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Contents

page 66 **General Editor's introduction**
Dr Helen Hodgson *CURTIN LAW SCHOOL*

page 67 **The convenient fiction — deductibility and capital**
Bill Mavropoulos *THE TAXPAYERS ASSOCIATION*

page 71 **The curious case of Ward, the Commissioner, a little matter of jurisdiction and some manifest absurdity**
Craig Meldrum *AUSTRALIAN UNITY PERSONAL FINANCIAL SERVICES LIMITED*

page 74 **The proposed new AMIT system**
Joseph Power *KING & WOOD MALLESONS*

page 80 **Developments in the role of GST in the quantification of damages**
Andrew Sommer *CLAYTON UTZ*

Information contained in this newsletter is current as at May 2015

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General Editor's introduction

Dr Helen Hodgson *CURTIN LAW SCHOOL*

After the tax reform edition last month, this month we have returned to the usual format of a more technically focused edition. We have a range of issues discussed in this edition; from basic principles of deductibility through superannuation and goods and services tax (GST) to the new exposure draft on attribution managed investment trusts.

Bill Mavropoulos has written an analysis of the Full Federal Court decision in the *SPI Powernet*[1] case, which returns to the basics in discussing the distinction between revenue and capital expenditure. It is easy to overlook the fundamentals when looking at a complex transaction but the Full Federal Court applied the law to the particular facts of the case and the analysis turned on the characterisation of the outgoing under consideration. An appeal has been lodged to the High Court, so we will have to watch for the final decision on this case.

The second article, contributed by Craig Meldrum, relates to the penalties applied to excess superannuation contributions. Non-concessional contributions made prior to 1 July 2013 that exceeded the cap of $150,000 (or $450,000 over 3 years) were subject to substantial penalties that could only be remitted in exceptional circumstances. Generally in most cases that have gone before the Administrative Appeals Tribunal (AAT), the Tribunal has maintained the penalties that were imposed by the Commissioner. However, in *Ward*[2] the AAT regarded the outcome as "manifestly absurd" and remitted the penalties. The law has been changed with effect from 1 July 2013, but there may still be excess contributions tax assessments in the system.

Joe Power has contributed the third article in this edition, which is an examination of the exposure draft for the attribution managed investment trust regime. The exposure draft has been underway for about 5 years and we heard on Budget night that mandatory implementation has been deferred until 1 July. The regime is based on attribution and will address some of the problems that these trusts have in dealing with Div 6 of the Income Tax Assessment Act 1936 (Cth) and streaming rules. It doesn't seem that the new regime can be characterised as being simpler, but it should provide some certainty to trustees and investors in these investment vehicles.

The final article, from Andrew Sommer, looks at the application of GST to damages and the interaction of the common law and GST principles when settling a claim for damages. The discussion is based on the Victorian Supreme Court case of *Millington v Waste Wise Environment Pty Ltd*,[3] when the GST treatment by both parties became critical in quantifying the loss. Andrew also highlights the importance of taking account of such matters before finalising a settlement.

I hope that there is something in this edition that is relevant to your practice.

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Footnotes

1. *SPI PowerNet Pty Ltd v Commissioner of Taxation* (2014) 220 FCR 355; [2014] FCAFC 36; BC201402371.
2. *Ward v Commissioner of Taxation* [2015] AATA 138; BC201580120.
3. *Millington v Waste Wise Environment Pty Ltd* [2015] VSC 167; BC201503150.

The convenient fiction — deductibility and capital

Bill Mavropoulos *THE TAXPAYERS ASSOCIATION*

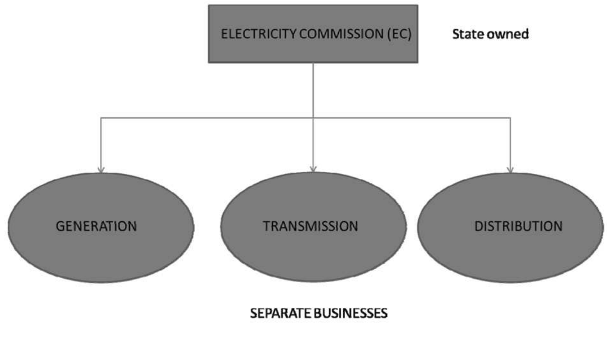
The arbitrary line between an outgoing classified as being on revenue account and one characterised as being on capital account is difficult to determine. The case law in this area is also fiendishly difficult to decipher and can seem confusingly contradictory. There are however general principles and important concepts that can guide a practitioner or taxpayer in respect of how to characterise a particular outgoing. This issue and the relevant concepts that come into play have recently been examined by the Full Federal Court in *SPI Powernet Pty Ltd v Commissioner of Taxation* (*SPI Powernet case*).[1] The case has been appealed to the High Court but serves as a useful case study to refresh one's understanding.

SPI Powernet key facts

The Victorian Government, through their Electricity Commission, originally owned the businesses that provide Victorians with electricity. In the 1990s the government decided to privatise part of these businesses. In order to examine relevant outgoings, it is important to gain a broad understanding of the way this privatisation process was conducted.

The first thing to understand is, broadly, who owned the electricity businesses before the privatisation. The Electricity Commission originally owned three related businesses as shown in the diagram below:

Prior to privatisation — ownership of business

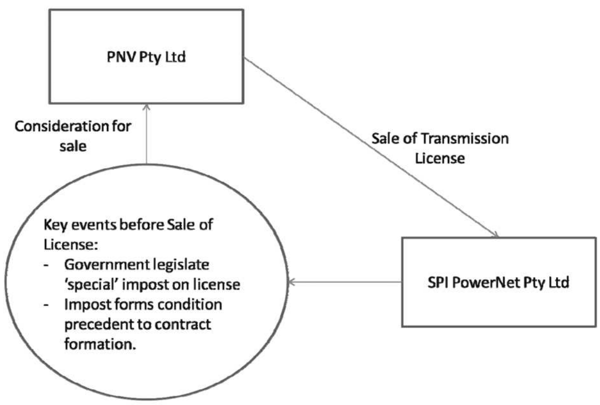


The businesses did three things:

- generated electricity;
- transmitted it to where it is used; and
- distributed it as appropriate.

This issue of deductibility arose with reference to the privatisation of the transmission business. In anticipation of the privatisation, a state-owned company (Power Net Victoria (PNV) Pty Ltd) was set up. A license in respect of the rights to run the transmission business was provided to the state-owned company.

The license asset was then sold to the taxpayer (SPI Powernet). However, a number of key events occurred prior to the sale of the license to SPI Powernet. First, an impost was declared on the holder of transmission licenses for a finite period of time in Victorian legislation. This impost was broadly designed to ensure a privatised transmission business did not earn too much profit from the transmission business in question. Second, this impost became a condition precedent to the contract and warranties were made in respect of this obligation by the parent company of SPI Powernet before the asset sale agreement could be executed. This can be represented diagrammatically below:



The transmission licence imposts were then the subject of protracted legal argument in relation to whether they were deductible under s 8-1 of the Income Tax Assessment Act 1997 (Cth) (ITAA 97). The court focused on whether the fees were capital or revenue in nature with a rather muted consideration of the issue of whether the nexus of the outgoing was close enough to the assessable income derived from the transmission license and a determination in respect of when the outgoing was incurred. In this article we will consider all of these issues.

SPI Powernet Full Federal Court case

This case was a majority decision that found that the imposts in question were capital in nature. There was a dissenting judgment in this decision that disagreed and felt the imposts were deductible. In reaching these conclusions the majority made a number of key observations to support their position.

The first key observation made was that by executing the agreement to transfer the licence from PNV to SPI Powernet, a contractual obligation arose to pay the "special" imposts that was over and above any statutory obligation to do so under the relevant Victorian legislation. This contractual obligation was further reinforced by warranties from SPI Powernet's parent company.

In the majority, McKerracher J referred to *Sun Newspapers Ltd v Federal Commissioner of Taxation* (*Sun Newspapers* case)[2] when outlining the guiding principle determining whether an obligation was an outgoing of capital or revenue as follows:

> There are, I think, three matters to be considered, (a) the *character of the advantage sought*, and in this its *lasting qualities may play a part*, (b) the *manner* in which it is *to be used*, relied upon or enjoyed, and in this and under the former head recurrence may play its part, and (c) *the means adopted to obtain it*; that is, by providing a periodical reward or outlay to cover its use or enjoyment for periods commensurate with the payment *or by making a final provision* or payment so as to secure future use or enjoyment. [Emphasis added.]

This principle was refined with reference to another High Court case — *Hallstroms Pty Ltd v Federal Commissioner of Taxation*.[3] This principle was expressed by Dixon J in a dissenting decision and so should be used with caution:

> What is an outgoing of capital and what is an outgoing on account of revenue *depends on what the expenditure is calculated to effect from a practical and business point of view, rather than upon the juristic classification of the legal rights, if any, secured, employed or exhausted in the process*. [Emphasis added.]

When these principles were applied together one majority justice concluded that, because the provision of the asset sale agreement imposed a separate contractual liability to pay the "special" imposts before the license could be acquired, the payment should be viewed as capital.

SPI Powernet possible High Court outcome

The High Court is yet to rule on this particular case. Having said this, a practitioner can use this case in order to further their knowledge of the application of general principles. This may reasonably give some insight into how the case may unfold but also, more importantly, provide a roadmap of how to approach problems of general deductibility.

The incurring of an outgoing

A critical aspect of determining deductibility in a practical sense is determining when an outgoing has been incurred. There is no statutory definition of the meaning of the word "incurred" contained in the ITAA 97. The courts have been reluctant to provide a definitive definition of this term but the following five factors outline the scope of the definition without necessarily being exhaustive:

- A taxpayer does not have to have paid any money to have incurred an outgoing or expense provided the taxpayer is committed to it in the year of income. A loss or outgoing can be incurred within s 8-1 even though it remains unpaid, provided the taxpayer "completely subjected" to the outgoing. That is, subject to the principles below, it is not sufficient for the liability to be merely contingent or no more than pending, threatened or expected, no matter how certain it is in the year of income that the loss or outgoing will be incurred in the future. It must be a presently existing liability to pay a pecuniary sum.
- A taxpayer can have a presently existing liability, even though the liability may be defeasible by others.
- A taxpayer may have a presently existing liability, even though the amount of the liability isn't precisely ascertained, provided it is capable of reasonable estimation (based on probabilities).
- Whether there is a presently existing liability is a legal question in each case, having regard to the circumstances under which the liability is claimed to arise.
- In the case of a payment made in the absence of a presently existing liability (where the money ceases to be the taxpayer's funds) the expense is incurred when the money is paid.

The incurring of an expense under s 8-1 is not enough; a loss or outgoing must be properly referable to a particular year of income. This principle is espoused in *Coles Myer Finance Ltd v Federal Commissioner of Taxation* (*Coles Myer*).[4] The matter of the taxpayer's accounting system can therefore be indicative of when a deduction could arise. Having said this, how a transaction is accounted for is by no means determinative of the income year to which an outgoing is properly referable.

The next step in the process would then be the characterisation of the outgoing as either capital or revenue. This can be determined with reference to the three important factors enumerated in the *Sun Newspapers* case. These factors are:

(a) the *character of the advantage sought*, and in this its *lasting qualities may play a part*,
(b) the *manner* in which it is *to be used*, relied upon or enjoyed, and in this and under the former head recurrence may play its part, and
(c) the *means adopted to obtain it*; that is, by providing a periodical reward or outlay to cover its use or enjoyment for periods commensurate with the payment *or by making a final provision* or payment so as to secure future use or enjoyment.

The key issue is the accurate identification of the outgoing in order to determine whether it should be characterised as revenue or capital.

Finally, where necessary the nexus between being necessarily incurred in carrying on a business for the purpose of producing assessable income must be examined with reference to the outgoing.

How the law may apply to SPI Powernet

Clearly SPI Powernet does not have a presently existing liability until the license has been transferred to them. It is relevant that both a statutory obligation as well as a contractual obligation exists in respect of the "special" imposts.

The question becomes does the statutory obligation *or* the contractual obligation result in a presently existing liability on the execution of the contract and transfer of the license, and does it matter which obligation is the one that results in a presently existing obligation? The answer to this question should hopefully be provided by the High Court.

Clause 13.3(d)(1) of the Asset Sale Agreement provides a clue as to how the contractual obligation should be framed; it is reproduced as follows:

> The amounts to be payable by [SPI] pursuant to the Licence Fee Order are an integral part of the regulatory framework of the industry and [SPI] accepts that it must pay the amounts set out in the Licence Fee Order in order to carry on the Business transferred from [PNV][.]

The license fee order was issued under s 163AA(1) of the Electricity Industry Act 1993 (Vic). It would seem that the contract bound SPI Powernet to adhere to its statutory obligation as a licensee to pay the "special" imposts. The liability or presently existing obligation to make payment of the "special" imposts therefore seems to have been derived from the statute itself.

If the High Court accepts that the statutory obligation is the cause of the present and existing obligation in respect of the outgoing, the question becomes whether the character of the advantage sought in paying this charge is the extinguishing of a liability that arises from time to time or a one off charge referable to the transfer of the licence or privatisation of the business. Presumably the Victorian Government may be able to issue further license fee orders which would potentially lead to the outgoing being more of a revenue type of outgoing. Critically, to what extent the Victorian Government is able to do this may be a decisive factor in determining the outcome of this decision.

The next question is how is this benefit to be used or enjoyed? This can perhaps be the continued and uninterrupted operation of the business. Finally, the means adopted to fund this outgoing or the provision made for it. Presumably this would be a form of non-current and/or current liability that would ultimately be funded through operations. Potentially third-party finance would fund this outgoing but that liability would then ultimately be extinguished presumably through the provision of funds from operations.

Finally, the outgoing should be examined with reference to whether it is necessarily incurred for the purpose of producing assessable income. Should the High Court accept that the statutory obligation gives rise to the outgoing and that this outgoing is referrable to holders of the electricity license in question, it seems reasonable to argue that it would have a sufficient nexus to result in deductibility. Practitioners are reminded that this outcome is based on a number of assumptions and the application of general principles to this case is by no means an authoritative statement of how the High Court will judge this case. The High Court is also privy to more information regarding the facts of the case in question and so practitioners should not accept this outcome without referring to the High Court judgment when it is released.

Conclusion

The question of general deductibility is more difficult than it would first appear. The High Court case in question turns on a specific set of facts and circumstances. Having said this, it is decided with reference to the general principles of deductibility. This means that practitioners with a good understanding of how these principles apply to a given case will be well equipped to advise their clients in a manner that reduces the risk of inadvertently claiming deductions that are not valid in both circumstances similar to this case as well as other circumstances in question.

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Footnotes

1. *SPI Powernet Pty Ltd v Commissioner of Taxation* (2014) 220 FCR 355; [2014] FCAFC 36; BC201402371.
2. *Sun Newspapers Ltd v Federal Commissioner of Taxation* (1938) 61 CLR 337; [1939] ALR 10; (1938) 12 ALJR 411; BC3900038.
3. *Hallstroms Pty Ltd v Federal Commissioner of Taxation* (1946) 72 CLR 634; [1946] ALR 434; (1946) 20 ALJR 277; BC4600017.
4. *Coles Myer Finance Ltd v Federal Commissioner of Taxation* (1993) 176 CLR 640; 25 ATR 95 at 105; 93 ATC 4214 at 4222; BC9303557.

Australian Tax Law
Bulletin

The curious case of Ward, the Commissioner, a little matter of jurisdiction and some manifest absurdity

Craig Meldrum *AUSTRALIAN UNITY PERSONAL FINANCIAL SERVICES LIMITED*

On 23 November 2012, the Commissioner of Taxation issued a notice of assessment of excess non-concessional superannuation contributions tax for the year ended 30 June 2011 to Mr Colin Ward.[1] Mr Ward subsequently applied to the Commissioner for a determination under s 292-465(1) of the Income Tax Assessment Act 1997 (Cth) (ITAA 97) that a specified amount of the non-concessional superannuation contributions for the relevant year be disregarded. The Commissioner decided not to make such a determination. Mr Ward lodged an objection against that decision and the Commissioner subsequently disallowed the objection.

Mr Ward then applied to the Administrative Appeals Tribunal (AAT) for review of the Commissioner's decision to disallow his objection. The AAT was required to determine the preliminary issue of whether it had jurisdiction to review a decision *not* to make a determination under s 292-465.

Background

The "Simpler Super"[2] reforms, which started on 1 July 2007,[3] imposed a new type of reasonable benefit limits (RBL),[4] one that capped the annual level of contributions that could be made to superannuation rather than the total concessionally taxed superannuation benefits that a person could receive during their lifetime.

Following a special "one-off" non-concessional cap of $1 million imposed from budget night[5] on 10 May 2006, the non-concessional cap for the start of "Simpler Super" from 1 July 2007 was set at $150,000 per annum with the ability for those under 65 in the year of contribution to effectively "bring forward" the next two income years to contribute $450,000 in one or more transactions. Concessional caps were initially set at $50,000 and a doubled "transitional" cap of $100,000 was provided for people contributing after turning 50.[6]

The disincentive to exceed the respective caps was through the introduction of a new "excess contributions tax"[7] (ECT). Contributions in excess of the non-concessional cap would be subject to the tax at the top marginal tax rate plus Medicare levy (then 46.5%), called excess non-concessional contributions tax[8] (ENCCT) and contributions in excess of the concessional cap would be subject to penalty tax of 30% plus Medicare levy, called excess concessional contributions tax[9] (ECCT), which, when including the 15% "contributions tax", equated to the same 46.5%.

Prima facie, a tax applied at the top marginal rate plus Medicare levy was fairly straightforward. However, in order to ensure that members could not circumvent the non-concessional cap by making excess concessional contributions, any excess amounts were also counted against the non-concessional cap.[10] This had dire, and in many cases, unintended consequences if the member had already utilised their full non-concessional cap. Where a member had already contributed say $450,000 (utilising the two year "bring forward rule") and in the same income year exceeded their concessional cap, that excess was not only taxed as an excess concessional contribution, but also as an excess non-concessional contribution which could potentially be subject to punitive tax at a rate of 93% and even higher if a tax file number was not quoted on a member's account.

Section 292-465

A measure of protection was afforded by the application of s 292-465[11] which gave the Commissioner discretion to disregard or reallocate contributions to a different financial year. However, and critical to the application of the relief, was that under s 292-465(3)(a), the Commissioner would only make a determination where he/she considered that there were "special circumstances".

The ATO issued a Practice Statement (PS LA 2008/1[12]) that outlined certain narrowly defined special circumstances which could include foreign exchange changes when transferring overseas super, employer contributions being made late and superannuation guarantee contributions (SGC) being made by ATO, and what the Commissioner considered not to be special circumstances such as financial hardship, ignorance of the law, incorrect professional advice and retrospectivity of the law or the adverse effect of legislative changes.

The case at hand

Without diverging into the bevy of AAT and Federal Court cases in which taxpayers tried (often unsuccessfully) to apply for the relief available under s 292-465, it is relevant for the current analysis that under s 14ZZ of the Taxation Administration Act 1953 (Cth), that a person dissatisfied with the Commissioner's objection decision may apply to the Tribunal for a decision if (under s 14ZZ(1)(a)) the decision is a *reviewable objection decision*.

Mr Ward subsequently applied to the Tribunal, relying on s 14ZZ and s 29(1) of the Administrative Appeals Tribunal Act 1975 (Cth), for review of the Commissioner's decision to disallow the objection and during the telephone directions hearing on 13 January 2015, the question arose whether the Tribunal actually had jurisdiction to review that decision.[13]

The Tribunal called for submissions from the parties and chose to decide on the question of the papers, as a preliminary question, whether it did have jurisdiction in relation to Mr Ward's review application.

As the Commissioner had decided not to make a determination under s 292-465(1) in relation to Mr Ward's non-concessional superannuation contributions:[14]

> The jurisdiction question [was] whether that decision was one against which Mr Ward could object under s 292-245. If it was not, then there was no objection for the Commissioner to disallow and, therefore, no "reviewable objection decision" … for [the] Tribunal to review.

In the 2010 decision of *McMennemin v Federal Commissioner of Taxation*,[15] the Tribunal decided it did not have jurisdiction to review a decision of the Commissioner to refuse to make a determination under s 292-465 due to a technical issue that was resolved in November of 2010 when s 292-465(2) was amended and ss 292-465(8) and (9) were inserted by the Superannuation Legislation Amendment Act 2010 (Cth).

Similar to *McMennemin*, but following the 2010 amendments, the question then turned to whether a person could object against the Commissioner's decision not to make a determination under s 292-465. That is, did the 2010 amendments mean that the Commissioner's decision was a decision against which Mr Ward could object? If it wasn't, then there was no objection for the Commissioner to disallow and, therefore, no "reviewable objection decision" which was required for the purposes of s 14ZZ(1) of the Taxation Administration Act for the Tribunal to review.

In the 2014 case of *Hope v Federal Commissioner of Taxation*[16] the Tribunal noted that:[17]

> ... the question arises whether s 292-465(9)(a) permits a person to object against an ECT assessment on the ground of dissatisfaction with the Commissioner's decision to refuse to make a determination. It is clear that it permits an objection to be made on the ground of dissatisfaction with the determination that has been made but, to my mind, it is not at all clear that it allows an objection to be made when the Commissioner has not made a determination at all on the person's application.

A "manifestly absurd" result

Referring back to *Ward v FCT* and quoting directly from para 13:

> Section 292-465(9)(a) … provides that a person may object only "on the ground that you are dissatisfied with a determination that you applied for under this section". The ordinary meaning conveyed by the expression "a determination that you applied for under this section" is a determination in the terms that the person applied for.

The Tribunal noted s 292-465(9)(a) as "manifestly absurd" because (at [13]):

> … a person would never be dissatisfied if the Commissioner made the determination that the person asked for. So, if the words were given their ordinary meaning, the only taxpayers entitled to object could not do so, because they would not be dissatisfied with the outcome, and those who were dissatisfied would not have a right to object despite that dissatisfaction. That would mean that the 2010 amendments, although evidently intended to remedy the outcome in *McMennemin*, had no practical effect.

The Tribunal subsequently relied on s 15AB of the Acts Interpretation Act 1901 (Cth) which allows for the use of extrinsic material in the interpretation of an Act. This came in the form of the explanatory memorandum to the Bill that became the amending Act (Superannuation Legislation Amendment Bill 2010 (Cth)) and included the following in relation to the inserted ss 292-465(8) and (9) of the ITAA 97 (at [16]):[18]

> The Commissioner may include notice of a determination made in a notice of assessment. The amendments also clarify that a person may object to an excess contributions tax assessment on the grounds that they are dissatisfied with the Commissioner's determination or the Commissioner's decision not to make a determination.

And thus, at [17]:

> … it is clear that that provision should be interpreted so as to grant a right to object where a person is dissatisfied with the Commissioner's determination or the Commissioner's decision not to make a determination.

The Tribunal noted the intent of the 2010 amendments but did not fail to mention the "inadvertent" consequences of the drafting, commenting that:[19]

> … Parliament overlooked an eventuality which must be dealt with if the purpose of the 2010 amendments is to be achieved: namely, where a person applies for a determination under s 292-465(1) and is dissatisfied with the outcome.

The Tribunal concluded that the decision to disallow the objection was a "reviewable objection decision" for the purposes of s 14ZZ(1) of the Taxation Administration Act, and the Tribunal did have jurisdiction to review that decision.[20]

Conclusion

The legislative remedies available under s 292-465 have been shown to be incredibly unreliable and impracticable, to say the least. The subsequent amendments to Div 292 of the ITAA 97 (amended by the Tax Laws Amendment (Fairer Taxation of Excess Concessional Contributions) Act 2013 (Cth) which apply to the 2013–14 and later income years to alleviate the punitive treatment of excess contributions) have been a welcome step in the right direction.

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Footnotes

1. *Ward v Commissioner of Taxation (FCT)* [2015] AATA 138; BC201580120.
2. The Tax Laws Amendment (Simplified Superannuation) Act 2007 (Cth) and related legislation received Royal Assent on 15 March 2007. The reforms applied from 1 July 2007. Australian Government Treasury, *Simplified Superannuation Home*, http://simplersuper.treasury.gov.au.
3. Australian Government Treasury, *Simplified Superannuation*, http://simplersuper.treasury.gov.au.
4. Australian Taxation Office, *Reasonable Benefit Limits*, April 2015, www.ato.gov.au.
5. Australian Government, *Budget 2006/07*, April 2012, www.budget.gov.au.
6. Transitional rules (1 July 2007 to 30 June 2012) of the Income Tax (Transitional Provisions) Act 1997, s 292-20.
7. Excess contributions tax defined in ITAA 97, s 995-1.
8. Excess non-concessional contributions tax defined in ITAA 97, s 995-1 and s 292-85, and imposed under the Superannuation (Excess Non-concessional Contributions Tax) Act 2007.
9. Defined in s 292-15 of the Income Tax (Transitional Provisions) Act 1997 and s 4 Superannuation (Excess Concessional Contributions Tax) Act 2007.
10. "The amount of your non-concessional contributions for a financial year [includes] the amount of your excess concessional contributions … for the financial year." See ITAA 97, s 292-90(1)(b). If a superannuation fund member makes excess concessional contributions to superannuation, the gross excess amount was counted toward the non-concessional cap under s 292-20(1)(b) of the ITAA 1997. There was no mechanism to take into consideration the excess concessional tax payable and accordingly if the excess concessional contributions resulted in excess non-concessional contributions, there was the potential for double tax to be paid.
11. ITAA 97, s 292-465.
12. Australian Taxation Office, *Practice Statement Law Administration PS LA 2008/1*, http://law.ato.gov.au.
13. Above, n 1, at [3]–[4].
14. Above, n 1, at [6].
15. *McMennemin v Federal Commissioner of Taxation* [2010] 53 AAR 187; [2010] AATA 573; BC201005405.
16. *Hope v Federal Commissioner of Taxation* [2014] AATA 877.
17. Above, n 16, at [30] per Forgie DP.
18. Also explanatory memorandum, Superannuation Legislation Amendment Bill 2010 [2] (Cth) at [4.32].
19. Above, n 1, at [19].
20. Above, n 1, at [21].

The proposed new AMIT system

Joseph Power *KING & WOOD MALLESONS*

On 9 April 2015, the government released an exposure draft (Exposure Draft) of legislation which will enact a new tax system for a new category of trusts, to be known as "attribution managed investment trusts" or, for those who prefer acronyms, "AMITs". The Exposure Draft proposes a start date for the new tax system of 1 July 2015. As part of the 2015-2016 Budget, however, the government subsequently announced that it will make the 1 July 2015 start date optional and defer the mandatory start date until 1 July 2016.

The proposed new tax system represents a fundamental change to the system of taxing certain managed investment trusts or MITs. (AMITs are a distinct subset of MITs, but more of that later). The new rules are as long awaited as they are significant. Some five and a half years ago, the Board of Taxation (Board) provided its report to the government on its review into the tax arrangements for MITs.[1] On 7 May 2010, the then Labor Government accepted the Board's recommendation to introduce a new tax regime for MITs and, with high hopes for the future, proposed a start date of 1 July 2010. Alas, it was not to be; the start date was deferred three times on its watch. The current government has also been unable to resist the temptation; in May 2014 it deferred the start date until 1 July 2015 and, as noted above, as part of the 2015–16 Budget it has deferred the (mandatory) start date yet again until 1 July 2016.

The Exposure Draft proposes to enact the key recommendation of the Board's report — to substitute an "attribution model" for determining the tax liabilities of certain MITs and their beneficiaries for the existing regime in Div 6 of the Income Tax Assessment Act 1936 (Cth) (1936 Act). The heart of the attribution model is, as its name suggests, the attribution of income and other tax attributes to the beneficiaries of the trust. It is the trustee that will undertake the act of attribution and it is that formal act that will usually dictate the beneficiaries' tax liabilities, rather than, as under Div 6, their present entitlement to trust income. The trustee's act of attribution is regulated in important ways; principally, by requiring the trustee to attribute income and other amounts on a "fair and reasonable basis" in accordance with the trust's constituent documents.

Simple in theory, difficult in practice. The Exposure Draft is not light reading; it is over 100 pp, and the accompanying Explanatory Material runs to 127 pp. The drafters appear to have revelled in the opportunity to invent a swathe of nomenclature. By the author's count, there are 28 new definitions. A sample of some of the new jargon that will ring in your ears as you turn the pages: there are "member components", "determined member components", "members' member components", and "taxable member components" (all of which are or may be different).

Existing MIT regimes

There are currently two separate tax regimes for MITs. The first and earlier regime, introduced in 2008, imposes a final withholding tax on "fund payments" made to foreign resident beneficiaries. Importantly, the MIT withholding tax regime imposes a concessional withholding tax of 15% on fund payments made to beneficiaries resident in "information exchange countries" (currently comprising 60 countries).

The second regime, introduced in 2010, enables MITs to make a choice to treat the disposal of certain assets, known as "covered assets", as being on capital account — that is, as being exclusively subject to the capital gains tax (CGT) regime. Although the MIT capital account regime affects the character of certain receipts of the trust, it does not actually govern the tax liabilities of resident beneficiaries; rather the ordinary taxation of trust rules in Div 6 of the 1936 Act — with all their history and anachronisms — apply.

Key features of Exposure Draft

The changes proposed by the Exposure Draft, extensive and complicated as they are, are broadly divisible into three categories:

1) first, changes that will affect MITs generally — that is, MITs subject to the existing MIT withholding and capital account regimes;
2) second, the introduction of the new attribution system for AMITs; and
3) third, the repeal of Div 6B of the 1936 Act and amendments to Div 6C.

Proposed changes for MITs generally

Consolidation of MIT definition

The current definition of a MIT is located in s 12-400 of Sch 1 of the Taxation Administration Act 1953 (Cth)

(TAA), and it is that definition which the MIT withholding tax regime relies on. The MIT capital account regime broadens the class of eligible MITs for its purposes — it applies to trusts which are MITs under s 12-400, but also some other trusts which do not qualify as MITs under that regime (for example, trusts that have a single beneficiary).

The Exposure Draft will relocate the existing MIT definition in s 12-400 into new Subdiv 275-A of the 1997 Act and will also consolidate it with the provisions in the MIT capital account regime, thereby extending the broader MIT concept in that regime to MITs generally. For example, a trust which does not qualify as a MIT under the current MIT withholding regime because of a particular temporary circumstance outside the trustee's control will qualify under the existing MIT capital account regime where it is fair and reasonable to treat the trust as a MIT. Under the Exposure Draft, the trust would now qualify as a MIT.

The new definition of MIT will also omit one element of the current MIT definition: the requirement that a substantial proportion of the investment activities carried out in relation to the MIT's Australian assets be carried out in Australia. That element will instead form part of the new concept of a "withholding MIT", to which the MIT withholding tax regime will exclusively apply.

As explained below, the upshot is that there will be MITs, withholding MITs (which may or may not be AMITs) and AMITs (which may or may not be withholding MITs).

Broadening of MIT definition

To qualify as a MIT, a trust must satisfy certain widely-held and closely-held tests during the income year. There is an existing concession for start-up trusts, which deems a trust to satisfy those tests in an income year if the trust was formed in the period starting six months before the start of the income year and ending at the end of the income year. The Exposure Draft would extend that period to cover the formation of a trust during the period starting 12 months before the start of the income year.

Where the (direct and indirect) beneficiaries of a MIT include certain qualifying investors (eg complying superannuation funds), those investors are each deemed to represent multiple beneficiaries — specifically, a number equal to their proportionate (direct and indirect) interest in the MIT multiplied by 50. The Exposure Draft would also add two classes of entities to the list of qualifying investors:

1) a foreign life insurance company; and
2) any entity that is directly, or indirectly, a wholly owned subsidiary of one or more qualifying investors.

The amendments to broaden the category of qualifying investors will apply retrospectively from 1 July 2014. (There is currently no provision in the Exposure Draft which addresses the effect of the retrospective application of these amendments on the transitional provisions which accompanied the 2010 amendments to the definition of MIT. Those transitional provisions, broadly, deem trusts which were MITs before the amendments to continue to be MITs for the 2010–11 to 2016–17 income years).

Attribution model for AMITs

What is an AMIT?

A MIT will only qualify as an AMIT if the interests of beneficiaries are "clearly defined" at all times during the income year.[2] There is an additional requirement where the trust is a MIT with one beneficiary — in that case, the sole beneficiary must itself be a MIT.

The interests of beneficiaries will be "clearly defined" if:

- broadly, the amount of taxable income that is attributed to each beneficiary can be worked out on a fair and reasonable basis in accordance with the trust's constituent documents; and
- the right of each beneficiary to the income and capital of the trust cannot be materially diminished through the exercise of a power or right.

Although neither condition requires that the interests of beneficiaries be identical, there are integrity rules which will limit the ability of trustees to attribute income to particular beneficiaries.

The "clearly defined interests" test contains two additional requirements for trusts which are unregistered managed investment schemes under the Corporations Act 2001 (Cth). First, the trust must be under an obligation to treat members who hold interests of the same class equally and members who hold interests of different classes fairly. Second, the trust's constituent documents (including the trust deed) can only be modified, repealed or replaced in certain limited circumstances. These additional requirements reflect the corresponding requirements in the Corporations Act for registered managed investment schemes.

The Commissioner also has discretion to conclude that the members' interests are clearly defined.

Overview of attribution process

The attribution system for taxing beneficiaries and trustees of AMITs represents a radical change to the current system for taxing beneficiaries and trustees under Div 6 of the 1936 Act. Under the attribution system, which will be contained in the new Div 276 of the 1997 Act, the trustee will attribute income and offsets to members on a fair and reasonable basis in accordance with the trust's constituent documents, and any unallocated income will be taxable to the trustee. The amounts attributed to beneficiaries will usually determine their tax liabilities.

The process of attribution under the Exposure Draft is complex but, at its most basic, it depends on the trustee preparing two documents. The first is a document under which the trustee quantifies the "trust component" (new term) of different classes of income and other tax amounts, each class is to be known as a particular "AMIT character" (new term). There are four classes of "AMIT characters" — income, exempt, non-assessable non-exempt (NANE) and offset — and each class, save one, contains multiple specific amounts that fall within that class. (The Commissioner may also specify other AMIT characters).

The sum of all the "trust components" determined by the trustee should equal the AMIT's taxable income calculated on the assumption that the trustee is an Australian resident and liable to pay tax. Under this system, deductions that relate directly to an amount should be deducted against that amount and any other deductions should be allocated "on a reasonable basis".

Think of this first document as one in which the trustee calculates the AMIT's taxable income and divides it into discrete categories, reflecting the various AMIT characters.

The second document is called an "AMIT member annual statement" or "AMMA statement" and, unlike the first, is provided to the beneficiaries. Think of the AMMA statement as the document in which the trustee notifies the beneficiaries of the amounts the trustee has attributed to them.

The amounts attributed to the beneficiaries are also divided according to the various "AMIT characters". The amounts attributed in the AMMA statement are known as "determined member components" of an AMIT character and reflect a beneficiary's share of the "determined trust component" of that character calculated according to two main rules:

- first, the attribution must be calculated "on a fair and reasonable basis in accordance with the constituent documents" of the AMIT; and
- second, the attribution of a particular amount cannot, subject to certain limited exceptions, occur "because of the tax characteristics of the member".

The process of attribution under the Exposure Draft is at times unclear. Consider, for example, the rule against streaming. It is framed as a test which focuses on the results of the attribution: the provision begins "the attribution must … not attribute" rather than the "trustee must not attribute". But the critical phrase, "because of the tax characteristics of the member", implies some kind of a purpose or knowledge test (how can a process, the attribution, attribute an amount *because of* anything?). The precise contours of such a test and its impact on the ability to stream are, however, unclear.

Tax consequences for members

Under the attribution system, the beneficiary will be taken to have derived each "taxable member component" in the beneficiary's own right (rather than as a beneficiary) and in the same circumstances as the AMIT derived that amount. The rule substitutes the beneficiary for the trustee and ensures that the character of the particular amount is preserved. ("Taxable member components" are usually the amounts set out in the AMMA statement, unless the member chooses to object against the trustee's attribution).

There are two main exceptions to this basic rule. First, the attribution rules do not apply to foreign residents where the interest, dividend and royalty withholding tax rules in Div 11A of the 1936 Act apply or where the MIT withholding tax regime applies. Second, the attribution rules do not apply where the member is subject to tax under the taxation of financial arrangement provisions in Div 230.

Additionally, the beneficiary will not be taken to have derived a franked distribution, and attached franking credits, for the purpose of applying the qualified person rules, and it will therefore be necessary to continue to satisfy those rules in determining the trustee's and beneficiaries' entitlement to the franking credits.

Tax consequences for trustees

The trustee is liable to pay tax at the top marginal rate where it does not properly attribute amounts to members. Such discrepancies may arise for individual members (where, for example, a beneficiary has successfully challenged an amount attributed to it) or for members generally (where, for example, the total amounts of a particular class attributed to beneficiaries falls short of the "determined trust component" of that class).

Where amounts are attributed to foreign resident beneficiaries, but the AMIT is not subject to the MIT withholding tax regime, the trustee is taxed on the attributed amounts, though the beneficiary is entitled to a tax credit for the tax paid by the trustee to offset its own liability.

The trustee may also be liable to pay tax under the "unders and overs" regime and the non-arm's length rule, discussed below.

Compulsory regime from 1 July 2016 (and optional from 1 July 2015)

The Board recommended that the new attribution regime be elective. One of the most contentious features of the proposed new AMIT regime is that the government has departed from this recommendation. The Exposure Draft proposes that the new regime apply automatically to any trust which qualifies as an AMIT from 1 July 2015. On 12 May 2015, however, the government announced as part of the 2015-2016 Budget that it would defer the mandatory start date until 1 July 2016 and make the regime optional from 1 July 2015 until 1 July 2016.[3] The deferral of the mandatory start date was prompted by concerns expressed during the public consultation process that the 1 July 2015 start date would not give MITs sufficient time to make amendments to their trust deeds and IT systems to reflect the new regime.

Other features of the attribution model

A short summary of the other main features of the attribution system is below.

The fixed trust dilemma — fixed

One of the most vexed questions for tax advisors is whether a trust is a "fixed trust" — that is, whether the beneficiaries have vested and indefeasible interests in a share of the income and capital of the trust. The relevance of the question is that fixed trusts (and their beneficiaries) enjoy certain tax benefits which non-fixed trusts (and their beneficiaries or objects) do not — for example, they are subject to less demanding trust loss recoupment rules.

The new AMIT regime includes a section which is intended to resolve the quandary by effectively deeming the AMIT to be a "fixed trust".

AMITs within an AMIT

One of the significant features of the AMIT regime is to allow the trustee to make an irrevocable choice to treat separate classes of membership interests in an AMIT as AMITs themselves (s 276-20). Where the election is made, each class will effectively be treated as a separate trust with separate trust property, and the attribution regime will accordingly apply to each separate class (with some limited exceptions).

Unders and overs system

Each year the trustee must determine the trust's income for the year. Sometimes trustees make mistakes in calculating the trust income and sometimes trustees simply don't have enough information to perform the calculations properly. The Exposure Draft adopts the Board's recommendation of introducing a formal "unders and overs" system to correct the tax consequences of these errors. The unders and overs system, at its most basic, allows trustees to correct mistakes in the year in which they discover them rather than in the income year to which they relate.

The unders and overs system follows the basic structure of the attribution system; it is concerned with understatements and overstatements of a particular AMIT character, rather than the net effect on the AMIT's overall net income. Where a trustee discovers in an income year that the amount of a particular AMIT character was understated (an under) or overstated (an over) in an earlier income year, the trustee may choose to adjust the trust component of the AMIT character in the year of discovery, rather than the earlier income year.

Where the understatements in a base year exceed the greater of 5% of the trust components for that year and 4% of the value of the trust's net assets for that year (determined in accordance with accounting principles), the understatements must be increased or "uplifted" in the discovery year by applying the shortfall interest charge. The trustee is also liable to an administrative penalty if the overall shortfall (or excess) exceeds the threshold as a result of the intentional or reckless disregard of the law.

The unders and overs system is not compulsory; trustees may instead seek to correct their errors in earlier years by reissuing AMMA statements to the beneficiaries for those years, whereupon the beneficiaries would be required to amend their assessments for those years.

Cost base adjustments

The Exposure Draft also adopts the Board's recommendation that a beneficiary's cost base in its interest in an AMIT be increased where the beneficiary is taxed on more income than it receives. There is currently only a mechanism to decrease a beneficiary's cost base where the beneficiary is taxed on less income than it receives. In that case, the cost base is reduced by the difference and, if the difference exceeds the cost base, the beneficiary is taxed on the excess.

Under the proposed new system, amounts which the beneficiary has received or has a right to receive, plus the value of any offsets, will reduce the beneficiary's cost base and amounts which are included in the beneficiary's assessable income increase the cost base. Where the net reduction to the cost base is greater than the remaining cost base, a new CGT event (E10) will happen to the beneficiary and will trigger a capital gain for the difference.

The Exposure Draft also contains rules which apply to adjust the beneficiary's cost of its interests in the AMIT where it holds those interests on revenue (not capital) account and to include amounts in the beneficiary's assessable income where any such reductions exceed the existing cost of the interests.

Debt-like interests

The Exposure Draft introduces a concept of a "debt-like AMIT instrument". Debt-like interests in an AMIT are not subject to the attribution rules because they are treated as debt rather than equity. An interest will be debt-like where it satisfies three conditions, including that distributions on the interest are calculated by reference to the amount subscribed but are payable at the trustee's discretion.

Arm's length rule

The Exposure Draft adopts the Board's recommendation to introduce a non-arm's length rule to protect the integrity of the corporate tax base. The core concern which the non-arm's length rule seeks to address is the shifting of profits from an active business to a trust by engaging in non-arm's length activities.

The trustee is liable to pay tax at the top marginal rate on any non-arm's length income when, broadly, the AMIT is a party to a scheme in which the parties are not dealing with each other at arm's length and one of those parties is not an AMIT.

There are several exceptions to the arm's length rule, including returns paid on debt interest where the rate of return does not exceed a rate of return equal to the shortfall interest charge.

A transitional rule will protect non-arm's length income derived before 1 July 2017 from arrangements entered into before the day the Bill is introduced into the House of Representatives.

Adjustments to MIT withholding regime

The Exposure Draft also contains elaborate changes to the MIT withholding tax regime so that it applies properly where the AMIT is subject to those rules. One important change is to enable custodian beneficiaries to elect to transfer their withholding tax liabilities to the AMIT trustee where they have not received payments from the trustee to allow them to discharge those liabilities.

Repeal of Div 6B and amendments to Div 6C

The Exposure Draft will also make concessional amendments to Div 6C of the 1936 Act, which operates to treat certain public trading trusts as companies. To qualify as a public trading trust, the trust must be a "public unit trust". One of the ways in which a unit trust may be a "public unit trust" is if 20% or more of the total money paid or credited by the trustee during the income year was paid or credited to "exempt entities" or entities deemed to be exempt entities. Under Div 6C, complying superannuation funds and certain other funds are deemed to be exempt entities.

Superannuation funds were at one time exempt from tax. Even when they became subject to tax at concessional rates, the inability to claim a refund for franking credits made investment in a unit trust more tax efficient than investment in a company. The rationale for the rule disappeared once the imputation system was amended to allow such entities to claim refunds on any excess franking credits.

Thus, an amendment to Div 6C will provide that such entities which are eligible for a refund of franking credits will be disregarded in applying the 20% test. Accordingly, a trust will not be a public unit trust and therefore taxed as a company merely because such an entity holds more than 20% of interests in the trust.

The Exposure Draft also adopts the Board's recommendation to repeal Div 6B of the 1936 Act.

The new MIT universe

To recap, in the new world:

- there will be MITs, withholding MITs and AMITs;
- withholding MITs and AMITs will each be a distinct and separate subset of MITs;
- MITs will be eligible to make the election in the MIT capital account regime (Div 275-B of the 1997 Act);
- withholding MITs will be subject to the MIT withholding regime (Subdiv 840-M of the 1997 Act and Subdiv 12-H of Sch 1 of the TAA); and
- AMITs will be subject to the AMIT regime (new Div 276 of the 1997 Act).

As noted above, withholding MITs and AMITs are each a discrete subset of MITs. A withholding MIT may be an AMIT, but it won't necessarily be one (ie because the beneficiaries don't have clearly defined rights). The converse is also true; an AMIT may be a withholding MIT, but it won't necessarily be one (eg because its investment management activities are carried out offshore).

For the mathematically inclined, imagine a venn diagram comprising one big circle with the heading "MITs". That circle represents all trusts which are MITs. Inside the big circle are two small circles, which partially overlap; the first smaller circle contains all the withholding MITs, and the second contains all the AMITs. The overlap between the two smaller circles represents those MITs which are both withholding MITs and AMITs. All the trusts in the circle would be able to make the MIT capital account election. Just three circles; six short of Dante's nine.

The author is grateful to Karen Rooke and Andrew Clements for reviewing drafts of this article. The views in this article (as well as any errors) are, of course, the author's own.

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Footnotes

1. Board of Taxation *Review of the tax arrangements applying to managed investment trusts* (August 2009). One member of the Board's working group was the current Commissioner of Taxation.
2. The Government has presumably elected to use the term "attribution managed investment trust" rather than the Board's term "regime managed investment trust" because it better reflects the attribution system on which it centres (and, possibly, because the Board's term would be reduced to an unpleasant acronym, "RMIT").
3. Commonwealth of Australia *Budget Paper No 2: Budget Measures* 2015–16 pp 23–4 (May 2015).

Developments in the role of GST in the quantification of damages

Andrew Sommer *CLAYTON UTZ*

When we consider the difficult areas of goods and services tax (GST), recurrent themes are "supply" and "consideration". One of the many places in which these two areas of difficulty intersect is the quantification of compensation for loss.

The principles for quantification are relatively easy to state. However, partly because of factual complexity and partly because of a lack of clarity in this area, we continue to see the strange treatment of GST becoming a substantive issue in the final stages of the settlement of disputes.

However, running an entire appeal to clarify the GST treatment after settlement had already taken place, takes this to a whole new level. This is what happened in the recent decision of the Victorian Supreme Court, Millington v Waste Wise Environment Pty Ltd.[1] The decision of Croft J in this case revisits some of the important principles from earlier cases and provides new guidance on important aspects — not just for future judicial dispositions of damages disputes but also for practitioners as we seek to structure settlement deeds so that finely balanced negotiations do not fall over because of GST issues.

The facts giving rise to the initial dispute were common enough — Mr Millington was driving a vehicle that collided with a garbage truck operated by Waste Wise due to Mr Millington's failure to stop at a red light. The accident caused significant damage to the garbage truck and in the Melbourne Magistrate's Court, an award of damages was made in Waste Wise's favour. It was the detail of that award which gave rise to the appeal:

- Millington was ordered to pay $49,628.18 to Waste Wise. This amount was calculated to be the GST exclusive amount of the loss and damage suffered by Waste Wise (of $45,459.92) plus GST;
- Waste Wise was ordered to repay $4168.26 to Millington some months later. This of course represented the amount of GST added to the GST exclusive compensation. It was established that Waste Wise was registered for GST purposes and would be entitled to an input tax credit for the acquisitions it made in making good its loss. This aspect of the order seems to have been intended to allow Waste Wise to pay the GST inclusive amount to its service providers, obtain the input tax credit and then pay that amount back to Mr Millington.

On appeal, it was argued that these orders:

- represented a failure to properly apply the "compensatory principle" because Millington should never have been required to pay the GST inclusive amount to Waste Wise; and
- breached the "once-and-for-all" rule for damages as a result of the additional step requiring Waste Wise to pay an amount back to Millington after the input tax credit had been obtained.

There are numerous fascinating elements to this case — the fact that Waste Wise took no part in the proceedings, the role of the *amicus curiae* in clarifying the issues for the court and the fact that the court entertained the appeal at all following resolution of the dispute between the parties.

From a GST perspective, what is important is the interaction of the principles of the GST law with the general legal concepts about the process of settling disputes.

GST and the quantification of loss

As was stated by Croft J:[2]

> In general terms, a court will award compensation for all losses that a plaintiff would not have suffered but for the wrong. Conversely, an injured plaintiff is not entitled to make a profit in an action in tort or contract; in other words, to be awarded damages for a loss never suffered.

Herein lies the difficulty with GST. If, in making good a loss suffered, a party incurs a GST inclusive amount but is entitled to an input tax credit equal to the additional amount paid because of GST, what is the proper measure of that party's loss?

The answer, in the mind of the GST lawyer at least, is obvious: only the GST exclusive cost is loss to such a party. Where an input tax credit is available, it is because the party incurring the cost is carrying on an enterprise and making the acquisition in the course or furtherance of that enterprise. Therefore, GST on inputs — including the remediation of business losses — is not intended to be a "cost" to such a party. The availability of the input tax credit is intended to ensure that the net cost to such a party is exclusive of the amount paid on account of GST.

In considering the quantification of loss for water damage to retail premises, the NSW Court of Appeal stated that:[3]

> … even though the Respondent [the party that suffered the loss] might pay out an amount of GST in connection with the goods and services which it acquired for the purpose of making good the damage to its premises, it would be able to recover that amount back, either in the form of a reduction of the net amount it must remit to the Commissioner … or as a refund. Thus the amount of GST component of any payments it made for making good the premises would not ultimately be a loss that it suffered.

This would neatly accord with the expected view. Less consistent would be the approach taken in a recent decision of the Industrial Court in Queensland where it was held that "cost" should be GST inclusive and the benefit of an input tax credit should be ignored because "there is little difference in concept (for the purposes of this exercise) between an input credit [sic] and a deduction."[4] This view would seem to be at odds with numerous other cases and the analogy with deductions for income tax purposes is, with respect, deeply flawed.

However, once we accept this as a correct principle, there remains the practical matters of how this is to be established and how it should operate.

First, there is the question of evidence regarding the cost of putting the plaintiff in the same position as if the damage had not been suffered. This in turn will depend on the plaintiff's ability to claim input tax credits for the acquisition of restitutionary goods and services. To reach an understanding on this point, the court will need submissions on the operation of the GST law along with evidence of:

- the "entity" to which acquisitions would be attributable (noting that there can be a difference between the plaintiff as a legal person and the "GST entity" to which the acquisitions would be attributable);
- the enterprise status of that entity;
- the relationship between the damaged asset and/or the repairs and the creditable purposes of that entity; and
- whether the acquisition of goods and services in the course of the making of goods were or would be acquisitions of taxable supplies.

In some cases, this may be relatively simple. However, in the cut and thrust of litigation any additional issues can lead to a broadening of the dispute and a disproportionate lengthening of proceedings.

Second, there is the way in which the court handles the cashflow implications of GST. In order to obtain the benefit of the restitutionary goods and services, there will generally need to be a "GST inclusive" payment to the service provider. This means that the plaintiff will need to fund the GST component and may be out of pocket of that amount for some time.

Where the works to be undertaken are considerable, an award of the GST exclusive sum may be inadequate. That is, although the plaintiff is entitled to an input tax credit, they may be unable to fund the additional 10% out of their own funds between the period in which they are contractually obliged to pay for the repair and the period in which they will receive the benefit of an input tax credit for the acquisition of that repair.

Again, presumably, this would be a matter for evidence in the specific case.

In *Millington*, the orders granted at first instance would have addressed this cash flow issue from the plaintiff's perspective. That is, the plaintiff was to be paid the GST inclusive amount — enabling them to pay the GST inclusive sum to the repairers — and given time to obtain the benefit of the input tax credit before being obliged to repay that amount to the defendant. The fact that the defendant bears the cost of funding the GST component over this period is consistent with normal principles of compensation.

However, Croft J found that the "proper application" of the compensatory principle would have been for "an amount of interest [to] be added to the award of damages to compensate for the time value of the damages amount"[5] rather than adopting the "payment/repayment" approach.

GST and the assessment of compensation

The initial assessment of the loss is only the first stage in the analysis. The second stage to be considered is whether the payment by the defendant to the plaintiff will itself give rise to GST consequences. Again, the principle is fairly clear — if payment of an amount awarded by the court will trigger a liability to pay GST, then this should be allowed in the award that is made.

In most cases, there will be no GST payable in connection with a compensatory payment. In Goods and Services Tax Ruling GSTR 2001/4,[6] the Commissioner has long expressed the view that that there will be no relevant connection between a payment and a supply where the payment is "mere compensation" for loss.

In *Peet*,[7] the plaintiff sought payment for work done on a quantum meruit basis. A quantum meruit claim is one based in contract but in circumstances where the amount payable is not determined under an express term of the contract but is a claim for "reasonable remuneration" for work done. Thus, it raises issues of quantification akin to a claim for damages. In that case, Hollingworth J allowed the award to be calculated by reference to the fact that Peet would be liable for GST in connection with amounts payable by Mrs Richmond in accordance with the award. Thus, it was assumed (rightly) that the payment of the amounts claimed would trigger a GST liability for Peet.

As such, Peet needed to be put in funds by the defendant for the amount of GST payable in connection with the award. The orders made in *Peet* involved several stages of compliance: the issuance of a tax invoice, the payment of the GST exclusive amount, and finally the payment of an additional amount on account of GST, following the defendant being provided with documentary proof that the GST had been paid to the Commissioner.

Thus, if a plaintiff can establish that the circumstances of their claim are outside the circumstances in which no GST would be payable, then it would be appropriate for the court to order the plaintiff to pay an additional amount on account of GST. Whereas in *Peet* and other cases in the income tax context a "wait and see" or two-stage order was made, the decision in *Millington* seems to call the validity of doing so into question.

In *Millington*, the two-stage order that was made at first instance that required the payment of the GST inclusive sum first and then a subsequent repayment of the input tax credit, was held to be a breach of the "once-and-for-all" rule.

In the facts of the case, Croft J found that there was simply no need to adopt orders that carried "considerable risk of unnecessary complexity and difficulty".[8] Although Croft J considered the decision in *Peet* and other similar cases in the income tax consequences, no view regarding the correctness of the orders in those cases was offered.

On this view, an award that required a ruling or further advice to be obtained in order to properly identify the GST consequences of the payment would only be permissible where there was significant uncertainty that merited departing from the "once-and-for-all" rule in the particular case.

Conclusion

It remains critically important to prepare evidence at the initial stages of a dispute regarding the GST status of amounts expended in making good a loss and the GST consequences of amounts received as compensation for that loss. This evidence, combined with clear and concise explanations of the operation of the GST law will assist the court in making the appropriate orders with the requisite degree of certainty without having to resort to complex multi-staged orders. Such evidence will also prove to be essential on appeal — should you and your client be unlucky enough to need it.

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Footnotes

1. *Millington v Waste Wise Environment Pty Ltd* [2015] VSC 167; BC201503150.
2. Above, n 1, at [26], quoting *Wertheim v Chicoutimi Pulp Co* [1911] AC 301 at 307–8; [1908] All ER Rep 707.
3. *Gagner Pty Ltd t/as Indochine Café v Canturi Corp Pty Ltd* (2009) 262 ALR 691; 236 FLR 401; [2009] NSWCA 413; BC200911626 at [147].
4. *Australian Pacific LNG Pty Ltd v Building and Construction Industry (Portable Long Service Leave) Authority* [2015] ICQ 013 at [59] per Martin J.
5. Above, n 1, at [37].
6. GSTR 2001/4: Goods and Services Tax: GST consequences of court orders and out-of-court settlements.
7. *Peet Ltd v Richmond (No 2)* (2009) 76 ATR 644; [2009] VSC 585; BC200911394.
8. Above, n 1, at [61].

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