[3] Fundamentally, *Bendel Case* confirms that a loan or debt, being a creature of the common law, is not analogous to remedies available in equity such as the right to call upon unpaid present entitlements (**UPEs**).

6. Where Parliament consider that the measures introduced to deal with UPEs for companies are ineffective, rather than imposing a trust tax, either:

   a. the review and amendment of these anti-avoidance measures could be considered; or

   b. the non-refundable offset for the minimum 30% tax could be integrated with the imputation system applying to companies and made a refundable credit for individuals.

7. The reason integration into the imputation system may be preferrable is that it would appear to better achieve the aim of aligning tax on the trust income with that of workers. Rather than creating a circumstance where private companies are treated punitively by having their trust income subject to corporate tax, without the benefit of a credit from the trust tax already paid on that income.

8. We further note that the meaning of "workers" is not set out in detail in the Consultation Paper. We highlight that business risks extend beyond tax compliance obligations. These risks can mean that workers form trusts or companies to contract with third parties to insulate that worker from business risks. These workers may be independent contractors. The objectives of these changes should be set out explicitly and in detail to ensure the consequences of the changes are

[1] '*Consultation Paper: Minimum tax on discretionary trusts*' page 2.
[2] Ibid.
[3] '*Division 7A: Extending the Definition of 'loan''*, *The Taxpayer*, October 2013.

understood and achieve their objective.

9. This submission is intended to be a starting point to give context and encourage the measurement of the policy impact of the tax changes being proposed. Once this starting point and context has been set out, it becomes easier to determine whether proposals will achieve the aims set out.

Capital and Revenue Mismatch

10. The perceived problems with the taxation of trusts, while complex, have been considered both judicially and by the Parliament before. The problems stem from the difference between the nature of a trust at law compared to how it is taxed.

11. Fundamentally, it is well settled that the concept of a trust at general law is a relationship between legal persons rather than a legal person itself.[4] Contrast this with the tax law, where a trust is an entity.[5]

12. This difference in treatment by general law and tax law is the origin of one of the most fundamental problems in taxation, being how receipts are characterised differently for trust law purposes and taxation. At general law the receipt is characterised in the hands of the trustee subject to their relationship with beneficiaries. But for tax purposes, the receipt is characterised in the hands of the trust as an entity for the purpose of reporting it to determine liability.

13. The way the tax law characterises these receipts is helpfully set out in *Commissioner of Taxation v Bamford* (2010) 240 CLR 481 (***Bamford Case***).

    a. Stone and Perram J in the Full Federal Court decision (cited with approval by the High Court in *Bamford Case*) making it clear that for trust law purposes whether a receipt is capital or revenue is a function of the administration of successive equitable estates with the balancing of life interests in the receipt of income and remainder interests in the preservation and augmentation of capital;

    b. The characterisation of amounts as income or capital have their origin in rules developed by the courts of equity that should be viewed as presumptions that give way to provision made in the trust instrument;

    c. In the context of the trust law and trust deed, the characterisation of an amount as income or capital by the trust would not necessarily be the same for tax purposes; and

    d. The degree to which the tax law modifies or replaces the meaning of words in property law

[4] *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth* [2019] HCA 20; 93 ALJR 807 at [24] (Kiefel CJ, Keane and Edelman JJ) and [129] (Gordon J).
[5] Income Tax Assessment Act 1997 (Cth) s 960-100

will be a matter of statutory construction keeping in mind the confusion that can arise when transferring from one context to another, see *Gartside v Inland Revenue Commissioners* [1968] AC 553, 617.

14. The Australian Taxation Office (**ATO**) seeks to acknowledge the difference in treatment for trusts by suggesting that being a trust is a relevant factor in the characterising of a receipt as income or capital is whether it is derived by a trust.[6]

15. The minimum 30% tax on discretionary trusts should contemplate the mismatch between capital and revenue. While measures recently enacted seek to make capital taxed in a similar way to revenue, this will be an issue for example where small business capital gains tax concessions are applicable.

Existing Trust Taxation Uncertainty

16. While trusts are entities for tax purposes, it is the trustee that is subject to a tax liability under Division 6 modified by Division 6E.[7] These provisions were modified by the interim amendments following the *Bamford Case*.[8] A trustee for the purpose of tax law is as follows:

> "*(1) In this Act, unless the contrary intention appears:*
> …
> ***"trustee"*** *in addition to every person appointed or constituted trustee by act of parties, by order, or declaration of a court, or by operation of law, includes:*
>
> *(a) an executor or administrator, guardian, committee, receiver, or liquidator; and*
>
> *(b) every person having or taking upon himself the administration or control of income affected by any express or implied trust, or acting in any fiduciary capacity, or having the possession, control or management of the income of a person under any legal or other disability*"[9]

17. *Bamford Case* clarified that only a trustee in the ordinary sense of that word (in other words not meeting subsection 6(1)(a) or (b)) is subject to taxation under Division 6 and not under the

[6] TD 2011/21 *Income tax: does it follow merely from the fact that an investment has been made by a trustee that any gain or loss from the investment will be on capital account for tax purposes?*
[7] *Income Tax Assessment Act 1936* (Cth).
[8] *Tax Laws Amendment (2011 Measures No. 5) Act 2011* (Cth).
[9] *Income Tax Assessment Act 1936* (Cth) s 6 (Definition 'Trustee').

extended definitions, see:

> "*Thus, it is not to be assumed that every person or entity which answers the statutory definition will be a trustee for the purposes of Div 6 of Pt III. The opening words of the definition speak of a trustee in the ordinary sense of a person who holds property on trust while pars (a) and (b) include persons in whom trust property is not vested.*"[10]

18. The challenge has always been where the line is between what is a trustee in the ordinary sense of that word and what person will answer to the extended definition of the word trustee. This is because a trustee is only taxed if they meet the ordinary definition. The answer to this question appears to be determined with reference to the vesting of property, see:

> *"Workers compensation is a matter of legal entitlement, not charitable subvention. That being so and given the limited terms of s. 35(2) of the Workers Compensation Act , it must be concluded that compensation moneys paid to the Registrar are trust moneys in the ordinary sense. They are held by the Registrar in trust for the persons entitled to the compensation involved and, subject to the applicable legislative provisions, must be administered by the Registrar in accordance with the general law of trusts. Accordingly, the Registrar holds such moneys as trustee in the strict sense and there is no need to consider the alternative arguments based on the extended definition of ``trustee'' in s. 6(1) of the Income Tax Assessment Act."*[11]

19. The levy of a minimum 30% tax on discretionary trusts may result in unintended taxation outcomes because of the pre-existing issues with the taxation of trusts. For instance, a class action settlement deed may answer this definition thus subjecting that trust income to taxation where the mechanism of taxation remains Division 6 of the *Income Tax Assessment Act 1936* (Cth).

20. We further consider the typical legal settlement deed may often create trusts as do court orders where remedies such as constructive or resulting trusts are imposed on parties. We have not outlined the obvious issues with the definition of fixed trusts as this has been raised by other practitioners.

Group Anti-Avoidance versus Taxpayer Specific Anti-Avoidance

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[10] *Bamford v Commissioner of Taxation* [2010] HCA 10.

[11] *Registrar of the Accident Compensation Tribunal v Federal Commissioner of Taxation* (1993) 178 CLR 145 (**Compensation Case**).

21. In the context of a private companies. The decision of the court in the *Bendel Case* highlights the fusion of common law concepts, in this case loans and debt that do not sit comfortably with equitable concepts such as amounts set aside by a trust, in that case UPEs.

22. Precedent in respect of the specific trust anti-avoidance rules in section 100A of the *Income Tax Assessment Act 1936* (Cth) demonstrate the incentive advisors have to change the effect of trust deeds to influence, for instance capital characterisation.[12] That case appeared to be an (at least in part) an attempt to circumvent Division 7A of the *Income Tax Assessment Act 1936* (Cth).

23. The common theme is that anti-avoidance rules for trusts or for companies are subject to circumvention because they apply to a type of taxpayer (trust, company etc). We acknowledge the non-refundable offset intended to apply to this tax on trust income. We request reconsideration of the design of the measure. This is because the current form of the measure appears not to contemplate the problem as one applying to combinations of different types of taxpayer.

24. Commercial groups are made up of related and unrelated parties. Often income and assets are moved between a business group, typically made up of unrelated parties, to the family group typically made up of related parties. Discretionary trusts are often used to move the retained earnings of a trading company in a business group to a passive company in a personal or family group. The reason this happens is twofold as follows:

    a. to protect the assets making up the retained earnings from the risks of trading; and

    b. to allow the economic resources making up these assets to be further invested for the family.

25. The 30% minimum tax on discretionary trusts appears to change the taxation of businesses so that they are taxed more heavily than workers. This is contrary to the stated aim of the measure to align the taxation of businesses using trusts with those of workers.

26. Where you have any questions or concerns, please contact me on 0405045632.

Yours faithfully,

Billy Mavropoulos

Vasilios Mavropoulos
Partner
Law PM

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[12] *BBlood* (*B&F Investments Pty Ltd as trustee for the Illuka Park Trust v Commissioner of Taxation* [2023] FCAFC 89.

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Taxpayers AUSTRALIA INC

The Taxpayer

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Division 7A: Extending the definition of 'loan'

By Vasilios (Bill) Mavropoulos

The rules contained in Division 7A of the *Income Tax Assessment Act 1936* (ITAA36) have been the subject of considerable debate ever since the release of TR 2010/3 *Division 7A loans: trust entitlements* (TR 2010/3) and associated guidance by the Commissioner of Taxation (the Commissioner). One particularly contentious issue that arose following the release of TR 2010/3 is the Commissioner's interpretation of the extended meaning of the word 'loan' for the purposes of this Division.

Broadly, the Tax Office's interpretation of the law is that an unpaid present entitlement (UPE) would satisfy the extended definition of the word 'loan' in certain circumstances. This interpretation was met with consternation and uncertainty by tax practitioners. The article endeavours to contrast the official Tax Office position espoused in the Ruling with an alternative interpretation of the extended definition.

Definition of 'loan' under Division 7A

The majority of the provisions contained in the current legislative framework of Division 7A were introduced on 4 December 1997 by *Taxation Laws Amendment Bill (No. 7) 1997* (the title has since been updated to *Taxation Laws Amendment Bill (No. 3) 1998*). The logical starting point for an in-depth analysis of the extended definition of the word 'loan' under Division 7A is of course to review the actual wording of the subsection itself. In particular, ss109D(3) ITAA36 states:

In this Division, loan includes:

(a) an advance of money; and

(b) a provision of credit or any other form of financial accommodation; and

(c) a payment of an amount for, on account of, on behalf of or at the request of, an entity, if there is an express or implied obligation to repay the amount; and

(d) a transaction (whatever its terms or form) which in substance effects a loan of money.

As a principle of legislative interpretation, one should firstly attempt to determine the meaning of a subsection without reference to interpretative material. Pursuant to this fundamental principle, wherever possible, the clear meaning of legislation should be taken from the text of the actual provision itself. This rule of interpreting taxation laws is described in the High Court case *Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue (NT)* [2009] HCA 41; 239 CLR 27 on page 100 as:

Continued – page 100 ➔

Briefly

Taxpayers Australia welcomes...

Taxpayers Australia is committed to remain Australia's trusted source of tax and superannuation knowledge and expertise, but is also mindful of the accepted wisdom that continual and ongoing improvement is necessary to stay ahead of the pack.

As such, we are pleased to announce two new additions to our team, with Mark Chapman joining as Manager of Taxation Products & Services as well as Reece Agland joining as Manager of Superannuation Products & Services.

Mark brings a wide-ranging and reputable experience both in Britain and Australia with middle and large accounting firms such as Baker Tilly, PWC and Grant Thornton, has founded and directed a small tax consultancy, and has held various roles with the Tax Office, including Senior Director.

Reece has a solid background as policy adviser for superannuation and financial services, and has expertise in professional compliance. He fulfilled roles at the Tax Office and served as Legal Counsel before taking on the role of Senior Policy Adviser at the Institute of Public Accountants. He is also a Director at the Council of Small Business Organisations of Australia.

Both Mark and Reece are tasked with bringing new and improved offerings of products and services to our membership, as well as continue to improve and extend our present range — your input and ideas are of course welcome (info@taxpayer.com.au).

They join our Finance & Administration Manager Moti Kshirsagar to co-ordinate and facilitate Taxpayers Australia's reinvigoration of its products and services, as well as an ongoing improvement and extension of membership benefits. ■

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Newly appointed Treasury portfolio ministers

The new Government was sworn in on 18 September 2013.

The Tax Office as an agency within the Treasury portfolio is now reporting to the following ministers:

- Treasurer, the Hon Joe Hockey MP – overall responsibility for policy matters within the Treasury portfolio.
- Assistant Treasurer, Senator the Hon Arthur Sinodinos AO – primary responsibility for the Tax Office.
- Other ministers within the Treasury portfolio include:
- Parliamentary Secretary to the Treasurer, the Hon Steven Ciobo MP.
- Minister for Small Business, the Hon Bruce Billson MP.

A full list of new ministers can be found at the Department of the Prime Minister and Cabinet website: www.dpmc.gov.au ■

Pursuing meaningful tax reform ...

The election of the new Government has shifted the tax landscape and opened up a fresh debate about tax reform.

During the election campaign, the Coalition released its tax and superannuation policies with major proposals including a 1.5% reduction to the company tax rate and the repeal of the carbon and mining tax legislation. In implementing these proposed measures the Coalition has flagged that it will wind back concessions such as the small business instant asset and motor vehicle write-off, and the tax loss carry-back rules. See page 121 for an outline.

Importantly, the Coalition also announced that, if elected, a White Paper on tax reform would be released prior to the next election.

The possibility of meaningful tax reform being outlined in the White Paper is welcomed.

We believe that the new Government must make this a key priority. As such, it must bear in mind the following when formulating the paper:

- It is essential that every element of the tax system is on the table.

  A fallacy of the Henry Review was that the GST regime was omitted from consideration despite the review being referred to as 'root and branch'.

  GST collected currently makes up about 13% of the total tax take. Its exclusion from the Henry Review raised questions as to its legitimacy as a 'proper' tax review at the time. A mature debate about the future of the Australian tax system must include the GST - whether that includes a rate change, broadening of the base or something else.

  The White Paper must also canvass the simplification of the tax legislation itself. It has been 20 years since the Tax Law Improvement Project and we are still stuck with two Tax Acts. Reinvigoration is required. As part of overall tax reform, a plan to speedily improve and consolidate the tax laws into a single Act is necessary.

- Careful thought should also be given to the consultation process. Consultation should be open to all and not be limited to representative bodies, business or special interests groups. It should represent a balanced cross-section of the community. The Government must actively find ways to ensure voices from ordinary Australians are heard.

- Finally, the White Paper must have an end game in mind. Tax reform that achieves a simpler, equitable and efficient Australian tax system in the long term should be the objective.

  The 1,000 page Henry Review, which is now gathering dust, is evidence of where that objective was lost. The previous government pursued only a handful of review recommendations. Remaining recommendations were left untouched without any explanation.

  In this regard, any consensus reached from consultation on the White Paper must be followed by a clear, coherent and transparent plan. The biggest challenge for the Government would then be its implementation.

We hope that the White Paper is released early. This will allow the community sufficient time to debate the merits of its contents. From there, the Government should then draft concrete proposals in which to seek a mandate for re-election.

The pursuit of meaningful tax reform cannot begin any sooner. ■

Andy Nguyen – Taxation Specialist

This Court has said on many occasions that the task of statutory construction must begin with a consideration of the text itself. Historical considerations and extrinsic materials cannot be relied on to displace the clear meaning of the text. The language which has actually been employed in the text of legislation is the surest guide of legislative intention.

The High Court in this case went on to give guidance as to how external material will be accepted in support of an interpretation of the clear meaning of a provision as follows:

... [u]ltimately it is the text, construed according to such principles of interpretation as provide rational assistance in the circumstances of a particular case, that is controlling.

Where the wording of a provision cannot be ascertained clearly from a reading of the provision, the provision should be interpreted using documents or text which provides rational assistance in determining the meaning of the words in the circumstances of a particular case.

Liberal vs narrow interpretations

Some of the words used in ss109D(3) ITAA36 could be interpreted in more than one way. On one hand, a liberal interpretation may assert that the term *'provision of credit or any other form of financial accommodation'* for example, applies to any debit in favor of a shareholder or a shareholder's associate on a company's balance sheet. A different approach may suggest that an amount would only constitute *'financial accommodation'* where certain criteria or indicia are met. The critical consideration is the meaning of the words in the case in question.

This means that a practitioner needs to interpret this definition using the generally accepted principles of interpretation. However, practitioners need to keep in mind that the aids they use to interpret the provisions should provide rational assistance whilst not displacing the clear meaning of the legislation in a particular case.

The Tax Office has provided their interpretation of the extended definition of the word 'loan' for Division 7A purposes. However, before summarising their interpretation this article attempts to use the principles of interpretation to provide an alternative methodology in deducing the meaning of the words of the provision.

Literal reading of provision

When we examine ss109D(3) ITAA36 it is important to break down the provision and ascertain whether it is clear from the words of the provision what the subsection actually means. When reading the provision literally it contains two key concepts as follows:

- reference to the word 'loan' and expanding the definition of that word to include four other types of amounts, and
- inclusion in the extended definition of loan the following amounts:
  - an advance of money
  - provision of credit or any other form of financial accommodation
  - where there is an express or implied obligation to repay an amount, a payment of an amount for, on account of, on behalf of or at the request of, an entity, and
  - a transaction (whatever its terms or form) which in substance effects a loan of money.

Ordinary meaning of 'loan'

The word 'loan' can be ascribed its ordinary meaning as the provision inherently intends that the ordinary meaning is to be extended by the inclusion of other amounts. The ordinary meaning of the word loan from *Federal Commissioner of Taxation v Radilo Enterprises Pty Ltd* (*Radilo*) is as follows:

A loan of money may be defined, in general terms, as a simple contract whereby one person ('the lender') pays or agrees to pay a sum of money in consideration of a promise by another person ('the borrower') to repay the money upon demand or at a fixed date. The promise of repayment may or may not be coupled with a promise to pay interest on the money so paid. The essence of the transaction is the promise of repayment. As Lowe J put it in a judgment delivered on behalf of himself and Gavan Duffy and Martin JJ: '"Lend' in its ordinary meaning in our view imports an obligation on the borrower to repay'.

... Repayment is the ingredient which links together the definitions of 'loan' to be found in the Oxford English Dictionary, the various legal dictionaries and the text books.

There are two important things to deduce from this interpretation. The word loan generally means that it is a contract between a lender and a borrower. The lender agrees to pay a sum of money to the borrower (or actually pays the borrower that money) in exchange for the borrower agreeing to **repay** that amount upon demand or at some future date.

An advance of money

The term 'an advance of money' should be read keeping in mind that it is intended to extend the ordinary meaning of the word 'loan'. In other words, while there may be some overlap between these two terms, a practitioner should focus on circumstances that may constitute an advance of money, but not necessarily be a loan in ordinary parlance.

Where a company provides money to a shareholder or their associate in advance, for instance, and that shareholder or associate performs a service, that amount will be caught under this term of the extended definition in ss109D(3) ITAA36 even where no contract for services exists between the parties (ie. the arrangement is not considered a loan according to the ordinary meaning of that word).

Express or implied obligation to repay an amount

This term is very loosely worded. The term can be broken up into two key conditions. These conditions must be satisfied before an amount will be captured by this part of the extended definition of the word loan. The conditions are:

- an express or implied obligation to **repay** an amount must exist, and
- a payment of an amount for any of the following reasons is made by the company:
  - for an entity
  - on account of an entity, or
  - on behalf of or at the request of an entity.

Practitioners should note that this part of the provision while extending the definition of the word loan for the purposes of Division 7A is actually a form of payment. From a literal reading, this term is intended to include in the definition of the word loan, payments where an express or implied obligation to repay an amount exists between the company and its shareholder or associate. The payment needs to be to a third party for, on account of, on behalf of or at the request of the shareholder or an associate. Again, one must be cognizant of the potential overlap between this term and the general definition of the word loan.

In substance effects a loan of money

A transaction which in substance effects a loan of money whatever its terms or form is a 'catch all' type of provision. The primary consideration in respect of this term of the extended definition is that the essence of a loan of money is the requirement to **repay** an amount.

The principle of *ejusdem generis* may be applicable to interpreting this term. This principle applies where a list of objects which share some key common feature is followed by a general 'catch-all' phrase. The general catch-all is limited to things of the same type as the preceding items. This principle applies to limit the potentially very wide definition that could be applied to this term used in ss109D(3) ITAA36.

The definition that applies to the words *'a transaction (whatever its terms or form) which in substance effects a loan of money'* cannot therefore extend the definition of the word 'loan' to other types of amounts that are not already contemplated (or included) by the other items in the subsection. It will merely serve to catch amounts of the same type that may have different terms or be in a different form.

A provision of credit or any other form of financial accommodation

This component of the extended definition is perhaps the most contentious. In reviewing material that does not form part of the definition in ss109D (3) ITAA36, a practitioner must take care that the external interpretative aid does not contravene the principles of statutory interpretation. The aid should provide a rational approach in the circumstances without displacing the meaning of the actual provision.

In this vein, arguably the most logical starting point to shed some light on what 'credit or any other form of financial accommodation' actually means is contained in s109B ITAA36. This provision is the simplified outline to Division 7A. The practitioner can reasonably assume that deducing the aim or purpose of Division 7A broadly may be assisted by reference to the simplified outline. This understanding can then form part of the framework or context in which the vital extended definition of the word loan is interpreted. Division 7A should also be viewed with reference to its legislative history especially where a relevant provision is amended. Finally, the other provisions forming part of the Division should also be considered.

Once a practitioner has undertaken this review they then apply relevant case law within this context. However, the practitioner should be vigilant to ensure the case law interpretation does not displace the meaning of the words used in ss109D(3) ITAA36.

General outline and history of Division 7A

The extended definition of the word loan was part of the original enactment of Division 7A under *Taxation Laws Amendment Bill (No. 7) 1997.* The explanatory memorandum to that Bill stated that the purpose of Division 7A was as follows:

> *The purpose of the amendments is to ensure that private companies will no longer be able to make tax-free distributions of profits to shareholders (and their associates) in the form of payments or loans.*

Subdivision E was also enacted at this time. Importantly, Division 7A was subsequently amended by *Tax Laws Amendment (2004 Measures No. 1) Bill 2004* in order to insert Subdivision EA and EB to support Subdivision E. This amendment widened the scope of Division 7A in relation to interposed entities. When provisions are amended or inserted, the purpose of the amending legislation is often to rectify potential deficiencies in the original legislation. Relevantly, the explanatory memorandum to the amendments described the purpose of the amendment as follows:

> *To ensure that a trustee cannot shelter trust income at the prevailing company tax rate by creating a present entitlement to a private company without paying it and then distributing the underlying cash to a shareholder of the company.*

The mischief that is trying to be prevented by this amendment is the distribution of underlying cash to shareholders (and associates) of a company where the trust income is being taxed at company rates.

Other relevant provisions of Division 7A

Subdivision EA deals with the situation where a present entitlement between a company and trust exists. In order for Subdivision EA to apply the trust must also have a loan, payment or forgiven amount to a shareholder or associate of the company. The complicating factor in applying these rules is that the term 'associate' defined by s318 ITAA36 is very wide. The reason this may be troublesome is because a trust may itself be an 'associate' or shareholder of the company. If the extended definition of loan includes a UPE wouldn't this mean that the trust would be subject to the primary provisions dealing with a payment, loan or forgiven debt?

A number of provisions attempt to clarify which Subdivisions will apply to transactions caught by Division 7A. Examples of two such provisions are as follows:

- Subsection 109T (3) (which excludes Subdivision E from applying where a payment or loan is made that is otherwise assessable under Division 7A), and
- Subsection 109XI (3) (which excludes Subdivision EB from applying where an amount is assessable under Subdivision EA as a result of the present entitlement of an interposed trust).

The striking thing is that Subdivision EA does not have an equivalent rule. Essentially, Subdivision EA deems an amount to be assessable income (referred to as the 'Division 7A amount') where the amount was to attract the operation of the other Division 7A provisions under the following two conditions:

- the trust was deemed to be a company, and
- the shareholders and associates of the actual company were taken to be those of the deemed company.

This point is explored in more depth and discussed with reference to the extended definition of the word loan later on in the article.

Outline to Division 7A

The outline of Division 7A makes it clear that the rules treat three kinds of amounts as dividends paid by a private company to the extent that the company has a 'distributable surplus', namely:

- amounts paid by the company to a shareholder or shareholder's associate (**see section 109C**)
- amounts lent by the company to a shareholder or shareholder's associate (**see section 109D and 109E**), and
- amounts of debts owed by a shareholder or shareholder's associate to the company that the company forgives (**see section 109F**).

It may be important to note that the simplified outline in s109B ITAA36 refers to specific provisions ***after*** the relevant amount is described in each respective dot point. A logical inference from this observation is that the reference to sections links those sections with the specific amounts outlined by the dot points. Applying this inference, ss109D(3) ITAA36 as it is contained within s109D (the middle dot point) should deal specifically with '*amounts lent by the company to a shareholder or shareholder's associate*'. Subsection 109D(3) ITAA36 should be read within this context. The extended meaning of the word loan is described as covering all 'amounts lent'.

One must be careful that where the words used in ss109D(3) ITAA36 move beyond 'amounts lent' that they are not artificially attributed the simplified outline's meaning where this is contrary to what ss109D(3) ITAA36 states.

The outline of the Division pursuant to s109B ITAA36 describes Subdivision E with reference to amounts lent or paid through interposed entities. The outline then goes on to observe that an amount should be included in the assessable income of a shareholder or an associate of a shareholder under the following two conditions:

- a company has a UPE to income of a trust, **and**
- the trustee makes a payment or loan to, or forgives a debt of, the shareholder or associate **(see Subdivisions EA and EB).**

There are perhaps two important things to note about this part of the outline of the Division. Firstly, it clearly states that an amount is included in the shareholder or associate of the shareholder's assessable income where **both** of the above conditions are satisfied. Secondly, the provision refers to specific sections much like the first three dot points and that logically this infers that the situation described by the dot points is dealt with by the sections referred to.

The five situations described by the outline can therefore be summarised diagrammatically as shown on the following page.

The simplified outline of Division 7A in s109B ITAA36 attempts to impose a structure on the Division. The structure can be described as one in which particular provisions or subdivisions deal with different types of amount for the purposes of Division 7A. Note that section 109D is described in the simplified outline as dealing with '*amounts lent by the company to a shareholder or shareholder's associate*'.

Interpretation in this context

The extended definition of the word loan when read within this framework, suggests that the expanded definition of the word loan, should **not** be taken to re-characterise amounts that are dealt with under other provisions of Division 7A. Rather, the definition of loan should be expanded to capture amounts where this expansion does not impinge on the application of other provisions dealing with these different types of amounts. Guidance should be sought in terms of when a provision applies by reference to the 'tie breaker' provisions contained in the legislation. Another key consideration when reviewing the word 'loan' for Division 7A purposes is the Division's ultimate effect. Division 7A includes a dividend under s44 ITAA36 in the assessable income of a shareholder **or** associate who receives the loan, payment or forgiven amount.

The first major interpretative exercise in this context should be to define the words *'credit or any other form of financial accommodation'*. The *Radilo* case provides a definition of the words within the statutory context of a different provision. The case states:

> *Similarly, in its statutory context, the expression 'or any other form of financial accommodation' refers to a consensual arrangement between the person providing the accommodation and the recipient. Under a consensual arrangement for the provision of credit or financial accommodation a principal sum, or its substantial equivalent (by way of indemnity against a liability on maturing bills, for example, in the case of accommodation provided in the form of a bill acceptance facility), will ultimately be payable.*

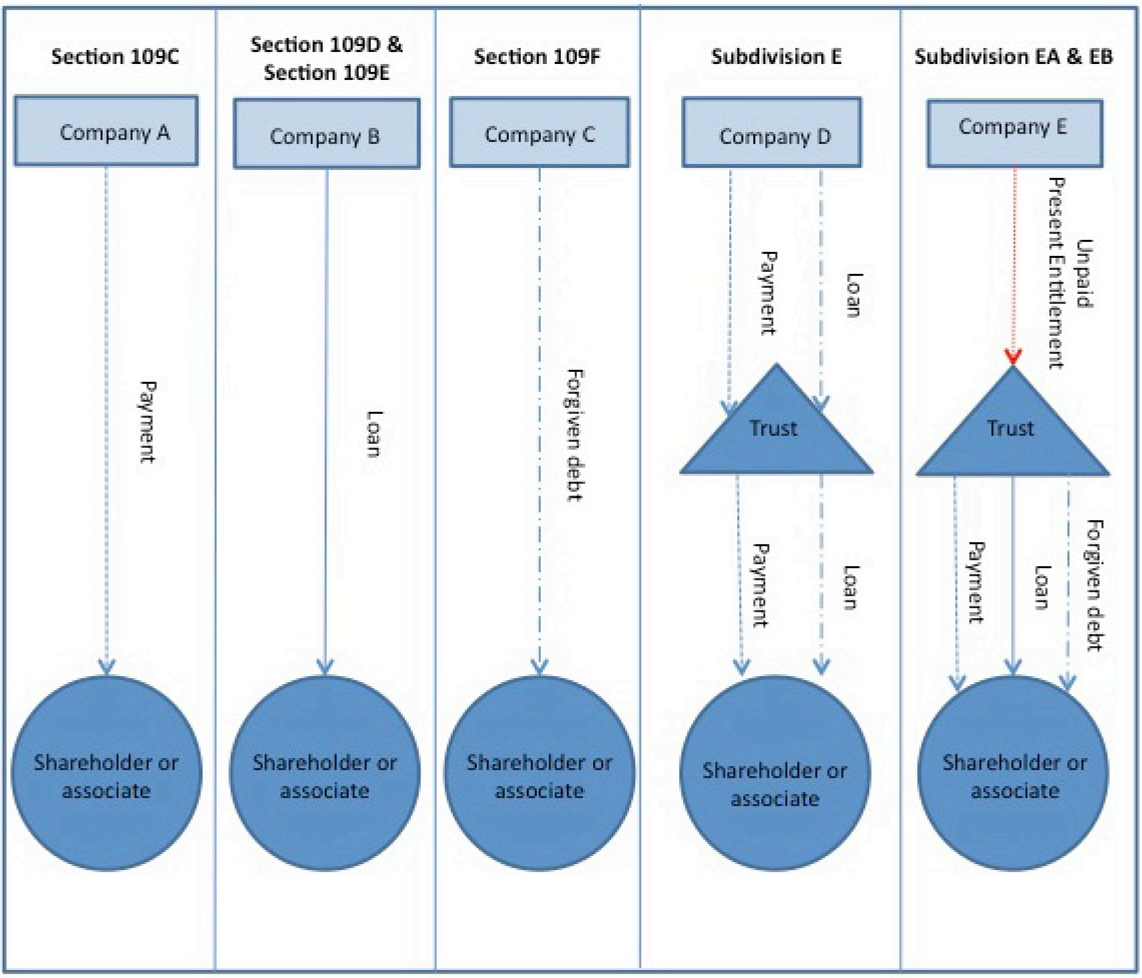
The term *'provision of credit or any other form of financial accommodation'* should be read within the context of ss109D(3) ITAA36 however. An extension of the word loan, keeping in mind the operation of Division 7A as a whole may therefore be different compared to the definition in *Radilo*. The other important thing to note is that the phrase in Division 7A refers to 'credit' and this reference does not. The word credit has a debtor and creditor connotation. This may color the interpretation of the phrase. In summary the requirements in *Radilo* of 'other form of financial accommodation' are:

- a consensual arrangement, and
- the provision of a principle sum or its equivalent which will ultimately be payable.

This brings us to the interpretation of the phrase 'present entitlement' specifically an 'unpaid present entitlement' (UPE). The term 'present entitlement' in the context of the ITAA36 deems for the purposes of that Act under s95A ITAA36 as follows:

- For the purposes of the ITAA36, where a beneficiary of a trust estate is presently entitled to any income of the trust estate, the beneficiary shall be taken to continue to be presently entitled to that income notwithstanding that the income is paid to, or applied for the benefit of, the beneficiary.
- For the purposes of the ITAA36, where a beneficiary has a vested and indefeasible interest in any of the income of a trust estate

General outline of Division 7A



but is not presently entitled to that income, the beneficiary shall be deemed to be presently entitled to that income of the trust estate.

In this context it has been considered by a number of High Court cases. For example in *Federal Commissioner of Taxation v Whiting* [1943] HCA 45 Rich J which stated that present entitlement is:

... entitled for an interest in possession as contrasted with an interest in expectancy ...

Based on the legislative context *'any other form of financial accommodation'* seems to suggest that the trust via a consensual arrangement with the company would provide a principle sum or its equivalent that would ultimately be payable to the company. The UPE is essentially the trust setting aside a share of its net income for the beneficiary company. Doubt exists as to both whether a consensual arrangement arises where present entitlement is conferred and also whether the extension of the word loan is so far reaching that it can capture an equitable entitlement when a loan is typically a common law entitlement.

To shed further light on the scope of the extended definition of loan it is perhaps reasonable to consider whether a UPE would be included within this definition by examining how a UPE is dealt with under Division 7A. In Subdivisions EA and EB specific reference has been made to 'unpaid present entitlements'. Subdivision EA and EB are two of the provisions that deal with interposed entities under Division 7A. Clearly both provisions deal with interposed entities where these entities are **not** shareholders or associates of a company. However, where the interposed trust is a shareholder or associate of the private company, the extended definition of the word loan were it to include a UPE could potentially mean that both s109D and one of these Subdivisions may apply.

Based on an in-depth reading of particular subsections that guide practitioners as to when certain provisions will apply and when they will be supplanted by other provisions, arguably two potentially more correct inference are that:

- Subdivision EA deals with **both** interposed entities that are associates of shareholders of a company as well as those that are not, and
- a UPE does not form part of the extended definition of the word loan

In order to explain these inferences, reference should be made to the primary provisions dealing with payments, loans and debt forgiveness where no interposed entity exists. These provisions essentially usurp Subdivision E where this subdivision and the primary provisions both potentially apply (see s109T ITAA36). This double up only really occurs in the case of a trust that is also an associate or shareholder of the company. Note that Subdivision EA works in a fundamentally different way however. This provision does two things:

- deems that essentially a 'notional company' is put in place of the trust, and
- deems the shareholder or associate of the actual company to be the shareholder or associate of the 'notional company' (the trust).

The amount included in the deemed shareholder or associate's assessable income can only be included where it would have been included in their assessable income under another provision of Division 7A given those modifications (See s109XB (1) ITAA36). However, the provision that actually applies to include the relevant amount in a shareholder or associates assessable income is still Subdivision EA. Section 109XB therefore has the effect of removing the UPE for the purposes of determining whether Division 7A should apply. By doing this Subdivision EA infers that the other provisions of Division 7A (except Subdivision EB) can only apply when a UPE is not a consideration. The extension of this inference is that the word loan for Division 7A cannot therefore include a UPE.

The Tax Office's interpretation

The Tax Office in TR 2010/3 seems to have interpreted the extended definition of the word 'loan' to include a UPE. The term 'financial accommodation' in the ruling was interpreted using the Oxford English dictionary. The dictionary did not contain the phrase 'financial accommodation' so the Commissioner instead took the interpretation of the word 'financial' and added it to the interpretation of the word 'accommodation'. The problem is that this method while giving the ordinary meaning of both words is arguably flawed in two ways. Firstly, when the meaning of two words is combined a reader must consider whether the phrase has a different or special meaning by virtue of the words appearing together. Secondly, the proper legislative context should be considered when applying the words. This means that the subsection in which the words appear and to a lesser extent the Division will color the meaning of the words.

The Commissioner does concede that the scope of the words 'financial accommodation' is limited somewhat by the legislative context in which they appear. However, the Commissioner refers to comments made by counsel for the applicant in a Full Federal Court decision *Corporate Initiatives Pty Ltd & Ors v. FC of T (Corporate Initiatives*) concerning a UPE in order to support the characterisation of a UPE as still forming part of the extended definition of the word 'loan' as follows:

> *... it is difficult to see the practical difference between a formally recorded loan and what happened here. In effect, Eldersmede was the recipient of a loan ...*

Counsel went on to state that they thought a benefit was provided to the trustee in that case by the beneficiary not calling for payment of the UPE. The three conditions that the Commissioner believes will make a UPE 'financial accommodation' are as follows:

- the supply or grant of some form of pecuniary aid or favour
- under a consensual arrangement (similarly to *Radilo*), and
- where a principal sum or equivalent is ultimately payable (similarly to *Radilo*).

The Commissioner bases his arguments on the assertion that Division 7A is broadly speaking targeting benefits provided by a private company to shareholders and associates. This is a fairly liberal interpretation of the purpose of Division 7A given the original explanatory memorandum states the purpose of the Division is to stop *'tax-free distributions of profits to shareholders (and their associates) in the form of payments or loans'.*

The Commissioner has since released guidance in respect of unpaid present entitlements and bad debt deductions that may cause further consternation. The relevant guidance is contained in ATO ID 2013/15 – *Deductions and expenses: unpaid present entitlement and bad debt deduction*. The Commissioner reasons in this ATO ID that writing off a UPE will not give rise to a bad debt deduction under s25-35 *Income Tax Assessment Act 1997* (ITAA97). This is because he states that a UPE is an equitable right and without more, no debtor-creditor relationship can exist. The ATO ID admittedly deals with a different provision of the tax law (and should therefore be read in a different context). However, the related concepts and methodologies employed by the Commissioner in this recent guidance even when accounting for the different context of the provisions, is still difficult to reconcile back to his position in TR 2010/3.

Where to from here?

The issue of Division 7A can be extremely complex. The Commissioner takes a particular interpretation in terms of what constitutes a loan for the purposes of the provisions. However, the practitioner must keep in mind that the Commissioner's interpretation in the form of comments made in TR 2010/3 should be analysed with reference to other interpretations based on generally accepted rules of statutory interpretation. The ultimate goal of this interpretation should always be to come to the most rational conclusion as to what the words of a provision mean. ■

Superannuation: Where are we now?

By Letty Tsoi

Since July 2012, there has been a flurry of government activity on the superannuation front: a number of significant reforms were enacted, or were announced but did not receive legislative passage before parliament was dissolved prior to the federal election. It is therefore an opportune time to do a stocktake of the current taxation landscape pertaining to superannuation legislative and regulatory reform.

Legislative changes – enacted

Topic	**Concessional contributions caps**
Description	Concessional contributions caps increased to $35,000: • for individuals aged 60 years and over – from 2013-14 • for individuals aged 50 to 59 years – from 2014-15.
Legislation	*Tax and Superannuation Laws Amendment (Increased Concessional Contributions Cap and Other Measures) Bill 2013* *Superannuation (Sustaining the Superannuation Contribution Concession) Imposition Bill 2013*
Topic	**Excess concessional contributions (ECCs)**
Description	From 2013-14: • ECCs are included in the taxpayer's assessable income. • ECCs are not subject to excess concessional contributions tax. • The taxpayer must pay a new 'excess concessional contributions charge' on the increase in their tax liability that arises from ECCs for the relevant year. • The taxpayer is entitled to an offset equal to 15% of ECCs without the refund requirement that was in place under the previous law. This offset is non-refundable. • Taxpayers may elect to have up to 85% of their ECCs released with fewer conditions than under the previous law. • The taxpayer's non-concessional contributions are reduced by 100/85 of the amount of any ECCs released. • Refunded ECCs are no longer ECCs. • The refund measure provides that the Commissioner may issue a 'release authority' to a superannuation provider.
Legislation	*Tax Laws Amendment (Fairer Taxation of Excess Concessional Contributions) Bill 2013* *Superannuation (Excess Concessional Contributions Charge) Bill 2013*
Topic	**Reduction of tax concession on contributions for high income earners**
Description	From 2012-13, taxpayers with combined income and concessionally taxed contributions exceeding $300,000 in a year are subject to new Division 293 tax at 15% on those contributions exceeding $300,000.
Legislation	*Tax and Superannuation Laws Amendment (Increased Concessional Contributions Cap and Other Measures) Act 2013*
Topic	**Refund of excess contributions (temporary measure)**
Description	Eligible individuals have the option to have excess concessional contributions of $10,000 or less refunded to them. Refunded amounts assessed as income and not subject to excess contributions tax. The rules apply for 2011-12 and 2012-13.
Legislation	*Tax and Superannuation Laws Amendment (2012 Measures No 1) Bill 2012*

Topic	Pension earnings tax exemption after death of pension recipient
Description	The tax exemption on earnings from assets supporting a pension will continue to apply following the death of the pension recipient until the deceased member's benefits have been paid out of the fund. The new rules apply from 2012-13.
Legislation	*Income Tax Assessment Amendment (Superannuation Measures No. 1) Regulation 2013*
Topic	**Low income superannuation contributions**
Description	Technical changes to the low income superannuation contributions (LISC) that apply from 2012-13 include: • The Commissioner will determine entitlement to LISC based on an income tax return and other information available. The Commissioner will also be able to estimate whether an individual is entitled to LISC where the Commissioner reasonably believes there is insufficient information to decide whether LISC is payable 12 months after the end of the relevant financial year. • All types of concessional contributions will attract LISC, including allocations from reserves and notional taxed contributions. • Any individuals entitled to be paid less than $10 of LISC on their behalf will have their entitlement rounded up to $10. • When an overpayment or underpayment occurs, the amount owed or recoverable has to be greater than $10 (with no rounding).
Legislation	*Tax and Superannuation Laws Amendment (Increased Concessional Contributions Cap and Other Measures) Bill 2013*
Topic	**Superannuation co-contribution**
Description	From 2013-14, the superannuation co-contribution maximum payment and eligibility income thresholds are: • The rate at which this payment is made is 50%. • The maximum co-contribution is $500. • The higher income threshold is $48,516. • The lower income threshold is $33,516. • The lower income threshold is indexed annually.
Legislation	*Tax and Superannuation Laws Amendment (2013 Measures No. 2) Bill 2013*
Topic	**SMSF auditor regime**
Description	SMSF auditors are now required to register in order to sign off audit reports after 1 July 2013.
Legislation	*Superannuation Auditor Registration Imposition Bill 2012*
Topic	**Other**
Description	The law has been amended to provide income tax relief to superannuation funds where there is a mandatory transfer of default members'' account balances to a MySuper product in another superannuation fund. From 1 July 2013, income tax is generally not payable on interest paid by the Commonwealth on unclaimed money. The fourth and final tranche of the MySuper reforms has been implemented in relation to regulatory matters, including the use of service providers, infringement notices, the Superannuation Complaints Tribunal and directors' breaches of statutory duties. Temporary loss relief for merging superannuation funds is available for mergers that occur between 1 October 2011 and 1 July 2017 (inclusive).

Proposed changes – did not become law

Topic	Capping the tax exemption for earnings on fund assets supporting income streams
Description	From 2014-15: • Earnings on assets supporting income streams will be tax free up to $100,000 for each individual. • Earnings above the $100,000 limit will be taxed at the rate of 15%. • Capital gains will be included in the $100,000 threshold test but transitional measures will apply.
Topic	**Deeming rules**
Description	From 1 January 2015: • The normal deeming rules will be extended to superannuation account-based income streams for the purposes of the pension income test to ensure all financial investments are assessed under the same rules. • Standard pension deeming arrangements will apply to new superannuation account-based income streams assessed under the pension income test rules after 1 January 2015. • All products held by pensioners before 1 January 2015 will be grandfathered indefinitely and continue to be assessed under the existing rules for the life of the product.
Topic	**Deferred lifetime annuities**
Description	From 1 July 2014, deferred lifetime annuities will be provided with the same concessional tax treatment that superannuation assets supporting income streams receive.
Topic	**Lost superannuation**
Description	Interest will be paid on all lost super accounts reclaimed from the Tax Office from 1 July 2013. The account balance threshold below which inactive accounts, and accounts of uncontactable members, are required to be transferred to the Tax Office will be increased to $2,000 from 1 July 2013. The account balance threshold will be further increased to $4,000 from 31 December 2015 and to $6,000 from 31 December 2016.
Topic	**Council of Superannuation Custodians**
Description	A Council of Superannuation Custodians will be established to ensure that any future changes are consistent with an agreed Charter of Superannuation Adequacy and Sustainability. The Council members will be announced in due course. A Charter Group will be established to consult and report on the proposed Charter and Council. The Charter Group members have been announced: Jeremy Cooper (Chair), Alan H Goldberg AO QC, Ross Jones, Elana Rubin and Steve Tucker.
Topic	**Administrative consequences and penalties for trustees of SMSFs**
Description	The government has released for public consultation *Tax Laws Amendment (Stronger Super Self-Managed Superannuation Funds) Bill 2012: Administrative Penalties, an exposure draft of legislation introducing administrative consequences and penalties for trustees of SMSFs and the accompanying explanatory material.* The Bill provides for administrative consequences for contraventions relating to SMSFs by introducing: • rectification and education directions which may be issued by the Commissioner for contraventions of the SISA and SISR, and • an administrative penalty regime for SMSF trustees for certain contraventions of the SISA. ***The proposed provisions will apply to contraventions that occur on or after 1 July 2013.***

Taxation Rulings

The Tax Office released the following significant tax rulings.

Taxation Ruling TR 2012/6

Taxation Ruling TR 2012/6 is about the deductibility under subs295-465(1) of the *Income Tax Assessment Act 1997* (ITAA97) of premiums paid by a complying superannuation fund for insurance policies which provide total and permanent disability (TPD) cover in respect of the fund's members.

In particular this Ruling explains:

- the Commissioner's view on how subs295-465(1), subs295-465(1A) and subs295-465(1B) together with paragraph 295-460(b) apply to such premiums (references are to the ITAA97)
- the relationship between the deductibility of the premiums and the rules for the provision of benefits by a complying superannuation fund to its members as set out in the *Superannuation Industry Supervision Act 1993* and the *Superannuation Industry Supervision Regulations 1994*, and
- the interaction of the relevant ITAA97 provisions with the relevant *Income Tax Assessment Regulations 1997*.

Taxation Ruling TR 2013/5

On 31 July 2013, the Tax Office issued Taxation Ruling TR 2013/5: *Income tax: when a superannuation income stream commences and ceases.* This ruling clarifies the Commissioner's position as to when a superannuation pension commences and ceases.

The ruling was previously released as Draft Taxation Ruling TR 2011/D3 on 13 July 2011. Refer to *The Taxpayer* Issue 4 of 2011/2012 (15 August 2011) for commentary on the draft ruling.

Although the views expressed in the ruling, in the main, have not changed since the draft ruling TR 2011/D3 (with an exception in the case of a partial commutation), the finalisation of the ruling is nevertheless a welcome move to bring certainty.

This ruling has retrospective application from 1 July 2007. However, the Commissioner has stated in the ruling that he will not undertake compliance action in relation to a year before 2012-13.

Interested in detailed analysis?

Taxpayers Australia conducted a series of superannuation seminars in August 2013. The seminar notes that each participant received contain in-depth commentary on the recent developments and announced reforms outlined above.

Anyone who missed out on attending one of the seminars has the opportunity to purchase a copy of the printed seminar notes. There is also the option of purchasing an accompanying DVD, in which an experienced superannuation professional presents his insights into the developments of 2012-13.

These products can be purchased via the Taxpayers Australia website or by contacting the Membership Services team on **1800 657 572**.

STOP PRESS! New Government

The Coalition was elected as the new Federal Government on Saturday 7 September.

Below is a snapshot of the new Government's key superannuation policies. This information was sourced from the Liberal Party's official policy documents released before the election.

At the time of writing, the new ministry was only recently appointed and no legislative detail has been released. The new Prime Minister, Tony Abbott, has indicated that federal parliament will not resume until late October or early November to deal with legislative changes.

- Delay the gradual increase in the superannuation guarantee from the current 9.25% to 12% by two years. Under the previous Government's changes, the rate was to have increased annually until it reached 12% in 2019-20. It is now anticipated that the 12% will not be reached until 2021-22.
- Develop an appropriate process to address all inadvertent breaches of the contribution caps where the taxpayer can show that their mistake was genuine and the error would result in a disproportionate penalty.
- Revisit concessional contributions caps and incentives for low income earners, such as super co-contributions, once the Budget is back in a strong surplus.
- Pay superannuation contributions at the compulsory superannuation rate for a recipient of the Government's paid parental leave.

- Review the minimum payment rules relating to account based pensions to assess their adequacy and appropriateness.

The Coalition's superannuation policy document indicates that it does not agree with the following changes that the outgoing Government made during its term:

- Lowering concessional contribution caps to $25,000 and freezing the indexation of the cap.
- Reducing the maximum co-contribution to $500 and reducing the eligibility thresholds.
- Introducing a new tax on superannuation for individuals earning more than $300,000.

However, the policy document does not specifically indicate that the Government will repeal these recent changes.

The incoming Coalition Government has also pledged not to make any 'unexpected negative changes' to superannuation. ■

Promoter penalty provisions: advisors beware

By Letty Tsoi

Some recent developments have brought the promoter penalty laws in Division 290 of Schedule 1 to the *Taxation Administration Act 1953* into the limelight. This article endeavours to discuss the operation of the specific legislative provisions governing the promoter penalty regime and also canvasses the Tax Office approach in administering these rules as outlined in its *Guide for tax intermediaries: Good governance and promoter penalty laws* (the Guide). It is imperative that tax advisers be aware of their obligations and conduct when advising clients and how a breach of the promoter penalty regime may affect them.

All legislative references are to Schedule 1 to the *Taxation Administration Act 1953* unless otherwise stated.

Promoter penalties in the spotlight

While the promoter penalty provisions have been in force for a number of years, a new cautionary announcement by the Tax Office and a recently handed down landmark court decision have brought the regime under the spotlight.

In August 2013, the Tax Office released Taxpayer Alert TA 2013/1 in relation to particular trust arrangements purportedly involving a deliberately created mismatch between the amounts beneficiaries are entitled to receive from a trust and the amounts they are taxed on.

One of the key issues concerning the Tax Office is whether any entity involved in the contemplated arrangement is a promoter of a tax exploitation scheme for the purposes of Division 290. The Taxpayer Alert also explicitly invites tax agents with information about people or companies that may be promoting such arrangements to contact the Tax Office.

The Full Court of the Federal Court of Australia (the Full Court) handed down its decision in *Commissioner of Taxation v Ludekens* [2013] FCAFC 100 (*Ludekens*) on 29 August 2013. The Full Court found in favour of the Commissioner of Taxation (the Commissioner) in his appeal from the decision of the primary judge and concluded that the two individuals involved in the legal proceedings were both promoters of a tax exploitation scheme for the purposes of Division 290.

Ludekens is a landmark decision as it represents the first time that an appellate court has considered Division 290. The judgment is very instructive as it outlines the Full Court's view of the correct construction and interpretation of the key concepts of Division 290.

Division 290: what are the promoter penalty laws?

The objects of Division 290 are as follows (s290-5):

*(a) to deter the promotion of tax avoidance *schemes and tax evasion schemes; and*

*(b) to deter the implementation of schemes that have been promoted on the basis of conformity with a *product ruling in a way that is materially different from that described in the product ruling.*

Division 290 applies in relation to conduct engaged in on or after 6 April 2006. The main civil penalty provision is contained in s290-50.

The first object: deterring promotion of schemes

Subsection 290-50(1) provides that an entity must not engage in conduct that results in that or another entity being a **promoter** of a **tax exploitation scheme**.

▶TIP

See Practice Statement Law Administration PS LA 2008/7 which sets out Tax Office guidelines for Tax Office staff on the principles to be followed in application of the promoter penalty laws to potential tax exploitation schemes. PS LA 2008/7 generally must be followed by Tax Office officers but it is not legally binding on the Commissioner or on taxpayers. However, it may provide a useful indication as to how the Tax Office may approach a particular situation.

What is the meaning of 'promoter'?

Section 290-60 explains that an entity is a **promoter** of a tax exploitation scheme if all of the following are met:

- the entity:
  - markets the scheme, or
  - otherwise encourages the growth of the scheme or interest in it
- the entity or its associate receives (directly or indirectly) consideration in respect of that marketing or encouragement, and
- having regard to all relevant matters, it is reasonable to conclude that the entity has had a substantial role in respect of that marketing or encouragement.

Marketing or encouragement

In *Ludekens*, the Full Court held that the conduct contemplated by the verbs 'markets' and 'encourages' may be seen to involve some notion of communication (of advantage or virtue of the scheme). Any such element would not need to be spoken or expressly written.

Advice exception

Subsection 290-60(2) provides that an entity is not a promoter of a tax exploitation scheme merely because the entity provides advice about the scheme. The operation of this exception is illustrated by this example from the explanatory memorandum (EM) to Division 290:

Example 3.1: When are tax advisers at risk of being promoters?

A partner (Graeme) in a major accounting firm approaches a high wealth client (Matthew) to advise him on an arrangement to minimise his tax liability by moving taxable income to an offshore tax haven.

The tax haven arrangement was initially developed by another partner (Brett) for another of the firm's clients and the firm decided it should offer similar arrangements to other clients in similar circumstances.

Brett receives a fixed percentage of the fee obtained by other accountants in the firm who offer the arrangement to other clients. The other partners - including Graeme - who offer the scheme to clients receive a fee that is significantly higher than the billing rate for routine tax advice and that partly reflects the magnitude of the tax savings for scheme participants.

Graeme is able to persuade Matthew to adopt the tax haven arrangement because Matthew will be paying much less tax. Graeme puts in place the offshore financial facilities to enable Matthew not to declare income in Australia.

Matthew then tells his friend Barbara about his offshore tax arrangements and Barbara takes the initiative to contact the accounting firm mentioned by Matthew. Graeme is not taking on new clients and therefore Barbara goes to Deborah, in another firm.

Deborah explains to Barbara how the offshore tax haven works, including the tax risks involved. Deborah bills Barbara her usual fee for advice.

In this example, Graeme and Brett would be likely to satisfy the criteria for being a promoter. This is because they have played a substantial role in marketing the scheme and encouraging client interest, and have also received consideration related to their promotional role. Deborah is not a promoter because she has only advised her client and would qualify for the advice exception.

Substantial role

'Substantial role' is not defined in the law. The EM indicates that substantial means 'considerable or large'. Whether an entity has a substantial role will turn on the facts of the case, having regard to all relevant matters. The EM provides the following guidance as to what these 'relevant matters' may comprise:

> *The matters that are relevant in this context are determined by the subject matter, scope and purpose of the provisions. They would include, for example, the degree of involvement of the relevant entity in the activities whereby the scheme was marketed or encouraged, the significance of that entity's role compared to the role played by others in those activities (ie, someone who plays a key role in devising the scheme and giving instructions to others in the course of its establishment and implementation will have a more significant role than someone who merely acts in accordance with those instructions), the nature and level of the consideration received by the entity in respect of the scheme, and the degree of the entity's participation in the management of the marketing or encouraging of the scheme.*

Employee exception

Under subsection 290-60(3), an employee is not taken to have had a 'substantial role' merely because they distributed information or material prepared by another entity (eg. if the employee distributed it on the instruction of their employer).

What is a 'tax exploitation scheme'?

Section 290-65 provides that a scheme is a 'tax exploitation scheme' if, at the time of the relevant conduct, one of the conditions listed in column A and one of the conditions listed in column B is satisfied (see table below):

What is a 'scheme'?

'Scheme' is defined in subs995-1(1) of the *Income Tax Assessment Act 1997* as:

- any arrangement, or
- any scheme, plan, proposal, action, course of action or course of conduct, whether unilateral or otherwise.

This definition is substantially the same as the definition of scheme in the Part IVA general anti-avoidance provisions in the *Income Tax Assessment Act 1936* (Part IVA).

What is a 'scheme benefit'?

A 'scheme benefit' is defined in subs284-150(1). An entity gets a scheme benefit from a scheme if, in respect of an accounting period:

- a tax-related liability is, or could reasonably be expected to be, less than it would be apart from the scheme or part of the scheme, or
- a tax refund or credit is, or could reasonably be expected to be, more than it would be apart from the scheme or part of the scheme.

Tax exploitation scheme conditions

Column A (satisfy one)	Column B (satisfy one)
If the scheme has been implemented It is reasonable to conclude that an entity that (alone or with others) entered into or carried out the scheme did so with the sole or dominant purpose of that entity or another entity getting a scheme benefit from the scheme.	**If the scheme has been implemented** It is not reasonably arguable that the scheme benefit is available at law.
If the scheme has not been implemented It is reasonable to conclude that, if an entity that (alone or with others) had entered into or carried out the scheme, it would have done so with the sole or dominant purpose of that entity or another entity getting a scheme benefit from the scheme.	**If the scheme has not been implemented** It is not reasonably arguable that the scheme benefit would be available at law if the scheme were implemented.

In *Ludekens*, the Full Court held that unlike in the Part IVA enquiry, there is no requirement to posit an 'alternative postulate'. The relevant enquiry is instead the assessment of a purpose attending activity at the time of conduct of a promotional kind, which is the mischief to which the provisions are directed. That purpose does not involve notions of alternative positions.

What is the 'sole or dominant purpose'?

According to the Guide, the sole or dominant requirement does not require that an entity obtain, or be able to obtain, the scheme benefit. The intended scheme benefit may be unavailable at law: for example, if the scheme is defeated by s8-1 ITAA97.

The Full Court in *Ludekens* held that in assessing the purpose and evaluating its importance, and whether it is dominant, one must appreciate that it is the scheme in question to which the enquiry is directed, not a general state of affairs other than the scheme. A conclusion that the dominant purpose was to get the scheme benefit is not affected by the existence of other purposes (eg. profit-making).

When is it 'reasonably arguable that a scheme benefit would be available at law'?

Subsection 290-65(2) provides that, in deciding whether it is reasonably arguable that a scheme benefit would be available at law, 'any thing that the Commissioner can do under a taxation law' should be taken into account. The legislation provides the following example: the Commissioner may cancel a tax benefit obtained by a taxpayer in connection with a scheme under Part IVA.

The legislation also notes that the condition in column B of the table on page 113 would not be satisfied if the implementation of the scheme for all participants were in accordance with binding advice given by or on behalf of the Commissioner. Such binding advice may include relevant public rulings or where all participants had private rulings.

The following example from the EM provides a comprehensive illustration of a situation where it would be reasonably arguable that a scheme benefit would be available at law and also the practical operation of key elements of Division 290.

Example 3.4: Not reasonably arguable at the time of the promotion

A large wholesaling operation is advised by its accountant (Naomi) of a method of valuing trading stock that will considerably reduce the company's tax liability. Naomi obtains a favourable legal opinion from a respected tax counsel (Rona Silk SC) that the valuation method she is proposing is allowed under the tax laws.

Naomi makes a compelling presentation to the company's Board of Directors focusing on the tax savings that will flow from this new method. The company's Chief Financial Officer (Gavin) recommends to the Board the adoption of the trading stock valuation proposal presented by Naomi. The Board is impressed with the potential tax savings and is reassured by the legal opinion about the scheme.

The company's financial position improves significantly because of the tax savings from the trading stock arrangement and Gavin gets a bonus based on the company's good financial performance. Naomi gets remuneration based on the tax savings from the scheme she has prepared for the company. Rona received a professional fee based on her normal billing rate.

Some years later, the Commissioner disallows the tax benefits claimed under Part IVA of the ITAA 1936. The company challenges the Part IVA determination in the Federal Court and loses; however, it is clear from the split decision in the case and the reasons that it was a close call and that Rona's opinion was not seriously flawed.

In this example, it is likely that none of the people named will be liable for civil penalties as promoters of a tax exploitation scheme. Naomi could rely on an argument that it was reasonably arguable that scheme benefits were available at the time of her promotion. Rona is able to rely on the adviser's exception since she did no more than provide a legal opinion. Gavin did not receive consideration in respect of marketing or encouraging interest in the scheme.

Note that, even if Naomi were a promoter of a tax exploitation scheme, Rona's conduct would not render her liable under the second limb of subsection 290-50(1) because it is not a cause of Naomi being a promoter. To conclude that the second limb is satisfied would subvert the adviser exception, which is not intended.

The second object: deterring implementation of schemes

The main civil penalty provision in s290-50 provides that an entity must not engage in conduct that results in a **scheme** that has been promoted on the basis of conformity with a **product ruling** being implemented in a way that is materially different from that described in the product ruling.

The note to the provision confirms that a scheme will not have been implemented in a way that is materially different from that described in a product ruling if the tax outcome for participants is the same as that described in the ruling.

▶TIP

See Practice Statement Law Administration PS LA 2008/8 which sets out Tax Office guidelines for Tax Office staff on the principles to be followed in application of the promoter penalty laws to schemes promoted on the basis of conformity with a product ruling but that may have been implemented in a materially different manner. PS LA 2008/8 generally must be followed by Tax Office officers but it is not legally binding on the Commissioner or on taxpayers. However, it may provide a useful indication as to how the Tax Office may approach a particular situation.

Remedies

Division 290 provides the Commissioner with a range of remedies for the contravention of s290-50, including civil penalties, injunctions and voluntary undertakings.

Injunctions

Subdivision 290-C allows the Commissioner to apply to the Federal Court of Australia (the Federal Court) to grant an injunction to:

- restrain the entity from engaging in the conduct (eg. the promotion of the scheme), and/or
- require the entity to do something.

The Federal Court may also grant an interim injunction to restrain the entity from particular conduct.

Voluntary undertakings

Subdivision 290-D provides that the Commissioner may accept a written voluntary undertaking given by an entity so long as it is in connection with furthering the 'objects' of Division 290. Therefore the terms of the voluntary undertaking must be consistent with one of the objects of deterring the promotion of schemes or deterring the implementation of schemes in a way that is materially different from that described in a relevant product ruling.

▶IMPORTANT

The EM clarifies that a voluntary undertaking can be made without either party admitting any liability.

The entity may withdraw or vary the undertaking with the Commissioner's consent.

If the Commissioner considers that a term of the undertaking has been breached, the Commissioner may apply to the Federal Court to make an order that the entity must comply with the term and/or make any other order that the Federal Court considers appropriate.

The Guide notes that examples of voluntary undertakings terms accepted by the Tax Office include the following:

- The entity will not promote, market or otherwise encourage another entity to participate in, enter into or carry out the arrangement, or cause any other entity to do so. This term is **mandatory** where conduct relates to the potential promotion of a tax exploitation scheme.
- Where the entity has caused information to be made publicly available that would encourage another entity to participate in the arrangement, the entity will make reasonable endeavours to remove, amend or retract that information.
- Where the entity is aware that another entity has entered into or is contemplating entering into the arrangement, the entity will advise the other entity to review their tax affairs and make reasonable endeavours to ensure that the other entity does not, or ceases to, carry out the scheme.
- The entity will not make any attempts to obtain, or to cause another entity to obtain, any payment, consideration or further agreement or transaction in relation to the arrangement.
- The entity will reimburse clients any fee paid in relation to the activity.
- The entity will implement internal governance arrangements to minimise future exposure to the promoter penalty laws.

Civil penalties

The Commissioner may apply for the Federal Court to impose a civil penalty (subs290-50(3)). The maximum amount of the penalty is the greater of:

- 5,000 penalty units (currently equal to \$850,000) for an individual or 25,000 penalty units (currently equal to \$4.25 million) for a body corporate, and
- twice the consideration received or receivable (directly or indirectly) by the entity and associates of the entity in respect of the scheme.

In deciding on an appropriate penalty, the law provides that the Federal Court may have regard to all matters in considers relevant, including (but not limited to) the following:

- the amount of consideration received or receivable (directly or indirectly) by the entity and its associates
- the deterrent effect of the penalty
- the amount of loss or damage incurred by scheme participants
- the nature and extent of the contravention
- the circumstances in which the contravention took place, including the deliberateness of the conduct and whether there was an honest and reasonable mistake or law
- the period over which the conduct extended
- whether the entity took any steps to avoid the contravention
- whether the entity had previously been found to have engaged in that or similar conduct, and
- the degree of cooperation with the Commissioner.

Exceptions from civil penalty provisions

The law provides for statutory exceptions from the civil penalty rules (s290-55).

Reasonable mistake or reasonable precautions

The Federal Court is not permitted to impose a civil penalty if the entity satisfies the Federal Court:

- that the conduct in question was due to a ***reasonable mistake of fact***, or
- that:
  - the conduct in question was due to:
    - the ***act or default of another entity***
    - an ***accident***, or
    - some ***other cause beyond the entity's control***, and
  - the entity took ***reasonable precautions*** and ***exercised due diligence*** to avoid the conduct.

▶TIP

The 'other entity' does not include someone who was an employee or agent of the entity when the alleged conduct occurred.

Reliance on Commissioner's advice

The Commissioner is not permitted to request the Federal Court to impose civil penalties if:

- the scheme is based on ***treating a taxation law as applying in a particular way***, and
- that way ***agrees with***:
  - ***advice*** given to the entity or the entity's agent ***by or on behalf of the Commissioner***, or
  - a statement in a ***publication approved in writing by the Commissioner.***

Time limitation

If the Commissioner exercises his discretion to apply to the Federal Court for a civil penalty, this must happen no more than four years after (as appropriate):

- the entity last engaged in conduct that resulted in the entity or another entity being a promoter of the tax exploitation scheme, or
- the entity last engaged in conduct in relation to implementation of the scheme that has been promoted on the basis of conformity with a product ruling.

▶WARNING

Where a scheme involves tax evasion the Commissioner's application for civil penalty is not restricted to the four year time limit.

Entity does not know result of conduct

The Federal Court cannot impose a civil penalty if the entity satisfies the Federal Court that ***it did not know, and could not reasonably be expected to have known***, that the entity's conduct would (as appropriate):

- result in another entity being a promoter of a tax exploitation scheme, or

- result in a scheme that has been promoted on the basis of conformity with a product ruling being implemented in a way that is materially different from that described in the product ruling.

This exception may protect employees, subcontractors and others who could not reasonably be expected to have known that their actions would result in a breach of the rules.

Employees

The Commissioner cannot request the Federal Court to impose a civil penalty in relation to an individual's involvement in a scheme as an ***employee*** if the Federal Court has ordered the individual's ***employer to pay a civil penalty*** in relation to the same scheme.

Tax Office focus

The Guide sets out examples of schemes and behaviours which are of concern to the Tax Office.

Schemes of concern

Schemes which are of concern to the Tax Office include:

- CGT avoidance schemes
- aggressive employee remuneration schemes
- deduction creation schemes
- income minimisation schemes
- mortgage restructuring arrangements
- loss generation and utilisation schemes
- international schemes
- business structure schemes
- superannuation schemes
- indirect taxes avoidance schemes
- trust schemes
- private company deemed dividend avoidance schemes, and
- imputation system schemes.

Behaviours of concern

The Tax Office is examining the role that some advisers play in influencing the tax compliance risks of taxpayers. The Guide sets out the recurring themes into which these behaviours fall that appear to make the entities involved a higher risk:

- problematic marketing of tax services
- contingent fees impeding objectivity of advice
- caveats used ineffectively
- misrepresentation of facts in ruling applications
- misuse of Tax Office advice
- mistaking a position as being reasonably arguable
- incorrect implementation and marketing of product ruling arrangements
- risk in purchasing an existing business unit from another entity, and
- risks in acquiring staff from another business.

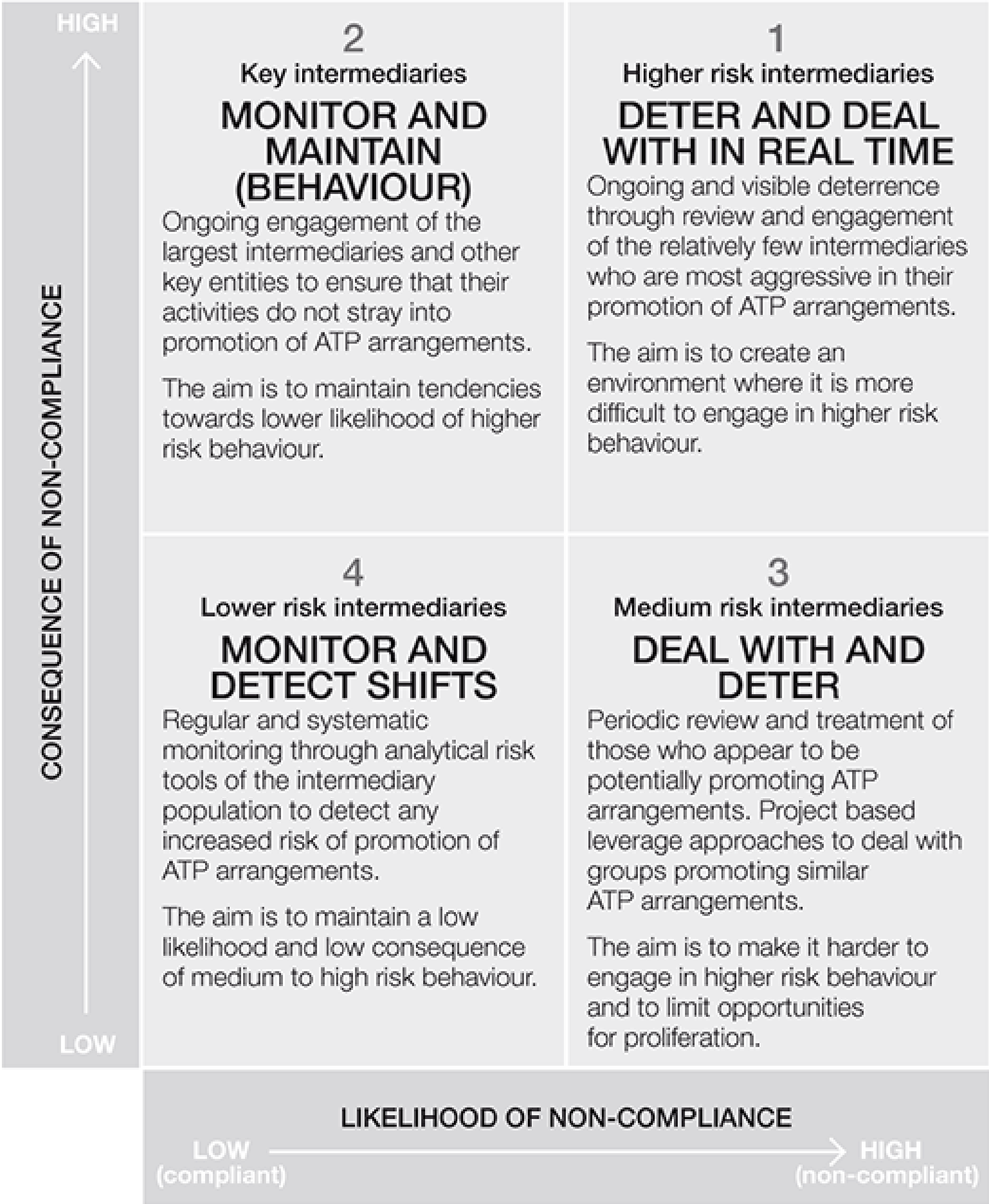
Promoter penalty risk differentiation framework

The Tax Office manages the risks relating to the potential promotion of tax exploitation schemes by identifying behaviours and differentiating its treatment approaches accordingly. The graphic on the following page appears in the Guide.

Be alert

There are multiple sides to every story: so is the case with aggressive tax planning and scheming. The Tax Office 'cracking down' on taxpayers by applying Part IVA or any of a number of specific anti-avoidance rules has long been a familiar version of events. The introduction of the promoter penalty laws in 2006 has been instrumental in turning the focus to the professional adviser side of the story. The recent *Ludekens* decision is a prominent reminder of the responsibility that advisers must take in understanding both the limitations imposed on their client dealings and their role in consumer protection. ■

Risk differentiation framework



Sourced from the Guide.

Taxation and standard business reporting

By Tom Ravlic

Standard Business Reporting (SBR) is an Australian Government initiative designed to simplify business-to-government reporting, and has been available for business use since July 2010. A major area of focus for the government's SBR team has been streamlining lodgement processes such as those for the Tax Office and other government agencies.

SBR standardises reporting methods and definitions across government agencies, and includes reports such as business activity statements (BAS), tax file number (TFN) declarations, pay as you go (PAYG) payment summaries and income tax returns for the Tax Office; financial reporting to Australian Securities and Investments Commission (ASIC); as well as payroll tax for the state and territory revenue offices.

The whole-of-government SBR function now reports to the Australian Business Registrar.

Accordingly, the specific premise for our update on developments in the SBR space in this publication, is recent discussions we had with Deputy Australian Business Registrar, Mark Jackson on the current status, scope and operational effect of SBR.

1. What is the current status of implementation of Standard Business Reporting?

In the past twelve months, we've seen SBR gaining momentum with business, with lodgements seven times higher than the previous year.

Most recently we have seen the SBR framework mandated for the superannuation industry as part of the SuperStream reforms. From 1 July 2013, the super data and payment standard required Australian Prudential Regulation Authority (APRA) regulated funds and retirement savings account providers to receive rollovers. APRA funds have six months up until 31 December 2013 to complete the transition-in process to become fully compliant with the Standard.

Government is embracing SBR as well.

Last year the Tax Office announced it will build on the advantages of SBR as it develops future online systems. They are already redeveloping some of their flagship systems into SBR technology. In fact the Tax Office will transition the electronic lodgment service (ELS) forms and schedules, including the individual tax return, to SBR technology by July 2015.

The SBR Taxonomy (a dictionary of reporting terms) now incorporates approximately 450 forms and has harmonised the number of reporting terms from about 29,000 to 6,600.

2. We hear that there has been an increasing number of people using SBR? What has been the growth in lodgements in recent years?

Business use of SBR for report lodgements increased sharply during the 2012-13 financial year. Total lodgements were in excess of 160,000, seven times the total lodgements for the last financial year.

BAS agents have emerged as the early adopters of SBR, and they tell us the SBR 'gateway' and information exchange with Government is delivering process advantages – it's quicker, easier and a better process overall.

But it's interesting to note that SBR is much more than a lodgement channel. During the 2012-13 financial year, SBR was used by businesses and their intermediaries for transactional information: to determine outstanding reporting obligations or to retrieve a list of previously submitted forms; to allow the client to request a specific form with obligations correctly specified and pre-filled with data; and to request validation of a form prior to submission.

Businesses tell us that they find these transactional services very valuable, as they contribute significantly to productivity gains.

3. In what areas have lodgements grown?

The majority of lodgements continue to comprise activity statements, PAYG statements and TFN declarations to the Tax Office.

Lodgements for the taxation of trusts, partnerships and of self-managed superannuaton funds (SMSF) Annual Returns, and financial reporting to ASIC, are also now coming through, as are payroll tax returns in New South Wales, Queensland, Victoria and Western Australia.

As SBR's capabilities are increasingly used for look up and information services (as opposed to report lodgements under regulatory reporting), we will be considering the most appropriate method of reporting these transactions, in order to reflect the benefits to business and government of these services.

4. When will lodgement of electronic documents be mandatory? There has been some talk of closing off a range of communication channels.

The Government recently released a paper which states that by 2020, all government agencies will be using digital platforms as their major channel of service delivery. One of its goals is that by 2020, Australia will rank as one of the top five OECD countries in the proportion of businesses and not-for-profit organisations using online opportunities to drive productivity improvements and expand their customer base. Australian Government agencies have already implemented a large number of government-to-government and business-to-government data exchange interfaces, and SBR is now being positioned as a key-enabler.

Service delivery initiatives are currently a priority within government. In some cases, the law already mandates the electronic lodgement of documents and has done so since at July 2000. For example, activity statements must be lodged electronically if a business exceeds particular turnover thresholds.

5. What is the status of adoption of SBR by the software developers?

The increasing availability of SBR-enabled software has been instrumental in the growth of SBR. The continuing increase in software offerings is expected to drive use even further in 2013-14 and beyond. There are now 114 commercial software developers licensed to develop SBR-enabled product, with 22 certified for one or more reports.

6. The SBR project will impact the method of electronic lodgement tax returns. Where is this project at?

We will be adding more forms, including the individual tax return (for lodgement by tax agents), by July 2015 and looking at ways to make SBR even more valuable to tax practitioners and business users. We have commenced consultation with the tax practitioner community and software providers, and plan to transition ELS services to SBR from 2015.

7. What will be the difference in the electronic lodgement system once SBR has been implemented?

For tax practitioners, the transition to SBR is expected to be seamless. We are currently working with software providers, businesses and tax practitioners to expand the SBR functionality. We are also increasing the range of forms available under SBR. But the main thing they will notice is increased capability and interaction when using accounting and practice management software, greater accuracy and taxpayer certainty.

8. Will the tax or BAS agent notice a difference?

SBR is far more powerful and has more features that make it easier for tax practitioners to do their work. They will notice less time and effort in preparing information and reporting to government. They will be a reduced risk of error.

Reports and forms are automatically pre-filled with data held in the tax practitioners' accounting and payroll records, as well as information held by government where it is available, like for activity statements, reducing the risk of errors. SBR users also spend less time resolving queries and can check their reports for discrepancies and omissions before lodging them.

9. Some accountants have expressed concerns about the security of SBR. Is the government able to access confidential data via the SBR channels?

All interaction with government is initiated by the business. Through the SBR interface the business controls what information is exchanged with government. Access to business data held by the government is controlled through use of the AUSkey which authenticates users and agency authorisation listings. This verifies the identity of the online user and ensures only those users with appropriate permissions can access the data.

10. What are the current developments related to SuperStream and how is SBR being used in that context?

The SuperStream reform involves contributions and rollovers being sent and received using a new super data payment standard. The SBR framework provides businesses with the foundation to conform to this new common data standard. Efficiencies will be created because funds will receive member information and linked payment data in a standard electronic format, reducing the need for manual processing. Automation will increase efficiency with faster flow of money to member's accounts and fewer lost accounts or unclaimed monies. ■

The Month of September…

From the Government

New Federal Government – Tax and superannuation policies

The Coalition was elected as the new Federal Government on Saturday 7 September. It was sworn in by the Governor-General on Wednesday 18 September.

Based on Liberal Party documents released before the election, the snapshot below outlines the new Government's key tax and superannuation policies. The Prime Minister, Tony Abbott, has indicated that federal parliament will not resume until late October or early November to deal with any legislative changes.

Absent legislative detail, whether these policies will be passed as proposed through Parliament is uncertain.

Tax policies

The new Government's key tax policies include the following:

- Cut the company tax rate from 30% to 28.5% from 1 July 2015.
- Not proceed with the previous Government's proposed changes to fringe benefits tax on car benefits by removing the statutory formula method.
- Introduce a paid parental leave scheme – six months' full pay (capped at a salary of $150,000 per annum), to be funded by a 1.5% levy on large businesses (which will effectively cancel out the reduction in the general company tax rate for affected businesses).
- Discontinue the new company tax loss carry-back measure.
- Remove the instant asset write-off and accelerated depreciation for motor vehicles for small businesses.
- Abolish the Schoolkids Bonus.
- Rescind the carbon tax, without changing the current income tax thresholds and the current pension and benefit fortnightly rates.
- Rescind the Minerals Resource Rent Tax (mining tax).
- Introduce an Exploration Development Incentive to allow investors to deduct mining exploration expenses against their income from 1 July 2014 (only be open to companies with no taxable income).
- Publish a White Paper on tax reform and take proposals to a subsequent election.
- Reduce regulatory burden for small business, including streamlining superannuation reporting and encouraging the Tax Office to make greater use of technology to deal with small business queries.

Superannuation policies

The new Government's policy for superannuation includes the following:

- Delay the gradual increase in the superannuation guarantee from the current 9.25% to 12% by two years. Under the previous Government's changes, the rate was to have increased annually until it reached 12% in 2019-20. It is now anticipated that the 12% will not be reached until 2021-22.
- Develop an appropriate process to address all inadvertent breaches of the contribution caps where the taxpayer can show that their mistake was genuine and the error would result in a disproportionate penalty.
- Revisit concessional contributions caps and incentives for low income earners, such as superannuation co-contributions. This is once the Budget is in a strong surplus.
- Pay superannuation contributions at the compulsory superannuation rate for a recipient of the Government's paid parental leave.
- Review the minimum payment rules relating to account based pensions to assess their adequacy and appropriateness.

The Coalition's superannuation policy document indicates that it does not agree with the following changes that the previous Government made during its term:

- Lowering concessional contribution caps to $25,000 and freezing the indexation of the cap.

- Reducing the maximum co-contribution to $500 and reducing the eligibility thresholds.
- Introducing a new tax on superannuation for individuals earning more than $300,000.

The policy document however does not specifically indicate that the Government will repeal these recent changes.

From the Administrative Appeals Tribunal

ZKBN and Commissioner of Taxation [2013] AATA 604

This case considered whether an engineer who spent considerable time away from Australia to work and live in a number of different countries during the 2007 and 2008 income years was a 'resident of Australia' for income tax purposes.

Background

The taxpayer was an engineer who, during the 2007 and 2008 income years, undertook contract work in various countries including Oman, the United Arab Emirates, France, Korea and the United Kingdom (UK). He occasionally returned to Australia with his wife to visit family and friends.

The taxpayer lived with his wife in Australia from 1997 and was self-employed until 2006.

The taxpayer owned a home on the Gold Coast which he purchased in 2003 and sold during his time overseas in June 2007.

In May 2008, the taxpayer relocated to the UK with his wife and had intended to make the country his permanent home. He was appointed as a director of a firm in the UK. In October 2008, the taxpayer however returned to Australia due to his mother-in-law's ill-health.

From April 2006 to October 2009, the taxpayer completed 10 incoming and 10 outgoing passenger cards. This required him to detail whether his travel to and from Australia were of a temporary or permanent nature.

Issue

The taxpayer contended that he was a non-resident of Australia for income tax purposes in respect of 2007 and 2008 income years. If so, he would not be assessed on his worldwide income. Conversely, the Commissioner of Taxation (the Commissioner) submitted that the relevant factors pointed to the taxpayer being a resident.

The law

A 'resident of Australia' is defined in s6(1) *Income Tax Assessment Act 1936* (ITAA36) to mean:

(a) a person, other than a company, who ***resides*** *in Australia and includes a person:*

(i) whose domicile is in Australia, unless the Commissioner is satisfied that the person's permanent place of abode is outside Australia; …

Decision

The Tribunal held that the taxpayer was a tax resident in respect of the 2007 and 2008 income years having satisfied the 'resides' test. It concluded that in those years the taxpayer had retained a 'continuity of association with Australia', had intended to return to Australia and had an attitude that Australia remained his home.

The Tribunal referred to the entries made by the taxpayer in his incoming and outgoing passenger cards as being a critical factor in determining his tax residency status (referring to the Supreme Court of NSW decision in *Re Taylor; Ex Parte Natwest Australia Bank Limited*).

In particular, the Tribunal observed that the taxpayer described himself in his immigration passenger cards as:

- a 'resident returning to Australia' in each of his **incoming passenger cards**, and
- an 'Australian resident departing temporarily' in all but one of his **outgoing passenger cards**.

The Tribunal relied on this evidence even though the taxpayer contended that it was unclear in which sense the term 'resident' was used in the cards. It followed that any interpretation would not have necessarily equated to the meaning used in tax law.

Other factors the Tribunal relied on that attributed to its ruling in the Commissioner's favour included:

- the taxpayer owned his Gold Coast home until June 2007 (and a motor vehicle until 2008)

- the storage of his personal belongings in Australia
- the taxpayer's reliance on his home address in Australia in relation to his overseas contract work (even after the property was sold), and
- his use of an Australian bank account for his income and disbursements.

COMMENT

Practitioners should be mindful of the growing reliance placed by the Commissioner and the courts on disclosures contained in immigration passenger cards as a factor in determining an individual's tax residency status. Care should be taken when completing such passenger cards to ensure that an individual's intention in relation to their residency is appropriately reflected.

From the Commissioner of Taxation

Decision Impact Statement – *Naidoo v Commissioner of Taxation* [2013] AATA 443

This case involved whether a partnership was carrying on an 'enterprise' for GST purposes and entitled to input tax credits (ITCs).

The case also considers the application of s105-65 of Schedule 1 to the *Taxation Administration Act 1953* (TAA) which, subject to certain conditions, allows the Commissioner **not** to refund a net amount of overpaid GST in respect of supplies that are deemed not to be 'taxable supplies'.

Background

The taxpayer was a husband and wife partnership who registered for GST in November 2000. The taxpayer owned and operated hotels until selling its hotels in 2006, including one which it sold to a related company of which the husband and wife were directors and shareholders.

The taxpayer asserted that after the hotels were sold in 2006, it provided management and support services for the hospitality industry and occasional pest control services. The related company was a key client in relation to those services.

The Commissioner found that the partnership was not carrying on an enterprise and cancelled its GST registration.

In making assessments for each of the relevant quarterly tax periods, the Commissioner disallowed the ITCs claimed by the taxpayer, but required it to pay amounts for GST collected. This resulted in assessments of positive net amounts despite the taxpayer not being entitled to be GST registered.

The Commissioner contended that s105-65 *A New Tax System (Goods and Services Tax) Act 1999* was to be taken into account in assessing the taxpayer's net amount for each of the relevant tax periods. The taxpayer was obliged to pay GST.

Tribunal's decision

The Tribunal held that:

1. The Commissioner was correct in determining that the taxpayer was not conducting an 'enterprise' and to cancel its GST registration.
2. Contrary to the Commissioner's argument, s105-65 cannot be taken into account in the determination of the net amount for a tax period. The Tribunal preferred the view that the provision operated after the net amount for a tax period is calculated under GST law. If an entity does not carry on an enterprise, then it cannot make 'taxable supplies' nor 'creditable acquisitions' even though it may still be registered for GST and have tax periods applying to it. Therefore, its GST liability and its ITC entitlement must each be zero.
3. The partnership in this case could not have overpaid GST in circumstances where the GST liability was entirely offset by a claim for ITCs that was also incorrectly reported.
4. It had no jurisdiction to hear an application to review a decision of the Commissioner with respect to s105-65.

Commissioner's administrative treatment

The Commissioner considers that s105-65 does not apply where an additional amount of GST is included in the net amount reported by a taxpayer, but the net amount itself is **not overpaid**.

As a result, the Commissioner's administrative approach following the decision is summarised as follows:

1. Where a taxpayer is found not to be carrying on an enterprise, the Commissioner will amend the net amount to each tax period to nil. The Commissioner may apply s105-65 to restrict a refund where the taxpayer has **actually** overpaid a positive net amount for a period. Further, any refunds will be recovered (plus shortfall penalty) for any negative net amount.
2. Where a taxpayer is found to have overpaid GST in circumstances where s105-65 applies, the taxpayer's assessment of the net amount for the relevant tax period will be amended to reflect the correct net amount for the tax period. However, unless the Commissioner exercises his discretion to pay a refund, an adjustment will be made to the taxpayer's running balance account to reflect the amount not being refunded (because of s105-65).
3. Where taxpayers self-assess presuming that the Commissioner will exercise the discretion in their favour and the refund is processed without regard to s105-65, the Commissioner may recover the refund as an 'administrative overpayment' pursuant to s8AAZN TAA.
4. Where the Commissioner makes a decision refusing to exercise discretion under s105-65 to pay a refund, he will advise taxpayers of the decision and that they have a right to seek judicial review. An informal review may be conducted by the Commissioner notwithstanding that there is no jurisdiction for a formal review.
5. Where the Commissioner has applied s105-65 in a way that is contrary to this decision (such that excess GST was recovered), there is scope for the taxpayer to be refunded for the overpayment. The request for a refund can be lodged via the GSTmail@ato.gov.au mailbox.

Further details on these administrative treatments can be obtained from the Decision Impact Statement. ■

From the helpline: Q&As

Income tax

QUESTION: Sue has provided her tax agent with information to complete her 2013 individual tax return. This information includes notification from her employer that, due to an administrative error, Sue was overpaid a total of $20,000 over the 2011 and 2012 years.

The overpayments were reflected in the 2011 and 2012 payment summaries provided by the employer. The tax agent had lodged Sue's 2011 and 2012 tax returns based on the overstated salary and wage figures. Sue has paid income tax liabilities for 2011 and 2012 based on the overstated income figures. Sue has entered into an agreement with her employer to repay the $20,000 over a number of instalments throughout the 2014, 2015 and 2016 income years.

The tax agent has asked whether each of the periodic repayments will be tax deductible in the year paid.

All legislative references are to the *Income Tax Assessment Act 1997* unless otherwise stated.

ANSWER: Tax Determination TD 2008/9 sets out the view of the Commissioner of Taxation (the Commissioner) in relation to this issue as follows:

- amounts mistakenly paid as salary or wages to employees, (or as income support payments or worker's compensation amounts to persons), to which they are not beneficially entitled, but are obliged to repay, are not derived by these persons as income according to ordinary concepts, and
- such mistakenly paid amounts are not assessable income of these persons under s6-5.

The TD contains three examples, including:

EXAMPLE 1

Taylor works as a public servant in a government department. Taylor is paid her salary on a fortnightly basis by direct credit into her bank account. During the 2006-07 income year Taylor temporarily performed duties at a higher pay scale level. A subsequent review of higher duty payments made to Taylor was undertaken by the department's personnel section. The review established that Taylor had, due to an administrative error, been mistakenly paid three amounts of $500 to which she was not entitled. That is, a total amount of $1,500 was paid to Taylor in error during the period that she performed duties at the higher pay scale. The circumstances are such that Taylor has an obligation to repay the three amounts paid by mistake. The mistakenly paid amount of $1,500 was a gross amount from which tax was withheld.

The amount of $1,500 is not ordinary income of Taylor during the 2006-07 income year, as she was not beneficially entitled to that amount.

Based on TD 2008/9, the correct approach for Sue's tax agent is to amend her 2011 and 2012 tax returns to reduce her assessable income by the relevant amount of the overpaid salaries and wages. Sue will receive refunds from the Tax Office, representing the tax that she paid on those overstated amounts. There will be no separate tax deductions available in respect of the instalments that Sue will pay her employer.

Note: For many individual taxpayers, the Commissioner will only have the power to amend prior year returns within two years after the day on which the Commissioner gives notice of the assessment: subs170(1) of the *Income Tax Assessment Act 1936* (ITAA36). Assuming that the taxpayer lodged their prior year returns within the statutory timeframes, this would generally mean that the Commissioner can amend the return of the two prior years.

The amendment period is extended to four years in specified circumstances, including where:

- the individual carried on a business during that year
- the individual was a partner or a trustee, except where the partnership or trust was not a small business entity during that year, or
- it is reasonable to conclude that any entity participated in a tax exploitation scheme with the sole or dominant purpose of the individual obtaining a scheme benefit.

Further, the Commissioner has no time limit for amendment where he is of the opinion that there has been fraud or evasion.

▶WARNING

In circumstances where an employer allows the employee time to repay such amounts of overpaid salary and wages, there is a loan benefit for fringe benefits tax (FBT) purposes under subs16(1) of the *Fringe Benefits Tax Assessment Act 1986* (FBTAA). By allowing time for repayment the employer is making a 'loan' (as defined in subs136(1) of the FBTAA) to the employee. A loan benefit can arise even where the obligation to repay the amount is not legally enforceable. Refer to TD 2008/10 for further discussion.

The existence of the loan benefit may affect the reportable fringe benefits amount (RFBA) that appears on the taxpayer's payment summary in respect of the year in which the loan benefit arises. While there will be no impact on the taxpayer's taxable income, the increased RFBA may affect the taxpayer's eligibility for certain tax offsets and government payments.

Income tax: travel allowances

QUESTION: What are the additional conditions that need to be satisfied when using the reasonable claim limits to claim domestic travel expenses without substantiation?

ANSWER: The *2013 & 2014 Tax Summary* provides a number of tables at 12.185 (page 597) reproduced from TD 2012/17. These tables set out the maximum dollar value of a claim that can be made for travel expenses in the 2013 income year, while relying on the substantiation exception in Subdivision 900-B *Income Tax Assessment Act 1997* (ITAA97).

The important thing to note is that the tables are **not** a replacement for the general rules of deductibility under s8-1 ITAA97 or a specific deduction provision for that matter.

Section 8-1 ITAA97 states that an expense is deductible in two situations, where the expense:

- is incurred in gaining or producing your assessable income, or
- is necessarily incurred in carrying on a business for the purpose of gaining or producing your assessable income

However, an expense is not deductible to the extent that:

- it is a loss or outgoing of capital, or of a capital nature, or
- it is a loss or outgoing of a private or domestic nature, or
- it is incurred in relation to gaining or producing your exempt income or your non-assessable non-exempt income, or
- a provision of this Act prevents you from deducting it.

Where travel is in relation to one of these four items it will not be deductible to the extent that one of those items applies. The tables simply set out what the Commissioner of Taxation (the Commissioner) will consider reasonable for the purposes of relying on the substantiation exception. However, in order to rely on this exception a taxpayer must satisfy a number of conditions.

These conditions are as follows:

- the deduction must be allowable under s8-1 ITAA97 (or another provision of the tax law)
- the employee must be paid a **bona fide travel allowance**:
  - the allowance is to cover the costs of travel such as food and accommodation (ie. it cannot be so low that it is inconceivable that it would cover the travel expenses claimed)
  - the allowance covers a specific journey, and
  - must be paid as an allowance (not as part of salary and wages)
- the claim must be justified or explained
- travel must be undertaken away from the employee's ordinary residence
- the employee must sleep away from home, and
- the amounts must not exceed the reasonable amounts published by the Commissioner.

The relief from the requirement to have written evidence is considered to be negated by some practitioners somewhat by the need to be able to prove the claim. Notwithstanding this concern, a taxpayer is still required to show the basis for determining the amount of their claim and that the expense was actually incurred for work-related purposes.

In order to assist in determining the documentation required to substantiate a claim the following table may be beneficial:

DOMESTIC TRAVEL		
Travel allowance received and:	**Written evidence**	**Travel diary**
the amount claimed does not exceed the reasonable allowance amount		
• travel less than six nights in a row	No	No
• travel six or more nights in a row	No	No
the amount claimed exceeds the reasonable allowance amount		
• travel less than six nights in a row	Yes – for the whole claim	No
• travel six or more nights in a row	Yes – for the whole claim	Yes

Taxpayers should note that the substantiation exception, while eliminating the need for detailed calculations and documentation, does still require the taxpayer to demonstrate the reasonableness of their claim.

QUESTION: Angela is employed by ABC Co Pty Ltd (ABC) as an internal auditor.

She is required to travel to various interstate offices as part of her employment to perform her duties. The time spent interstate can range from three days to a week.

Angela is provided with a travel allowance (which covers her overnight accommodation, food and incidentals). The travel allowance provided is in accordance with the requirements contained in Taxation Ruling TR 2004/6.

The allowance provided by ABC equates to the Commissioner of Taxation's (the Commissioner) amounts as prescribed in Tax Determination TD 2013/16.

Angela is expected by ABC to spend the entire allowance on the relevant accommodation, food and travel expenditure during her trips.

Required

Is ABC required to remit PAYG withholding in relation to the travel allowance? Is it required to disclose the allowance in Angela's payment summary?

Further, is Angela required to disclose the allowance in her personal income tax return for assessment?

ANSWER

Requirement to withhold and disclose in payment summary

Prima facie, the company is not required to disclose the travel allowance in Angela's payment summary nor is it required to withhold PAYG in respect of that allowance.

The Commissioner in TR 2004/6 (at para. 34) states that an employer can vary the amount of PAYG withholding where it is reasonable to expect that:

- expenses up to at least the amount of the allowance will be incurred by the employee
- the expenses will be incurred for the purpose for which the allowance is paid
- the expenses will be tax deductible to the employee, and

- the amount and nature of the allowance is shown separately in the accounting records of the employer.

The position is confirmed in *Pay As You Go (PAYG) Bulletin No. 1 - Taxing of allowances for the 2000/01 and later income years* (the Bulletin) where the Commissioner has approved a variation of the amount required to be withheld and their reporting on the payment summary with respect to a travel allowance. The Bulletin also requires the above expectations to be met.

Tax return disclosure

Prima facie, Angela would not be required to disclose the travel allowance or claim the corresponding accommodation, food and incidental costs incurred as a deduction in her tax return.

This is supported by paragraph 12 in TR 2004/6 which states:

> *Unless the following exception applies, all allowances must be shown as assessable income in the employee's tax return. However where:*
>
> - *the allowance is not shown on the employee's payment summary*
> - *the allowance received is a bona fide overtime meal allowance or a bona fide travel allowance*
> - *the allowance received does not exceed the reasonable amount, and*
> - *the allowance has been fully expended on deductible expenses*
>
> *the allowance received is not required to be shown as assessable income in the employee's tax return. Where the allowance is not required to be shown as assessable income in the employee's tax return, and is not shown, a deduction for the expense cannot be claimed in the tax return.*

Note: Broadly, a 'bona fide travel allowance' is an amount that could reasonably be expected to cover accommodation, or meals or expenses incidental to travel.

The above exception would appear to apply to Angela. It follows that she would not disclose the travel allowance in her tax return.

▶IMPORTANT

The outcomes outlined above apply to taxpayers in receipt of a travel allowance that satisfies the necessary requirements. This would not be appropriate for employees in receipt of a living-away-from-home allowance (LAFH allowance) (see tax ruling MT 2030 for distinction between a travel and LAFH allowance).

Most allowances would typically be included in a taxpayer's payment summary and would be subject to PAYG withholding. The Bulletin provides employers with guidance as to certain types of allowance (eg. cent per kilometre expense payments) where withholding and its disclosure are not necessary. ■

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General Editor's introduction

Associate Professor Helen Hodgson *CURTIN LAW SCHOOL*

We have three very different articles for you this month, addressing different areas of tax practice.

The first article is a timely contribution from a new contributor, Brett Davies, regarding the superannuation transition measures. One of the key features of last year's reforms was the introduction of the $1.6 million transfer balance cap which requires that superannuation funds with more than $1.6 million in retirement phase restructure to reduce that balance. Capital gains tax (CGT) rollover relief is available to reduce the effect of CGT where the changes require restructuring of asset holdings within the superannuation fund. In his contribution, Brett works through the implications of the Australian Taxation Office (ATO) ruling[1] on the application of the transitional rollover measures.

The second article discusses the deductibility of stamp duty when it is applied to the acquisition of leasehold property. John McLaren and John Passant highlight the effect of s 25–20 to allow a tax deduction for stamp duty in certain property acquisitions where the property is acquired under a lease. The authors note that although stamp duty is a capital expense that is attributed to the cost base of freehold property, s 25–20 of the Income Tax Assessment Act 1997 (Cth) applies to allow a deduction for stamp duty on the lease of a property that is used to produce assessable income. With the exception of property in the ACT, leasehold transactions are relatively unusual, however such transactions are becoming more common particularly in industries where the government does not want to see ownership in foreign hands, such as pastoral leases, rendering a tax advantage to purchasers under a lease.

The third article for this Bulletin returns to small business and the operation of Div 7A of the Income Tax Assessment Act 1936 (Cth). Vasilios (Bill) Mavropolous reviews the ATO interpretation in the context of unpaid present entitlements. Since 2010, the ATO has considered unpaid present entitlements to be loans within the meaning of Div 7A. The article examines this position using the rules of statutory interpretation to consider whether the ATO position is sustainable.

By the time you receive this edition of the Bulletin, the federal government will have handed down the 2017–18 Budget, and we will have some indication of what is in store for the coming year. I hope that we can help you to navigate the changes as they become law.

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Footnotes

1. ATO Law Companion Guideline 2016/8 (8 March 2017).

Transitional rules to reset the cost base of assets that support pensions and TRIS in SMSFs using the proportionate method

Adjunct Professor Dr Brett Davies *LEGAL CONSOLIDATED BARRISTERS & SOLICITORS*

Introduction

Under the reforms to superannuation that come into effect from 1 July 2107 anyone that has an amount exceeding $1.6 million of superannuation in pension phase will need to withdraw the excess from pension phase. The Australian Taxation Office (ATO) Law Companion Guideline 2016/8 (LCG 2016/8)[1] was released on 8 March 2017. It sets out transitional capital gains tax (CGT) relief available for funds that comply with the new transfer balance cap (TBC) and transition to retirement income streams (TRIS) reforms. Assets supporting income streams must be reallocated or reapportioned to accumulation phase before 1 July 2017, which may result in a capital gain on the dealing with the asset.

CGT relief is available up to midnight of 30 June 2017 to superannuation funds that need to:

- move assets to prepare for the TBC;[2] or
- deal with the changes to the tax treatment of TRIS and pensions.[3]

The LCG 2016/8 includes:

- how a superannuation fund makes the election to apply the relief;
- how the relief operates for both segregated and unsegregated funds;
- the effect of resetting an asset's cost base (CB); and
- statements regarding the operation of the general anti-avoidance provisions contained in Pt IV of the Income Tax Assessment Act 1936 (Cth) (ITAA 1936).

This paper considers the issues facing self-managed super funds (SMSFs) making the election to reset (increase) the CB of assets supporting pensions or the TRIS. The election is transitional, irrevocable and complex.[4]

What is a pension?

A member contribution in the "accumulation" phase is preserved in their account until they satisfy a condition of release.[5] Once the condition of release is satisfied a pension can be established with the account balance. The pension is a tax-free income stream. The most common pensions are:

- an account-based pension; or
- TRIS.

Under the current legislation, TRIS does not attract tax. However, From 1 July 2017 a fund loses the income tax exemption for assets supporting the TRIS.[6]

Also, the account-based pension will be capped at $1.6 million (the Cap). That part of the pension that exceeds the Cap and is returned to the accumulation account will now be subject to income tax and CGT.

Proportionate vs segregated methods

There are two separate methods to obtain the CGT relief:

- proportionate method (unsegregated); and
- segregated method.

Exercising the CGT relief election is valuable for members either not wishing to remain in pension mode or who exceed their $1.6 million TBC limit.[7]

Most SMSFs only have access to the proportionate method.[8] In part, this is because most SMSFs have already applied the proportionate method to claim their pension exemption.[9] This paper only considers the proportionate method.[10]

Situations where the SMSF trustee would not elect a CB reset include:

- where the asset's market value (MV) is less than its CB (ie, there is capital loss if sold);[11] and
- where the asset is likely to be sold before 30 June 2017 and the one-third CGT discount[12] is more valuable than the CB reset.

How does the transitional CGT relief operate?

The relief provisions can only apply to assets that were in the fund by 9 November 2016[13] and are still in the fund come midnight of 30 June 2017 (Pre-Commencement Period).[14] However, SMSF trustees can only take advantage of this opportunity if they make the election before lodging their FY 2017 tax return. The provisions are contained in Subdiv 294B of the Income Tax (Transitional Provisions) Act 1997 (Cth) (IT(TP)A).[15]

Calculating the proportionate method

The proportionate method is set out in s 295–390 of the Income Tax Assessment Act 1997 (Cth) (ITAA 1997). It can be applied to all of the SMSF's assets or on an asset-by-asset basis.[16] The SMSF first calculates the average balance and the days during the financial year that the average balances are held in the SMSF. It calculates the exempt portion of the SMSF's taxable income as follows:[17]

$$Exempt\ Amount = \frac{Average\ value\ of\ only\ the\ current\ pension}{Average\ total\ value\ of\ all\ superannuation}$$

If a fund has 100% of pension assets, then the exemption from capital gains is 100%. Therefore, it is worthwhile to consider establishing a second SMSF fund and rolling out all non-pension assets (accumulation assets).

Four conditions to take advantage of the proportionate CGT CB reset election

The four conditions are set out in ss 294–115 to 294–120 of the IT(TP)A. They are:

- the exempt amount is above zero;
- the SMSF asset is held during Pre-Commencement Period;
- the SMSF has no segregated pension assets during the Pre-Commencement Period (this is usually the case for SMSFs); and
- the SMSF trustee makes the valid election before lodging the SMSF's FY 2017 income tax return.

If the four conditions are satisfied then at the 12th stroke of midnight 30 June 2017, for CGT purposes, the SMSF is deemed to have:[18]

- sold the asset; and
- immediately purchased back the asset at the asset's MV (the CGT asset's CB is reset to the asset's MV as at midnight of 30 June 2017).[19]

"The deemed repurchase results in the fund becoming the owner of the asset 'again' at the repurchase time, for the purposes of the CGT regime."[20] The "repurchase time" or acquisition date is midnight of 30 June 2017.

The legislation provides two ways to implement the proportionate approach.

Method 1: paying the tax for the accumulation portion in the FY 2017

The non-exempt portion or (accumulated portion) is added to taxable income for FY 2017. Using this approach:

Example

An SMSF has $6 million in assets of which $4 million is in pension phase. The CB of the assets is $500,000. The assets have been held for over 12 months. The trustee has elected for CGT relief.

Step 1: calculate the amount of the SMSF that is tax exempt

$$Exempt\ Amount = \frac{Average\ value\ of\ only\ the\ current\ pension}{Average\ total\ value\ of\ all\ superannuation} = \frac{4}{6} = \frac{2}{3}$$

The two-third is the pension amount which receives the new CB with no CGT consequences. The remaining one-third is the accumulation amount and is subject to CGT.

Step 2: determine the notional capital gain (NCG) on 30 June 2017

= MV — CB

= 6,000,000 – 500,000 = $5.5 million

Step 3: calculate the capital gain that is exempt from CGT

= 1/3 x capital gain

= (1/3 x $6,000,000) – (1/3 x $500,000) = $1.83 million

Step 4: the CGT for FY 2017

CGT in FY 2017

= $1.84 million x [15% x (1 – 1/3)][21]

= $184,000 with a CB of $6 million

If the SMSF trustee does not elect to apply the CGT relief it means that they suffer CGT of $5.5 million x [15% x (1 – 1/3)] = $550,000.

Method 2: defer notional tax on accumulation assets until they are sold

An SMSF trustee can defer the accumulation NCG until that asset is eventually disposed of.[22] Deferring an otherwise upfront tax payment is usually highly beneficial to the member.[23] If the SMSF trustee elects to defer the NCG then the non-exempt portion is not included in the SMSF's assessable income until the asset is disposed of.[24]

Example

The Smith Super Fund purchased 1000 listed shares on 1 July 2006 for $40,000 (this means that the shares' CB is $40,000). These shares are now worth $170,000.

The shares are sold in 6 years' time. A deferment can be used if the SMSF trustee defers the gain on the non-exempt portion of the fund until the event occurs.

Unrealised capital gain
= 170,000 – 70,000
= $100,000

Capital gain
= 100,000 x (1 – 1/3)
= $66,667

The SMSF trustee has an opportunity to reset the CB of these shares to their market value. As 50% of the fund is in pension mode for FY 2017, the capital gain is:
= $66,667 x 50%
= $33,333.50 NCG arises in FY 2017.

Conclusions

It may be argued that there is an obligation to inform all trustees of SMSFs under the accountant's care of this opportunity. Beware, a client may have recently started a pension without the accountant's knowledge. It may be prudent to send information to all SMSF clients. To follow is some wording that an accountant may wish to base their letter upon.

Accountant's sample letter to client

> I am writing to all SMSF clients. If you have a pension or transition to retirement income stream (TRIS) (or had the right to set one up), then before midnight 30 June 2017 consider whether you need to elect to change the cost base of some of the assets. This generally has a favourable tax result as it may reduce the capital gain that you pay when you eventually sell that asset.
> The issues are complex. If you instruct us, then we would be happy to review your Super fund on an asset-by-asset basis. This is to determine whether an election should be made for some of the assets.
> Each election is irrevocable. Once the election is made, it cannot be reversed.

Part IVA of the ITAA 1936

As with any tax benefit strategy, Pt IVA of the ITAA 1936 is always a consideration. CB resetting is an ideal opportunity to reduce CGT on assets and save the 10% CGT.[25] Therefore, consider whether it is a "scheme" that helps the SMSF member minimise potential future CGT exposure.[26] Advisors must not artificially manipulate clients' circumstances to meet the CGT relief provisions.

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The author wishes to acknowledge the research undertaken by Legal Consolidated Barristers & Solicitors' Intern, Natalie Connor, LLB, BCom, law and commerce graduate from The University of Western Australia.

Footnotes

1. The LCG 2016/8 was released previously in draft form as Draft LCG 2016/8 and now includes more examples to illustrate the operation of the capital gains tax (CGT) relief where a fund uses the segregated method throughout the pre-commencement period (9 November 2016 to 30 June 2017).
2. The TBC starts at $1.6 million and is indexed periodically in $100,000 increments in line with consumer price index (CPI). If your pension balance exceeds $1.6 million the excess must be transferred out of the pension account. The transfer of the excess can be dealt with in two ways: transferring to accumulation or by withdrawing the excess from the superannuation fund. See ATO "Transfer balance cap" (28 March 2017) www.ato.gov.au/individuals/super/accessing-your-super/transfer-balance-cap/. See also, T Power "Burden for retirees: monitoring $1.6 million transfer balance cap" (29 March 2017) www.superguide.com.au/retirement-planning/liberals-1-6-million-cap-pension-start-balances.
3. See Australian Government The Treasury "Improving the integrity of transition to retirement income streams" (9 November 2016) www.budget.gov.au/2016-17/content/glossies/tax_super/downloads/FS-Super/11-SFS-Improve_integrity_of_transition_to_retirement_income_streams-161109.pdf.
4. A member is able to make a commutation election pursuant to s 136–20 of the ITAA 1936. The election applies on a per asset basis, not on a per asset class.
5. The conditions are outlined at ATO "Conditions of release" (2 May 2016) www.ato.gov.au/Super/Self-managed-super-funds/Paying-benefits/Conditions-of-release/.
6. LCG 2016/8, at [3A]. For more explanation on the legislative changes, see D Butler and G Chau "TRIS strategies after 1 July 2017" (2017) 51(8) *Taxation in Australia* 443.
7. This is because such assets are no longer protected by the pension exemption after 1 July 2017.
8. The segregated method is not available unless the fund was segregated before 9 November 2016. This is the date that the proposed legislation was announced.
9. For an explanation on the Segregation Model see: see D Butler and G Chau "Transitional CGT relief for pension and TRIS assets for FY2017" (21 December 2016) www.dbalawyers.com.au/federal-budget/transitional-cgt-relief-pension-tris-assets-fy2017. See also LCG 2016/8, at [19]–[27].
10. Under s 295–387 of the Income Tax Assessment Act 1997 (Cth) (ITAA 1997), from 1 July 2017, the SMSF is no longer permitted to apply the segregated method to calculate the exempt income where a member is in pension phase and has over $1.6 million in superannuation.

11. In contrast, a capital loss is usually lost if the fund is in segregated pension mode.
12. ITAA 1997, Div 115.
13. The relevance of 9 November 2016 is that it was the day the Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016 (Cth) was tabled in the House of Representatives. The Bill became Act No 81 of 2016 (Treasury Laws Amendment (Fair and Sustainable Superannuation) Act 2016 (Cth) (FSSA)) on assent on 29 November 2016.
14. Income Tax (Transitional Provisions) Act 1997 (Cth) (IT(TP)A), ss 294–110(1)(c) and 294–115(1)(c) require an asset to be held throughout the Pre-Commencement Period.
15. This was inserted by the FSSA.
16. The difference between the segregated method and proportionate is that the CB reset will trigger a capital gain on assets not fully in pension phase. Therefore, it triggers a potential tax on capital gain.
17. It is determined in accordance with the formula set out in s 295–390 of the ITAA 1997.
18. See LCG 2016/8, at [54]. If the fund ceases, for an instant in time, it is deemed to have disposed of the relevant CGT asset at the applicable sale time, and CGT event A1 will be triggered.
19. IT(TP)A, ss 294–110(3)(a) and 294–115(3)(a).
20. LCG 2016/8, at [58].
21. Applying s 115–25 of the ITAA 1997.
22. The SMSF may choose not to defer any capital gain. Proposition for this statement is based on Example 3.61 in the Explanatory Memorandum to the Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016 (Cth). For example, the Trustee of the SMSF sells the asset or it is transferred in specie to a member. This is under s 294–120 of the IT(TP)A.
23. See s 294–120(4) of the IT(TP)A.
24. IT(TP)A, s 294–120(4).
25. The CGT rate is 15% but this is automatically reduced by one-third, making the CGT rate 10% if the member holds the asset for greater than 12 months. See ITAA 1997, s 115–25.
26. ITAA 1936, s 177D.


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Leasehold property and the deductibility of stamp duty

John McLaren *CHARLES DARWIN UNIVERSITY and* ***John Passant*** *THE AUSTRALIAN NATIONAL UNIVERSITY*

Introduction

The purpose of this paper is to explain the operation of s 25–20 of the Income Tax Assessment Act 1997 (Cth) (ITAA97) and the legal basis for the deductibility of stamp duty on leases if the property is used for the purposes of earning assessable income and to raise awareness of the existence of this important section of the ITAA97. The reason why there is an important need to produce this paper is that over the past few months senior tax agents and accountants working in Victoria and the NT have been asked this question: is stamp duty a deductible expense if the property is being used for income producing purposes in the ACT?[1] The answer has always been a resounding "no". The second question that has been asked is if the investment property is leasehold title and not freehold title, would that make any difference to your answer? The response has also been a resounding "no". The explanation has always been that stamp duty is a capital expense and therefore not deductible, but it becomes part of the cost base for capital gains tax purposes when the investment property is sold. The logical approach that is taken is that stamp duty is a one-off expense and is regarded as being of a capital nature and caught by the first negative limb of s 8–1 of the ITAA97. The accountant or tax agent knows that it will form part of the second element of the cost base for capital gains tax purposes pursuant to s 110–25 of the ITAA97. This view is reinforced by s 110–35(4) where stamp duty is listed specifically as an "incidental cost", namely the second element for cost base purposes. This will always be the correct approach when the interest in the real property that is being used for income producing purposes is freehold and not leasehold.

To be fair to those senior tax agents and accountants if they had been practicing their professions in the ACT, then they would probably know that the answer to the first question is a resounding "yes". All real property in the ACT is of leasehold title and there is no freehold title in the land. People who own their own house or business premises in the ACT have a 99-year lease over the land. This means that as a consequence of the operation of s 25–20, where the leasehold property in the ACT is purchased for rental purposes and stamp duty paid to the ACT Government will be deductible.[2] But, what is of great concern is that many pastoral properties in the NT and WA are of leasehold title and stamp duty is paid by the lessee. Many commercial properties are leased for many years and therefore their interest in the real property is a leasehold interest and stamp duty is paid. As will be seen later in this paper, agricultural schemes involving trees and fruit plantations also involve the land being used to grow the trees and the investor obtains a leasehold interest in the real property where the produce is being grown. The Stamp Duty Act 1978 (NT) specifically imposes stamp duty on both freehold and leasehold interests in real property.

For ease of understanding it is worthwhile to briefly explain the difference between a leasehold title to land and a freehold title to land. The starting point is to state that property is classified by law as being either real property or personal property.[3] Real property consists of land and anything attached to it such as minerals, trees and buildings.[4] Personal property is all property that is not real property such as tangible things, namely cars, books or intangible things, namely intellectual property rights or shares in a company.[5] All interests in land are "real" except for leases which are classed as "personalty".[6] The Crown, or as is the case in Australia, the Commonwealth Government or the governments of the states or territory own all real property absolutely. All you receive when you purchase real property from the government or a previous owner is an "interest" in the land.[7] An interest in land can be held either as a freehold interest or as a leasehold interest. A freehold estate is for an undefined period of time whereas a leasehold interest is for a certain period. In the case of all real property in the ACT, it is leasehold for a period of 99 years for residential purposes and a reduced period for commercial or pastoral leases.

Leasehold and stamp duty

For the purposes of this paper, the most important section that is often forgotten is s 25–20 of the ITAA97.

It is not always remembered by accountants and tax agents when preparing a client's tax return. The section allows for expenses incurred in the acquisition of an interest in leasehold real property to be claimed as a deduction against assessable income.

The specific deduction, "Lease document expenses", s 25–20 states:

> (1) You can deduct expenditure you incur for preparing, registering or stamping:
> (a) a lease of property; or
> (b) an assignment or surrender of a lease of property;
> if you have used or will use the property *solely* for the purpose of producing assessable income.
>
> Property used partly for that purpose
>
> (2) If you have used, or will use, the leased property only *partly* for that purpose, you can deduct the expenditure to the extent that you have used, or will use, the leased property for that purpose.

In particular, the expense associated with paying stamp duty to a state or territory government on the value of the leasehold interest in the land is deductible pursuant to s 25–20 of the ITAA97 if the leasehold property is being used in an income producing activity. The section essentially allows a capital expense to be immediately deductible where the leasehold property is used for income producing purposes. Professor Ross Parsons, in his authoritative work published in 1985,[8] recognised the operation of s 68 of the Income Tax Assessment Act 1936 (Cth) (ITAA 36), now s 25–20 as prevailing over s 51(1) now s 8–1. He makes the following statement as to how the two sections interact:

> The words of the section must have a wide operation, and will for the most part cover situations where s 51(1) (s 8–1) would not allow a deduction. A lease of property will most often be a structural asset of the lessee, though the possibility that a lease is in some circumstances a wasting revenue asset should not be excluded. If s 68 and s 51(1) do overlap, problems of correlation will not arise since each section will have the same operation. At least this is so if s 51(1) gives an immediate deduction, as clearly s 68 does, of costs of a wasting revenue asset. The view has been expressed above that the expense under s 51(1) should be spread over the life of the wasting revenue asset. If there is overlap and a problem of correlation arises, s 68 (s 25–20) will, presumably, prevail as the more specific provision.
>
> There will be a number of situations within s 68 (s 25–20) where a deduction would not be allowable under s 51(1) (s 8–1) because the expense is not a working expense or it is not contemporaneous.[9]

The deductibility of stamp duty in the ACT is well-known because of the fact that all real property consists of leasehold title. As the Australian Taxation Office (ATO) says in its guide for rental property owners *Rental Properties 2016*:

> **Lease document expenses**
>
> Your share of the costs of preparing and registering a lease and the cost of stamp duty on a lease are deductible to the extent that you have used, or will use, the property to produce income. This includes any such costs associated with an assignment or surrender of a lease.
>
> For example, freehold title cannot be obtained for properties in the Australian Capital Territory (ACT). They are commonly acquired under a 99-year crown lease. Therefore, stamp duty, preparation and registration costs you incur on the lease of an ACT property are deductible to the extent that you use the property as a rental property.[10]

However, clearly the deductibility of the stamp duty is not just limited to rental properties or the ACT. Stamp duty on any leasehold interest in real property, if it is used for the purpose of producing assessable income, is deductible under s 25–20 of the ITAA97. The ATO has confirmed the deductibility of stamp duty in a range of circumstances in product rulings relating to agricultural investment schemes. A few of these rulings are listed below just to reinforce the application of s 25–20 of the ITAA97 to a wide range of circumstances.

Product rulings and the deductibility of stamp duty

These seven ATO Rulings all say that the cost of stamping the lease for the various agricultural projects is deductible under s 25–20. Those leases appear mainly to be in WA. Many of the tax-effective agricultural investment projects that were heavily marketed in the late 1990s and early 2000s all involved the investor owning an interest in an agricultural product or timber on land leased from the original title holder.[11] All of these investment projects obtained product rulings from the ATO in order to give the investor an assurance as to the level of tax deductions that were available. Clearly the ATO confirmed that stamp duty on the leased land was deductible.

- TR 2005/6 — Income tax: lease surrender receipts and payments (as at 29 November 2006)
- PR 2009/11 — Income tax: 2007 Macgrove Project (2009 Growers) (as at 18 March 2009) — establishment of macadamia trees in Queensland:

  > (vi) The fee for registering and stamping the Sub Leases is a lease document expense and deductible in full under section 25–20 in the year that it is incurred. It is incurred for acquiring a sub lease over a property that is used or is to be used during the Term of the Project solely for income producing purposes.

- PR 2008/8 — Income tax: Mediterranean Olives Project 2008 — (Growers not in Joint Venture) (as at 6 February 2008)
- PR 2007/104 — Income tax: WA Blue Gum Project 2008 (Growers not in Joint Venture) (as at 19 December 2007)

- PR 2007/103 — Income tax: WA Blue Gum Project 2008 (Joint Venture Growers) (as at 19 December 2007)
- PR 2007/38 — Income tax: WA Blue Gum Project 2007 Joint Venture Growers (as at 18 April 2007)
- PR 2007/37 — Income tax: WA Blue Gum Project 2007 not Joint Venture Growers (as at 18 April 2007)

These Rulings confirm beyond doubt that s 25–20 allows for the deductibility of stamp duty costs in relation to leases of real property used for the purposes of earning assessable income.

Conclusion

It is very difficult for tax practitioners to know every section of the ITAA97 or the ITAA 36. Tax practitioners do have a very good knowledge of the general taxation law and how to apply it to a wide range of practical matters that occur within their practice and their clients. However, s 25–20 of the ITAA97 is sometimes overlooked because practitioners are usually dealing with clients that have investments in real property having a freehold title and not a leasehold title in the land. The exception being tax practitioners that operate in the ACT. It is important to be aware of the application of s 25–20 because investors in property are now finding that more land is being sold as leasehold interests when the various governments in Australia want to retain their absolute interest in the land but are content to see it being used for a certain period of time. Many of the large cattle stations that are being sold to foreign investors in the NT are of leasehold title and not freehold title and eventually the lease runs its term and the land reverts to the government or the lease is renewed. However, one very substantial advantage that these investors have is that the stamp duty paid to the NT Government is a deductible expense for income tax purposes.

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This article has been subject to independent review.

Footnotes

1. On 30 December 2016 when discussing the sale of the tax practice with a very senior tax agent of 35 years' experience in Melbourne and asking the same two questions of two senior tax agents at a function in Darwin on 9 December 2016.
2. The ACT Government has a long-term plan which has been in operation for more than 4 years to remove stamp duty and replace it with annual land taxes. At present there is a hybrid arrangement where each year, stamp duty reduces and land tax is increasing. See J McLaren "The Australian Capital Territory has adopted measures to abolish stamp duty and impose a land tax on all real property: will this approach be adopted by other states in Australia?" (2013) 8(1) *Journal of the Australasian Tax Teachers Association* 101.
3. C Turner and J Trone *Australian Commercial Law* Lawbook Co, 2017 p 514.
4. Above n 3.
5. Above n 3.
6. Above n 3, p 522.
7. Above n 3.
8. R W Parsons *Income Taxation in Australia: Principles of Income, Deductibility and Tax Accounting* The Law Book Co, 2011 (facsimile reproduction).
9. Above n 8, p 551.
10. ATO *Rental Properties 2016* (2016) 14 www.ato.gov.au/uploadedfiles/content/mei/downloads/rental-properties-2016.pdf.
11. Many of the problems faced by investors in the now-failed managed investment schemes developed by Timbercorp or Gunns in timber projects were a result of the investor not being able to harvest the timber growing on the land as the leasehold title had reverted to the owner of the freehold title.

Revisiting Div 7A — a critique of the current ATO position

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Division 7A of the Income Tax Assessment Act 1936 (Cth) (ITAA 1936) is a complex set of rules. The interpretation of the provisions contained within this Division has historically been contentious and difficult ever since the Australian Taxation Office (ATO) released binding guidance in Taxation Ruling (TR) 2010/3 "Division 7A loans: trust entitlements" (TR 2010/3). This article revisits and critiques this interpretation to provide practitioners with guidance in relation to their approach to what can be a fiendishly difficult exercise in practice.

Current state of play — ATO position over time

The ATO's official position in relation to an unpaid present entitlement (UPE) in relation to whether this type of equitable obligation falls within the extended definition of loan is based upon certain circumstances and the date on which they changed their view of these provisions in TR 2010/3. Prior to this tax ruling, the ATO did not hold this view.

This ATO approach can be artificial and has created a degree of ambiguity for tax practitioners. It is important to understand that the ATO position is one of many views on the issue and an independent analysis of the law may yield a different interpretation.

Legislative analysis

The genesis of the current Div 7A rules was enacted by Taxation Laws Amendment Bill (No 3) 1998 (Cth) introduced on 4 December 1997. The wording of the provision examined by this article is contained in s 109D(3) of the ITAA 1936 as follows:

> In this Division, ***loan*** includes:
> (a) an advance of money; and
> (b) a provision of credit or any other form of financial accommodation; and
> (c) a payment of an amount for, on account of, on behalf of or at the request of, an entity, if there is an express or implied obligation to repay the amount; and
> (d) a transaction (whatever its terms or form) which in substance effects a loan of money.

The first step in interpreting legislation is to try to determine the correct construction of the relevant legislative provision by reference to the provision itself without the aid of interpretative materials. This methodology is supported by High Court authority, for instance see *Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue* as follows:

> This court has stated on many occasions that the task of statutory construction must begin with a consideration of the text itself. Historical considerations and extrinsic materials cannot be relied on to displace the clear meaning of the text. The language which has actually been employed in the text of legislation is the surest guide to legislative intention.[1]

This rule of interpretation enunciated by the High Court was accompanied with guidance on how extrinsic materials should be used by practitioners to support characterisation of a legislative provision as follows: "Ultimately it is the text, construed according to such principles of interpretation as provide rational assistance in the circumstances of a particular case, that is controlling."[2]

The legal rule boils down to ascertaining the clear meaning of a provision. Where this is judged not to be possible the legislation should be interpreted using documents or texts that give rational assistance to determine the appropriate construction in the circumstances.

Contrast of different characterisations

There are obviously both liberal and narrow constructions that can apply to the words of any provision. Section 109D of the ITAA 1936 is no exception. A wide interpretation of the provision in question may characterise the words "provision of credit or any other form of financial accommodation" to mean any debit arising on behalf of a shareholder or their associate disclosed on a balance sheet of a company or not disclosed at all.

On the other hand, this same wording in the provision may only be enlivened where certain criteria are met or in certain circumstances. The critical issue in interpretation is always the meaning of the words in their current context. A practitioner should be alive to the need to interpret provisions in accordance with the High Court methodology and established principles of interpretation. In doing this, it would be remiss not to consider how the use of aids and external documents are used to assist in the characterisation process. This exercise should be done without displacing the clear meaning of the legislation in a particular set of circumstances.

These methodologies and principles should then be examined in light of the official ATO position in relation to the extended definition of the word "loan" for Div 7A purposes. It is important that a practitioner performs their own characterisation before examining the ATO position critically to ensure integrity in the position they hold.

Plain view of provision

The plain view of what s 109D(3) of the ITAA 1936 means can be broken down into its component parts. Then a practitioner should try to discern the provision's meaning without reference to anything else. The two key concepts when reviewing the provision are as follows:

- the word "loan" and an expansion of the definition of that word to include four other types of amounts; and
- the following key matters that form part of the expanded definition:
  - an advance of money;
  - provision of credit or any other form of financial accommodation;
  - where there is an express or implied obligation to repay an amount, a payment of an amount for, on account of, on behalf of or at the request of, an entity; and
  - a transaction (whatever its terms or form) which in substance effects a loan of money.

While this exercise seems obvious, it assists in the more difficult parts of the analysis to follow. Essentially, a practitioner should go through the component parts of the definition and characterise them.

Loan — ordinary meaning

It is settled by the Full Federal Court decision *Commissioner of Taxation v Radilo Enterprises Pty Ltd*[3] (*Radilo*) that the word "loan" for the purposes of a predecessor of the provision in question takes its ordinary meaning defined as such:

> A loan of money may be defined, in general terms, as a simple contract whereby one person (the lender) pays or agrees to pay a sum of money in consideration of a promise by another person (the borrower) to repay the money upon demand or at a fixed date. The promise of repayment may or may not be coupled with a promise to pay interest on the money so paid. The essence of the transaction is the promise of repayment.
> As Lowe J put it in a judgment delivered on behalf of himself and Gavan Duffy and Martin JJ: "'Lend' in its ordinary meaning in our view imports an obligation on the borrower to repay" … Repayment is the ingredient which links together the definitions of "loan" to be found in the Oxford English Dictionary, the various legal dictionaries and the text books. In essence then a loan is a payment of money to or for someone on the condition that it will be repaid.[4]

The meaning of the word loan is generally defined as one in which there is a contract between the borrower and lender. Furthermore, the lender agrees to pay out an amount of money to the borrower in exchange for the borrower agreeing to repay that amount when demanded or at some future time and date.

Advance of money

This term expands the meaning of the ordinary word "loan" interpreted above. While some overlap exists between this term and the ordinary meaning of the word loan, it should be borne in mind however that the focus of the process of characterisation should be on what constitutes an advance of money, but is not a loan within the ordinary meaning of that word.

Put simply, an advance of money from a company to a shareholder or their associate is captured here. For instance where that person performs services for the company without a contract specifically in place governing these services between the parties, although the arrangement would not meet the definition of the word loan, it would clearly fall into the definition of an advance of money.

Obligation to repay — both express and implied

This term can be further simplified into two component parts. These two components should be satisfied before a transaction can be captured under this part of the expanded definition. The components are:

- an express or implied obligation to repay an amount must be on foot; and
- payment of the sum for any of the following reasons by the company must exist:
  - for an entity
  - on account of an entity; or
  - on behalf of or at the request of an entity.

This extension to the ordinary meaning of the word loan is actually a payment. Based on a literal reading of this limb, this term brings into the definition of the word loan actual payments where they are made because of an express or implied obligation to repay an amount by shareholders or their associates.

The payment needs to be to a third party for, on account of, on behalf of, or at the request of, the shareholder or associate. There may also be an overlap here between this limb and the ordinary meaning of the word loan.

Substance of the transaction is a loan of money

This limb acts as a "catch-all" type of provision. Where a transaction does not fit into any other limb and does not meet the ordinary definition but in essence is a loan of money is the requirement to repay an amount.

Here an established legal principle may be of some assistance. The doctrine of ejusdem generis may, in interpreting this limb, shed light on intended meaning of this part of the provision. This doctrine generally applies where a list of objects which share some key feature are followed by a general "catch-all" phrase. The general catch-all is limited to things of the same type as the preceding items with that same key feature. This principle can potentially apply to limit the very wide definition that could be applied to this term used in s 109D(3) of the ITAA 1936.

The definition that applies to the words "a transaction (whatever its terms or form) which in substance effects a loan of money" cannot therefore extend the definition of the word "loan" other than to types of amounts with the same key feature contemplated by the other items in the subsection. It will merely serve to catch amounts of the same type that may have different terms or be in a different form.

Provision of credit or any other form of financial accommodation

The provision the ATO utilises to bring in UPEs is the provision of credit or financial accommodation. This is the most contentious part of the construction exercise. This is where a practitioner should take care when reviewing the external interpretative aids so as not to fall foul of the established legal principles of statutory interpretation. The interpretation should always implement a rational approach given the circumstances so as not to displace the meaning of the actual provision.

The starting point is clearly in other parts of the legislation. The term "credit or any other form of financial accommodation" is actually used in s 109B of the ITAA 1936. This provision is the simplified outline to Div 7A, so it is reasonable to assume that this simplified outline will help in discerning the aim or purpose of Div 7A. The framework provides important context to aid understanding of a practitioner in determining the vital extended definition of the word "loan". Another aid may be the legislative history of the provision especially where a relevant provision is amended. Finally, the other provisions forming part of the Division can provide guidance.

Once a practitioner has gone through this review, they should then apply case law within this context. However, as ever care should be taken to ensure the case law interpretation does not displace the meaning of the words used in s 109D(3) of the ITAA 1936.

History and outline — Div 7A

The extended definition of the word "loan" was part of the original enactment of Div 7A under Taxation Laws Amendment Bill (No 7) 1997 (Cth). The Explanatory Memorandum to that Bill stated that the purpose of Div 7A was as follows:

> The purpose of the amendments is to ensure that private companies will no longer be able to make tax-free distributions of profits to shareholders (and their associates) in the form of payments or loans.

Subdivision E was also enacted at the time of the above Bill. Division 7A was then subsequently amended by the Tax Laws Amendment (2004 Measures No 1) Bill 2004 (Cth) to insert Subdiv EA and EB in support of Subdiv E. This amendment widened the scope of Div 7A in relation to interposed entities. When provisions are amended or inserted, the purpose of the amending legislation is often to rectify potential deficiencies in the original legislation. Relevantly, the Explanatory Memorandum to the amendments described the purpose of the amendment as follows:

> To ensure that a trustee cannot shelter trust income at the prevailing company tax rate by creating a present entitlement to a private company without paying it and then distributing the underlying cash to a shareholder of the company.[5]

The mischief that is trying to be prevented by this amendment is the distribution of underlying cash to shareholders (and associates) of a company where the trust income is being taxed at company rates.

Other provisions of legislation

Subdivision EA deals with the situation where a present entitlement between a company and trust exists. In order for Subdiv EA to apply, the trust must also have a loan, payment or forgiven amount to a shareholder or associate of the company. The complicating factor in applying these rules is considering the term "associate" defined by s 318 of the ITAA 1936 being so wide. The reason this is difficult is due to a trust often being an "associate" or shareholder of a private company. If the extended definition of loan included a UPE, wouldn't this mean that the trust would be subject to the primary provisions dealing with a payment, loan or forgiven debt?

A number of provisions attempt to clarify which Subdivisions will apply to transactions caught by Div 7A. Examples of two such provisions are as follows:

- section 109T(3) of the ITAA 1936 which excludes Subdiv E from applying where a payment or loan is made that is otherwise assessable under Div 7A; and
- section 109XI(3) of the ITAA 1936 which excludes Subdiv EB from applying where an amount is assessable under Subdiv EA because of the present entitlement of an interposed trust.

The striking thing is that Subdiv EA does not have an equivalent rule. Essentially, Subdiv EA deems an amount to be assessable income (referred to as the "Division 7A amount") where the amount was to attract the operation of the other Div 7A provisions under the following two conditions:

- the trust was deemed to be a company; and
- the shareholders and associates of the actual company were taken to be those of the deemed company.

This point is explored in more depth and discussed regarding the extended definition of the word loan later on in the article.

Division 7A — generally

Division 7A generally makes it clear three types of transactions are subject to its rules and should be treated as a dividend, subject of course to a company's distributable surplus. These are:

- amounts paid by the company to a shareholder or their associate (s 109C);
- amounts lent by the company to a shareholder or their associate (ss 109D and 109E); and
- amounts of debts owed by a shareholder or their associate to the company that the company forgives (s 109F).

The simplified outline contained in s 109B of the ITAA 1936 is important. This provision guides a practitioner to specific parts of the Division. This observation leads to the logical conclusion that the reference to sections links those sections with the specific amounts outlined by the dot points.

This conclusion can be applied to s 109D of the ITAA 1936 as it is contained within s 109B (the middle dot point) which should deal specifically with "amounts lent by the company to a shareholder or shareholder's associate". Section 109D(3) of the ITAA 1936 should be read within this context.

The word loan and its extended meaning should be considered in this context as covering all "amounts lent". Care should again be taken that the clear wording of the provision should not be displaced and a practitioner should not ascribe a meaning where one does not rightly exist.

The outline of the Division pursuant to s 109B of the ITAA 1936 describes Subdiv E with reference to amounts lent or paid through interposed entities. The outline then goes on to observe that an amount should be included in the assessable income of a shareholder or associate of a shareholder under the following two conditions:

- a company has a UPE to income of a trust; and
- the trustee makes a payment or loan to, or forgives a debt of, the shareholder or associate (see Subdivs EA and EB).

There are perhaps two important things to note about this part of the outline of the Division. First, they state that an amount is included in the shareholder or associate of the shareholder's assessable income where both of the above conditions are satisfied. Second, the provision refers to specific sections much like the first three dot points and that logically this infers that the situation described by the dot points is dealt with by the sections referred to.

The five situations described by the outline can therefore be summarised diagrammatically as shown below. The simplified outline of Div 7A in s 109B of the ITAA 1936 attempts to impose a structure on the Division. The structure can be described as one in which particular provisions or Subdivisions deal with different types of amount for the purposes of Div 7A. Note that s 109D is described in the simplified outline as dealing with "amounts lent by the company to a shareholder or shareholder's associate".

Contextual interpretation

The extended definition of the word loan, when read within this framework, suggests that the expanded definition of the word loan should not be taken to re-characterise amounts that are dealt with under other provisions of Div 7A. Rather, the definition of loan should be expanded to capture amounts where this expansion does not impinge on the application of other provisions dealing with these different types of amounts.

Guidance should be sought in terms of when a provision applies by reference to the "tie breaker" provisions contained in the legislation. Another key consideration when reviewing the word "loan" for Div 7A purposes is the Division's ultimate effect. Division 7A includes a dividend under s 44 of the ITAA 1936 in the assessable income of a shareholder or associate who receives the loan, payment or forgiven amount.

The first major interpretative exercise in this context should be to define the words "credit or any other form of financial accommodation". The *Radilo* case provides a definition of the words within the statutory context of a different provision. The case states:

> Similarly, in its statutory context, the expression "or any other form of financial accommodation" refers to a consensual arrangement between the person providing the accommodation and the recipient. Under a consensual arrangement for the provision of credit or financial accommodation [of] principal sum, or its substantial equivalent (by way of indemnity against a liability on maturing bills, for example, in the case of accommodation provided in the form of a bill acceptance facility), will ultimately be payable.

The term "provision of credit or any other form of financial accommodation" should be read within the context of s 109D(3) of the ITAA 1936 however. An extension of the word loan, keeping in mind the operation of Div 7A as a whole, may therefore be different compared to the definition in *Radilo*. The other important thing to note is that the phrase in Div 7A refers to "credit" and this reference does not. The word credit has a debtor and creditor connotation. This may colour the interpretation of the phrase. In summary the requirements in *Radilo* of "other form of financial accommodation" are:

- a consensual arrangement; and
- the provision of a principle sum or its equivalent which will ultimately be payable.

This brings us to the interpretation of the phrase "present entitlement" specifically a UPE. The term "present entitlement" in the context of the ITAA 1936 deems for the purposes of that Act under s 95A of the ITAA 1936 as follows:

- For the purposes of the ITAA 1936, where a beneficiary of a trust estate is presently entitled to any income of the trust estate, the beneficiary shall be taken to continue to be presently entitled to that income notwithstanding that the income is paid to, or applied for the benefit of, the beneficiary.
- For the purposes of the ITAA 1936, where a beneficiary has a vested and indefeasible interest in any of the income of a trust estate but is not presently entitled to that income, the beneficiary shall be deemed to be presently entitled to that income of the trust estate.

In this context it has been considered by a number of High Court cases. For example in *Federal Commissioner of Taxation v Whiting*[6] which stated that present entitlement is "entitled for an interest in possession as contrasted with an interest in expectancy".

Based on the legislative context, "any other form of financial accommodation" seems to suggest that the trust via a consensual arrangement with the company would provide a principle sum or its equivalent that would ultimately be payable to the company. The UPE is essentially the trust setting aside a share of its net income for the beneficiary company. Doubt exists as to both whether a consensual arrangement arises where present entitlement is conferred and also whether the extension of the word loan is so far reaching that it can capture an equitable entitlement when a loan is typically a common law entitlement.

To shed further light on the scope of the extended definition of loan, it is perhaps reasonable to consider whether a UPE would be included within this definition by examining how a UPE is dealt with under Div 7A. In Subdivs EA and EB, specific reference has been made to the term "unpaid present entitlements". Subdivisions EA and EB are two of the provisions that deal with interposed entities under Div 7A. Clearly both provisions deal with interposed entities where these entities are not shareholders or associates of a company. However, where the interposed trust is a shareholder or associate of the private company, the extended definition of the word loan where it is to include a UPE could potentially mean that both s 109D and one of these Subdivisions may apply.

Based on an in-depth reading of particular subsections that guide practitioners as to when certain provisions will apply and when they will be supplanted by other provisions, arguably two potentially more correct inferences are that:

- Subdivision EA deals with *both* interposed entities that are associates of shareholders of a company as well as those that are not; and
- a UPE does not form part of the extended definition of the word loan.

In order to explain these inferences, reference should be made to the primary provisions dealing with payments, loans and debt forgiveness where no interposed entity exists. These provisions essentially usurp Subdiv E where this Subdivision and the primary provisions both potentially apply (see s 109T of the ITAA 1936). This double up only really occurs in the case of a trust that is also an associate or shareholder of the company. Note that Subdiv EA works in a fundamentally different way however. This provision does two things:

- deems that essentially a "notional company" is put in place of the trust; and
- deems the shareholder or associate of the actual company to be the shareholder or associate of the notional company (the trust).

The amount included in the deemed shareholder or associate's assessable income can only be included where it would have been included in their assessable income under another provision of Div 7A given those modifications (see s 109XB(1) of the ITAA 1936). However, the provision that actually applies to include the relevant amount in a shareholder or associate's assessable income is still Subdiv EA. Section 109XB therefore has the effect of removing the UPE for the purposes of determining whether Div 7A should apply.

By doing this, Subdiv EA infers that the other provisions of Div 7A (except Subdiv EB) can only apply when a UPE is not a consideration. The extension of this inference is that the word loan for Div 7A cannot therefore include a UPE.

The ATO's interpretation

The ATO in TR 2010/3 seems to have interpreted the extended definition of the word "loan" to include a UPE. The term "financial accommodation" in the ruling was interpreted using the *Oxford English Dictionary*. The dictionary did not contain the phrase "financial accommodation" so the Commissioner instead took the interpretation of the word "financial" and added it to the interpretation of the word "accommodation". The problem is that this method, while giving the ordinary meaning of both words, is arguably flawed in two ways. First, when the meaning of two words is combined a reader must consider whether the phrase has a different or special meaning by virtue of the words appearing together. Second, the proper legislative context should be considered when applying the words. This means that the subsection in which the words appear, and to a lesser extent the Division, will colour the meaning of the words.

The Commissioner does concede that the scope of the words "financial accommodation" is limited somewhat by the legislative context in which they appear. However, the Commissioner refers to comments made by counsel for the applicant in a Full Federal Court decision *Corporate Initiatives Pty Ltd v Commissioner of Taxation*[7] (*Corporate Initiatives*) concerning a UPE in order to support the characterisation of a UPE as still forming part of the extended definition of the word "loan" as follows: "It is difficult to see the practical difference between a formally recorded loan and what happened here. In effect Eldersmede was the recipient of a loan …"[8]

Counsel went on to state that they thought a benefit was provided to the trustee in that case by the beneficiary not calling for payment of the UPE. The three conditions that the Commissioner believes will make a UPE "financial accommodation" are as follows:

- the supply or grant of some form of pecuniary aid or favour;
- under a consensual arrangement (similarly to *Radilo*); and
- where a principal sum or equivalent is ultimately payable (similarly to *Radilo*).

The Commissioner bases his arguments on the assertion that Div 7A is broadly speaking targeting benefits provided by a private company to shareholders and associates. This is a fairly liberal interpretation of the purpose of Div 7A given the original Explanatory Memorandum states the purpose of the Division is to stop "tax-free distributions of profits to shareholders (and their associates) in the form of payments or loans".

The Commissioner has since released guidance in respect of UPEs and bad debt deductions that may cause further consternation. The relevant guidance is contained in TD 2016/19 "Is a beneficiary of a trust entitled to a deduction under s 25–35 of the Income Tax Assessment Act 1997 for the amount of an unpaid present entitlement to trust income that the beneficiary has purported to write off as a bad debt?"[9] (TD). The Commissioner reasons in this TD that writing off a UPE will not give rise to a bad debt deduction under s 25–35 of the Income Tax Assessment Act 1997 (Cth) (ITAA 1997). This is because he states that a UPE is an equitable right and without more, no debtor-creditor relationship can exist.

The TD admittedly deals with a different provision of the tax law (and should therefore be read in a different context). However, the related concepts and methodologies employed by the Commissioner in this recent guidance, even when accounting for the different context of the provisions, is still difficult to reconcile back to his position in TR 2010/3.

Guidance — Div 7A

The issue of Div 7A can be extremely complex. The Commissioner takes a particular interpretation in terms of what constitutes a loan for the purposes of the provisions. However, the practitioner must keep in mind that the Commissioner's interpretation in the form of comments made in TR 2010/3 should be analysed with reference to other interpretations based on generally accepted rules of statutory interpretation. The ultimate goal of this interpretation should always be to come to the most rational conclusion as to what the words of a provision mean.

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Footnotes

1. *Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue* (2009) 239 CLR 27; (2009) 260 ALR 1; [2009] HCA 41; BC200908882 at [47].

2. Above n 1, at [51].
3. *Commissioner of Taxation v Radilo Enterprises Pty Ltd* (1997) 72 FCR 300.
4. Above n 3 at 313.
5. Explanatory Memorandum, Tax Laws Amendment (2004 Measures No 1) Bill 2004 (Cth) 7.
6. *Federal Commissioner of Taxation v Whiting* [1943] HCA 45.
7. *Corporate Initiatives Pty Ltd v Commissioner of Taxation* (2005) 142 FCR 279; (2005) 219 ALR 339; [2005] FCAFC 62; BC200502493.
8. Above n 7, at [25].
9. Which replaced ATO Interpretative Decision (ID) 2013/15 "Deductions and expenses: unpaid present entitlement and bad debt deduction".

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