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Taxation *in* Australia

SMSF succession planning, BDBNs, and more
Daniel Butler, CTA

Proper management of a trust: lessons from Owies
Norman Hanna

Contents

Cover article

559

SMSF succession planning, BDBNs, and more

Daniel Butler, CTA, Director, DBA Lawyers

Feature article

568

Proper management of a trust: lessons from Owies

Norman Hanna, Barrister, Deane Chambers

Insights from the Institute

534 President's Report

535 CEO's Report

536 Senior Tax Counsel's Report

Regular columns

533 Tax News – at a glance

538 Tax News – the details

543 Tax Tips

549 Mid Market Focus

557 Higher Education

575 A Matter of Trusts

577 Events Calendar

578 Cumulative Index

Invitation to write

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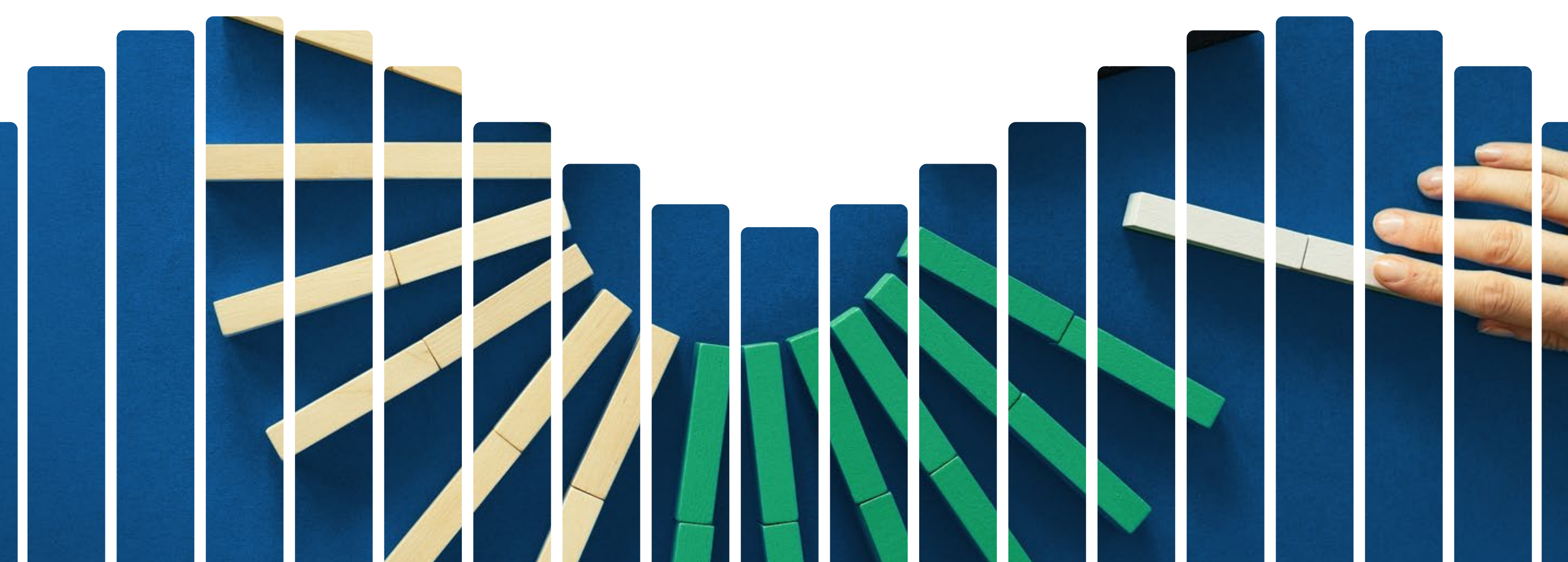

Tax News – at a glance

by TaxCounsel Pty Ltd

April – what happened in tax?

The following points highlight important federal tax developments that occurred during April 2024. A selection of the developments is considered in more detail in the "Tax News – the details" column on page 538 (at the item number indicated).

Minimum tax for multinationals

In a joint media release on 21 March 2024 with the Assistant Minister for Competition, Charities and Treasury and the Assistant Minister for Employment, the Treasurer announced the release of exposure draft legislation, explanatory material and a discussion paper in relation to the implementation of a global and domestic minimum corporate tax rate of 15%. **See item 1.**

Penalty unit increase

An amending Bill (the Crimes and Other Legislation Amendment (Omnibus No. 1) Bill 2024), which was introduced into parliament on 27 March 2024, contains amendments that will amend the *Crimes Act 1914* (Cth) to increase the Commonwealth penalty unit amount from $313 to $330, with effect in relation to offences committed on or after 1 July 2024. **See item 2.**

FBT: statutory or benchmark interest rate

The statutory or benchmark interest rate for the FBT year ending 31 March 2025 is 8.77%. **See item 3.**

FBT: cents per kilometre

The Commissioner has released a determination that sets out the rates to be applied on a cents per kilometre basis for calculating the taxable value of a fringe benefit arising from the private use of a motor vehicle other than a car for the FBT year commencing 1 April 2024 (TD 2024/1). **See item 4.**

FBT: LAFHA reasonable amounts

The Commissioner has released a determination that sets out the amounts that he considers reasonable under s 31G of the *Fringe Benefits Tax Assessment Act 1986* (Cth) (FBTAA86) for food and drink expenses incurred by employees receiving a living-away-from-home allowance (LAFHA) fringe benefit for the FBT year commencing 1 April 2024 (TD 2024/2). **See item 5.**

FBT: record-keeping exemption

The exemption threshold under s 135C FBTAA86 for the FBT year ending 31 March 2025 is $10,334. **See item 6.**

FBT determinations: adequate alternative records

Legislative instruments have been made as to what will constitute adequate alternative records to employee declarations in respect of fringe benefits for a range of specific purposes, applicable for FBT years ending 31 March 2025 and beyond. **See item 7.**

Decision impact statement: Bowerman case

The Commissioner has released a decision impact statement in relation to the decision of the AAT in *Bowerman and FCT* [2023] AATA 3547. **See item 8.**

Hybrid mismatch rules

The Commissioner has released a draft determination that sets out the ATO view on two separate but related issues that arise under the hybrid mismatch rules in Div 832 of the *Income Tax Assessment Act 1997* (Cth) which are designed to prevent multinational corporations from exploiting differences in the tax treatment of an entity or instrument under the laws of two or more tax jurisdictions (TD 2024/D1). **See item 9.**

FBT: otherwise deductible rule

In a joint judgment, the Full Federal Court (Derrington, Downes and Hespe JJ) has dismissed an appeal by the taxpayer from a decision of Logan J at first instance that the "taxable value" of certain "residual fringe benefits" in the form of travel arranged and paid for by the taxpayer employer for its employees was not reduced to nil by reason of the "otherwise deductible rule" provided for by s 52(1) FBTAA86 (*Bechtel Australia Pty Ltd v FCT* [2024] FCAFC 33). **See item 10.**

Director penalty: summary judgment

The Queensland Supreme Court (Martin SJA) has rejected a company director's defence to an application by the Commissioner for summary judgment in proceedings brought against the director under the director penalty regime in respect of amounts that had not been remitted to the Commissioner under the PAYG provisions of the *Taxation Administration Act 1953* (Cth) (*DCT v Gerhard Horst Heinrich* [2024] QSC 51). **See item 11.**

President's Report

by Todd Want, CTA

Stay ahead of the upcoming Federal Budget

President Todd Want discusses the Federal Budget 2024–25 and what resources members can expect from our team.

The 2024–25 Federal Budget will be handed down this month and, as always, our team is working hard to ensure that we provide analysis and insights on the announced measures as early as possible.

This year, make sure you register for our member-only webinars. There will be a Reflection Panel on 15 May to share our initial impressions and opinions about the Budget measures, followed by a more in-depth Insights and Analysis session on 16 May, further breaking down some of the key announcements and the implications for you and your clients.

Look out also for our annual Federal Budget report which will hit your inboxes early on the morning of 15 May. Our Tax Policy and Advocacy team, which plays such an integral role in delivering all of our members benefits, works hard to produce this report in order to get you quickly up to date on announced measures and what they mean.

If you have already read our pre-Federal Budget submission this year, you'll know that we continue to call for meaningful and genuine reform in the Australian tax system. Factors such as higher inflation and the burden of rising living costs have introduced additional uncertainty into our economy. For tax professionals, this is compounded by the shortage of skilled professionals working in the field, and various changes to our tax and superannuation system (not all of which have yet been enacted).

These changes of themselves don't constitute meaningful reform – and in fact often only add more complexity and compliance time. Our current tax and superannuation system is not suitable to support our people and economy during future challenges. While sweeping and holistic reform is needed, some of the key areas (among many worthy considerations) that we are hoping to see come out of this Federal Budget include the following:

1. Consideration of the concept of "worker" to replace the existing concepts of "employee" and "contractor". Focus on the meaning of "employee" has been in the spotlight this year, making the Federal Budget an opportune time to re-examine its definition across the tax and superannuation landscapes.

A harmonised definition across federal and state or territory Acts can reduce the existing complexity, promote certainty for taxpayers, and lessen the compliance burden. This is especially important in the context of the past few years, as the sharing or "gig" economy introduced further complexity to tax compliance in a dated system. A broad definition of a "worker" that includes employees, contractors, and those in non-traditional work relationships would simplify our system, both for those workers and the tax professionals supporting them.

2. Inefficient taxes such as FBT. Fringe benefits tax is often held up as the flagship "inefficient tax" – and for good reason. FBT accounts for less than 1% of Australia's net cash collections, has one of the consistently highest tax gaps, and incurs significant administrative work, far out of balance with the benefits it brings.

We advocate for the existing FBT regime to be abolished and replaced with a principled approach in line with recommendation 112 of the Henry review. This would not only reduce red tape and administrative burden, but also assist with consistent interpretation of policy and law in this area.

3. Simplification of superannuation caps, thresholds and concessions. Complexity also leads to adverse outcomes for taxpayers, not because of an intention to avoid paying their fair share of tax, but because it is confusing. The complex overlay of caps, thresholds and concessions in the superannuation system can be tricky, even for professionals at times. More consistent and simple rules around superannuation caps, thresholds and concessions would help to increase compliance in this regard.

These are just three of the numerous areas that we hope to see addressed in the Federal Budget announcement. I encourage you to read the pre-Federal Budget submission in full.

In the hours and days after the Budget is handed down, we want to ensure that we provide you – the expert in your field – with the resources and insights you need to ensure that you can stay at the top of your game, and have informed conversations on how the measures will impact you and your clients.

So, please keep an eye out for our Budget coverage, bring your questions along to the webinars, and remember we are here to support you.

CEO's Report

by Scott Treatt, CTA

The role of advocacy at the Institute

CEO Scott Treatt reflects on the role of the Tax Policy and Advocacy team in serving our members.

As you know, before taking up the role of CEO at the Institute, I headed up the Tax Policy and Advocacy (TPA) team. The advocacy role that the Institute plays for our members is close to my heart, not only because I led the formation of a newly strengthened TPA team, but also because I recognise the far-reaching impacts that it can have for members and the tax profession in general.

Our TPA team: keeps members informed about the latest tax news and developments; promotes the sharing of knowledge and networking opportunities through our various committees; engages with our expert members in the field to provide appropriate guidance; and assists members with queries regarding tax policy or administrative processes and, where appropriate, can escalate matters to the ATO on members' behalf. The team also amplifies member voices on policy matters to key government agencies, including the Treasury, the ATO, the Board of Taxation, the Inspector-General of Taxation and Taxation Ombudsman, the Tax Practitioners Board, and other key stakeholders.

The TPA team's primary role is to educate and advocate by being an intermediary connecting our members with key government stakeholders. We are convinced that the collective impact of our considered representations on behalf of members has a greater impact on effecting change than individual voices expressing concerns.

The TPA team oversees and works with our eight national technical committees (Dispute Resolution, FBT & Employment Taxes, GST, Large Business & International, Not-For-Profit, SME, Superannuation, and Taxation of Individuals), and six state taxes committees. Each of these committees meets six times per year.

The primary objective of the national technical committees and state taxes committees is to support The Tax Institute and the TPA team in their policy and advocacy efforts by representing members in raising their concerns. Around 150 members volunteer for these committees, and the commitment and effort of these members are instrumental in us being able to undertake our advocacy activities.

The TPA team also has carriage of the six state councils, involving (currently) 73 members. The councils each meet, generally, nine times per year. All secretariat services for these committees and councils are undertaken by the TPA team.

All up, this involves coordinating over 130 meetings each year, preparing minutes/action lists and agendas, and seeking feedback on key matters and technical positions.

Drawing on the specialised expertise of our members, the committees delve into intricate tax matters, offer expert analysis and recommendations, and provide insights that assist in the preparation of our submissions.

Involvement in crucial stakeholder consultations is a priority for us, with 23 submissions made in 2023 across various policy areas, such as GST, international tax, FBT, and the small business sector. As at the end of March 2024, we have already lodged around 30 submissions, including the significant Treasury consultation on the reforms to the *Tax Agent Services Act 2009* and the ATO's draft ruling on software royalties.

Some other highlights include that the Institute:

- has prepared submissions to the Treasury as part of the consultation on the Pillar Two rules. Several legislative and administrative measures, including franked distribution and capital raisings, thin capitalisation, and public country-by-country reporting, have undergone positive transformations as a result of our successful submissions;
- continues to be involved in targeted consultation on payday superannuation;
- has advocated for nearly two years for improvements to the client–agent linking process (CAL) which is currently the cause of much angst among our members (see TaxVine edition 11, dated 5 April 2024, for our interview with ATO Deputy Commissioner, Andrew Watson, on CAL); and
- proactively engages in self-initiated submissions by utilising our specialised working groups, committees and membership to exert influence on significant tax policy matters that have a broader scope of impact. For example, we are currently working with our members to prepare a submission on the harmonisation of payroll tax issues.

On top of this, the TPA team and our committee Chairs contribute articles that canvass the recent tax updates and advocacy issues within their sights. This includes the widely-read, weekly *TaxVine* newsletter, this journal, technical content for the Federal Budget report, and the Tax Time checklists for the benefit of our members.

Members have exclusive access to our free webinars and can access content on a range of topics including Div 7A, the main residence exemption, trust fundamentals, capital allowances, aggregated turnover, year end issues, s 100A and s 99B. These webinars are produced by our TPA team and committees, and you can expect to see more of them in the future as we work to further increase the value provided to you as a member.

Senior Tax Counsel's Report

by Julie Abdalla, FTI

Better targeting Div 296

Good tax and superannuation policy takes time to develop. It is important to ensure that consideration is given to future impacts, and whether opportunities exist to address related issues.

New Div 296 is proposed to be inserted into the *Income Tax Assessment Act 1997* (Cth) by Sch 1 to Sch 3 to the Treasury Laws Amendment (Better Targeted Superannuation Concessions and Other Measures) Bill 2023 (the Bill). The proposed amendments give effect to the government's announcement on 28 February 2023 to introduce an additional 15% tax on the earnings attributable to superannuation balances above $3m. The Bill is currently before the Senate Economics Legislation Committee (the Committee) for inquiry, with the report due on 10 May 2024.

The proposed measure is a prime example of the need for detailed and meaningful consultation, and consideration of the future implications of new ideas. The proposed design of the new tax risks adding to existing complexity, creating unfair outcomes, and setting dangerous precedents for the future. Discussed below are some key aspects of the design of Div 296 and some alternatives that should be adopted.

Taxation of unrealised gains

The underlying design of Div 296 will tax unrealised gains. As detailed in our submission to the Committee, along with the evidence that I provided at the recent public hearing for the inquiry, The Tax Institute does not support taxing unrealised gains. Doing so is contrary to the basic premise of our taxation system, and any perceived economic benefits will be outweighed by the practical impact on taxpayers. Taxing unrealised gains is likely to place significant pressure on superannuants due to the mismatch in cash flow between the funds from the disposal of the asset and the taxing of the unrealised gain. It can also result in permanent effects through taxing an amount that may never be realised. This is inherently unfair.

Alternative approaches have been suggested but have not been adopted so far. Page 196 onwards in the explanatory memorandum to the Bill notes that three other options were considered but not agreed to due to increased compliance costs for the administrator and concerns about the most accurate methodology.

On balance, it appears that increased resources for the Commissioner to appropriately manage the issues, or perceived lower accuracy, may have resulted in the government choosing to implement the original design. More time should have been spent considering alternatives in a public forum to ensure that a more appropriate solution could be designed.

Mitigating the impact

If the government intends to proceed with taxing unrealised gains, it is essential that the approach is confined to Div 296 and does not set a precedent more broadly across the tax and superannuation system. Steps should also be taken to minimise the impact of the mismatch in cash flow. These include incorporating:

- a loss carry-back mechanism to allow taxpayers to recognise losses in a timely manner, removing the risk of taxpayers being unable to utilise carry forward losses; and
- a payment deferral mechanism to allow taxpayers to repay Div 296 debts in a later year when their cash flow better matches their taxation liability.

Indexation of the $3m threshold

The announcement of the measure noted that Div 296 was expected to apply to approximately 80,000 people (or 0.5% of Australians). However, the $3m threshold is not proposed to be indexed or subject to regular review. If the threshold is not indexed or adjusted in line with inflationary movements, Div 296 will suffer from bracket creep, impacting more taxpayers over time than was originally intended when the measure was announced. This would seem contrary to the policy intent of making our "superannuation system more sustainable and fairer with one modest change that affects less than 0.5% of all Australians".

The proposed design of Div 296 represents a missed opportunity to simplify the complex system of rates and thresholds prevalent in the superannuation framework. As noted in our *Case for Change 2021*, the transfer balance cap (TBC) — a key threshold — would benefit most from simplification. An opportunity exists to simplify the TBC and align it with the Div 296 threshold once it reaches $3m. This could indicate a clear policy regarding what the government considers to be a high superannuation balance and provide a clearer delineation for taxpayers to understand.

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Tax News – the details

by TaxCounsel Pty Ltd

April – what happened in tax?

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

Government initiatives

1. Minimum tax for multinationals

In a joint media release on 21 March 2024 with the Assistant Minister for Competition, Charities and Treasury and the Assistant Minister for Employment, the Treasurer announced the release of exposure draft legislation, explanatory material and a discussion paper in relation to the implementation of a global and domestic minimum corporate tax rate of 15%.

In the 2023–24 Budget, the government announced that it would introduce a 15% global minimum tax and domestic minimum tax for multinational companies with an annual global revenue of at least €750m (approximately A$1.2b). The core rules are to apply for fiscal years beginning after 1 January 2024.

The media release states that minimum taxes are a key part of a coordinated global approach by the OECD to put a floor on tax competition and establish a fairer domestic and international tax system. The proposed legislation will ensure that Australia will be among the lead jurisdictions implementing global and domestic minimum taxes as a key part of the OECD/G20 Two-Pillar Solution that was agreed in 2021.

The exposure draft legislation (which includes draft primary legislation, subordinate legislation in the form of rules, and accompanying explanatory materials) builds on legislation recently passed by parliament that aims at stopping multinationals claiming excessive debt deductions to wipe out or reduce tax in Australia and increasing transparency. This legislation is the *Treasury Laws Amendment (Making Multinationals Pay Their Fair Share – Integrity and Transparency) Act 2023* which was passed by parliament on 27 March 2024 and received royal assent and became law on 8 April 2024.

2. Penalty unit increase

An amending Bill (the Crimes and Other Legislation Amendment (Omnibus No. 1) Bill 2024), which was introduced into parliament on 27 March 2024, contains amendments that will amend the *Crimes Act 1914* (Cth) to increase the Commonwealth penalty unit amount from $313 to $330, with effect in relation to offences committed on or after 1 July 2024.

Penalty units are used to describe the amount payable for monetary penalties imposed for criminal offences in Commonwealth legislation and territory ordinances. The penalty unit mechanism allows for the maximum monetary penalty for all offences under Commonwealth legislation, including territory ordinances, to be automatically adjusted with a single amendment to s 4AA of the *Crimes Act 1914*. This removes the need for multiple legislative amendments and ensures that monetary penalties in Commonwealth legislation and territory ordinances remain comparable.

The explanatory memorandum to the amending Bill states that maintaining the value of the penalty unit over time ensures that financial penalties for Commonwealth offences reflect community expectations and continue to remain effective in deterring unlawful behaviour.

In 2015, the *Crimes Act 1914* was amended to provide for the automatic Consumer Price Index adjustment of penalty units every three years. The three-yearly indexation cycle will continue as usual, with the next indexation increase to occur on 1 July 2026.

The Commissioner's perspective

3. FBT: statutory or benchmark interest rate

The statutory or benchmark interest rate for the FBT year ending 31 March 2025 is 8.77%.

The rate of 8.77% is used to calculate the taxable value of:

- a fringe benefit provided by way of a loan; and
- a car fringe benefit where an employer chooses to value the benefit using the operating cost method.

FBT does not apply to a loan in relation to a shareholder in a private company, or an associate of such a shareholder, that causes (or will cause) the private company to be taken under Div 7A of the *Income Tax Assessment Act 1936* (Cth) (ITAA36) to pay the shareholder or associate a dividend.

4. FBT: cents per kilometre

The Commissioner has released a determination that sets out the rates to be applied on a cents per kilometre basis for calculating the taxable value of a fringe benefit arising from the private use of a motor vehicle other than a car for the FBT year commencing 1 April 2024 (TD 2024/1).

The rates are:

Engine capacity	Rate per kilometre
0 – 2500cc	66 cents
Over 2500cc	77 cents
Motorcycles	19 cents

5. FBT: LAFHA reasonable amounts

The Commissioner has released a determination that sets out the amounts that he considers reasonable under

s 31G of the *Fringe Benefits Tax Assessment Act 1986* (Cth) (FBTAA86) for food and drink expenses incurred by employees receiving a living-away-from-home allowance (LAFHA) fringe benefit for the FBT year commencing 1 April 2024 (TD 2024/2).

Where the total of food and drink expenses for an employee (including eligible family members) does not exceed the amount that the Commissioner considers reasonable, those expenses do not have to be substantiated under s 31G FBTAA86. Where an employee receives a LAFHA fringe benefit with a component for food and drink expenses, for the employer to reduce the taxable value of the fringe benefit by the exempt food component, the expenses must be either:

- equal to or less than the amount that the Commissioner considers reasonable; or
- substantiated.

If the total of an employee's food or drink expenses exceeds the amount that the Commissioner considers reasonable, the substantiation provisions will apply.

TD 2024/2 sets out the amounts that the Commissioner considers reasonable for food and drink within Australia and overseas.

6. FBT: record-keeping exemption

The exemption threshold under s 135C FBTAA86 for the FBT year ending 31 March 2025 is $10,334.

Two conditions must be satisfied for the record-keeping exemption arrangements to apply to an employer for an FBT year. These are:

1. a base year needs to be established; and
2. during the FBT year immediately before the current year, the employer has not received a notice from the Commissioner requiring the employer to resume record-keeping.

Section 135C FBTAA86 sets out a number of conditions that must be met before an FBT year is a base year of an employer. One of the conditions is that the employer's aggregate fringe benefits amount in the base year does not exceed the exemption threshold.

7. FBT determinations: adequate alternative records

Legislative instruments have been made as to what will constitute adequate alternative records to employee declarations in respect of fringe benefits for a range of specific purposes, applicable for FBT years ending 31 March 2025 and beyond.

Broadly, alternative records are required to be written in English and contain the information specified in the applicable instrument.

The legislative instruments that have been made relate to the following fringe benefits:

- temporary accommodation relating to relocation;
- the private use of vehicles other than cars;
- fly-in fly-out and drive-in drive-out employees;
- car travel to an employment interview or selection test;
- car travel to certain work-related activities;
- relocation transport reimbursed on a cents per kilometre basis;
- "otherwise deductible" benefits;
- overseas employment holiday transport reimbursed on a cents per kilometre basis;
- travel diaries;
- living-away-from-home benefits; and
- remote area holiday transport on a cents per kilometre basis.

8. Decision impact statement: Bowerman case

The Commissioner has released a decision impact statement in relation to the decision of the AAT in *Bowerman and FCT*.[1]

In that case, the AAT held that the taxpayer was entitled to a general deduction under s 8-1 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) for the loss she made on the sale of an apartment that she used as her home as she had, on the evidence, acquired it with the purpose of making a profit in a commercial manner and the loss was not in the circumstances of a private or domestic nature.

The sale of the home occurred under a contract that was entered into in the 2020 income year but was not completed until the 2021 income year. The AAT held that, although the loss was incurred for the purposes of s 8-1 ITAA97 in the 2021 income year, the Commissioner's binding public ruling TR 97/7 meant that the taxpayer could claim the deduction in the 2020 income year.

The Commissioner's decision impact statement makes the following points:

1. the AAT's finely balanced conclusion in respect of the issue of whether the transaction was on capital or revenue account was open on the particular facts of the case and was an available application of the established *Myer Emporium*[2] principles;
2. the unusual factual findings in the *Bowerman* case would limit the application of the AAT's decision in future cases;
3. the Commissioner considers that the AAT's reasons regarding the non-operation of s 8-1(2)(b) ITAA97 (loss or outgoing of a private or domestic nature) were informed by its finding that the taxpayer's most significant reason for acquiring and selling the apartment was her profit-making purpose; and
4. the Commissioner agrees with the AAT's observation that existing authority supports the conclusion that the taxpayer did not "incur" the loss until the contract of sale of the property was completed and that her loss was necessarily only realised on the receipt of the proceeds of settlement. The Commissioner takes a different view to the AAT as to the interpretation of TR 97/7 and is considering whether to update TR 97/7 to

remove any perceived ambiguity or uncertainty as to its interpretation.

9. Hybrid mismatch rules

The Commissioner has released a draft determination that sets out the ATO view on two separate but related issues that arise under the hybrid mismatch rules in Div 832 ITAA97 which are designed to prevent multinational corporations from exploiting differences in the tax treatment of an entity or instrument under the laws of two or more tax jurisdictions (TD 2024/D1).

The two issues are:

1. whether hypothetical income or profits within the tax base of a country can be used to identify a "liable entity" or entities in the country for the purposes of s 832-325 ITAA97; and
2. whether a "non-including country" for the purposes of s 832-320(3) ITAA97 of the "hybrid payer" definition can be a jurisdiction other than the country where the payee of the relevant payment is located or resides.

TD 2024/D1 states that identification of a "liable entity" or entities in a country in respect of income or profits for the purposes of s 832-325 ITAA97 can be based wholly on hypothetical income or profits within the tax base of the country. This will be necessary where, for example:

- an entity has not actually derived any income or profits in a particular period; or
- an entity has derived income or profits in a particular period, but no part of those income or profits are within the tax base of the country.

For the purposes of s 832-320(3) ITAA97, a non-including country can be a jurisdiction other than the country where the payee of the relevant payment is located or resides. Therefore, the laws of a jurisdiction other than the country where the payee is located or resides may fall for consideration when determining whether there is a hybrid payer within the meaning given by s 832-320 ITAA97.

Recent case decisions

10. FBT: otherwise deductible rule

In a joint judgment, the Full Federal Court (Derrington, Downes and Hespe JJ) has dismissed an appeal by the taxpayer from a decision of Logan J at first instance that the "taxable value" of certain "residual fringe benefits" in the form of travel arranged and paid for by the taxpayer employer for its employees was not reduced to nil by reason of the "otherwise deductible rule" provided for by s 52(1) FBTAA86 (*Bechtel Australia Pty Ltd v FCT*[3]).

In keeping with the business worldwide of the Bechtel group of companies, the taxpayer employer carried on a business in Australia of providing contracting services in respect of large-scale construction projects. Such services included engineering, procurement, construction and project management services and design and build services.

One such project entailed the performance of engineering, procurement and construction contracts awarded to the taxpayer employer for the liquefied natural gas (LNG) projects on Curtis Island (the Curtis Island projects). The Curtis Island projects entailed the construction of three large LNG plants and related facilities on Curtis Island. Curtis Island is situated near Gladstone in Central Queensland. There were no bridges to Curtis Island. It was thus accessible only by sea or air. A ferry service operated between Curtis Island and the nearby mainland.

The travel expenses incurred by the taxpayer employer related to "field non-manual fly-in fly-out" (FNM FIFO) employees to take them:

- from the high-capacity airport nearest to the employee's point of origin location to Gladstone Airport; and
- from Gladstone Airport to the point of origin.

That is, the travel expenses in issue concerned travel booked as a return trip from and to Curtis Island. Each of these trips was typically organised and paid for by the taxpayer employer. The taxpayer employer also organised, and paid for, bus transport from or to Gladstone Airport, to or from the ferry terminal, and for ferry transfers to and from the ferry terminal to Curtis Island.

Australian national FNM FIFO employees were rostered on for shifts (or "swings") on the Curtis Island projects, which commenced at the project location for a number of weeks (generally four), and then rostered off for one week (assignment leave).

International FNM FIFO employees were rostered on for shifts of longer duration. They were entitled to:

- during each 12-month period, assignment leave after three, six and nine months; and
- home leave after 12 months.

International FNM FIFO employees were paid for travel days. On rostered days off outside of assignment leave or home leave, international FNM FIFO employees spent their time in or around Gladstone.

Clauses 4.1 and 4.2 of the taxpayer employer's "Travel Procedure CSO Curtis Island LNG Projects" provided:

> "4.1 Assignment Leave – National: This travel is related to the rest and recreation roster time off from the Project that national non-local employees are entitled to take after working their approved roster cycle at the Project.
>
> …
>
> 4.2 International Project Leave
>
> A) Assignment Leave – International: Assignment leave term for international employees refers to the entitlement to fly home for a rest and recreation period as applicable to their assignment conditions …
>
> B) Home Leave – International: Home leave for international employees refers to the annual

> leave that family or accompanied status employees are entitled to …"

Travel schedules for assignment leave (for Australian national and international FNM FIFO employees) and home leave (for international FNM FIFO employees) were typically generated and managed by the taxpayer employer's in-house Central Services Organisation Transport Department, including booking flights to each employee's point of origin airport. Once made, such bookings could only be altered with managerial approval.

The taxpayer employer organised travel arrangements from an employee's point of origin to Curtis Island so that employees arrived at the Curtis Island projects sites in time to commence their shifts, allowing time to check in to their temporary accommodation.

Travel from Curtis Island to an employee's point of origin usually commenced on the last day of a swing. Employees performed their duties at the project site for part of the day but were also given time to pack their belongings at their temporary accommodation, check out, and commence return travel, although they were paid for a full day. Employees required approval from their project manager or director if they wanted their travel arrangements altered to fly to a location different from their point of origin.

In affirming the decision of Logan J that the taxable value of the residual fringe benefit constituted by the travel arranged by the taxpayer employer was not reduced by the otherwise deductible rule in s 52 FBTAA86, the Full Court said that it was common ground that it was the general deduction provision (s 8-1 ITAA97) that was the relevant section when considering whether the travel expenses, had they been incurred by the employees, would have been deductible.

The Full Court said that it had long been established that the expenses of travelling from home to work or business and back again were not deductible. In the context of travel expenses, the essential character of expenditure is not determined by reasoning which asserts that "because expenditure on fares from a taxpayer's residence to his place of employment or place of business is necessary if assessable income is to be derived, such expenditure must be regarded as 'incidental and relevant' to the derivation of such income". To say that expenditure is a prerequisite to the earning of income is not to say that such expenditure is incurred in, or in the course of, gaining or producing the employee's income; rather, such expenditure is a consequence of living in one place and working in another.

Employee expenditure on travel will be incurred in gaining or producing assessable income where the travel occurs in the course of performing employment duties. By contrast, expenditure incurred before an employee commences, or after they cease, to perform their employment duties is not incurred in gaining or producing assessable income.

The Full Court said that the question was determined by identifying the point at which an employee commences or ceases to perform their employment duties. In the present case, by the terms of employment, each employee was assigned to work at Curtis Island. It was at Curtis Island that each employee performed their employment duties.

11. Director penalty: summary judgment

The Queensland Supreme Court (Martin SJA) has rejected a company director's defence to an application by the Commissioner for summary judgment in proceedings brought against the director under the director penalty regime in respect of amounts that had not been remitted to the Commissioner under the PAYG provisions of the *Taxation Administration Act 1953* (TAA53) (Cth) (*DCT v Gerhard Horst Heinrich*[4]).

The TAA53 imposes an obligation on a director of a company to cause the company to comply with its PAYG withholding and remittance obligations. A default by the company potentially triggers the operation of the director penalty regime. That regime provides, among other things, for the imposition of penalties on the directors of companies which do not meet their obligations to pay withheld amounts to the Commissioner. Ordinarily, the penalty will be the same as the outstanding PAYG withholding obligation.

In the present case, the director resisted the Commissioner's application for summary judgment against him on the following two bases:

1. that the tax-related liabilities had been compromised; or
2. that he had a defence under s 269-35(2), Sch 1 TAA53 because:
    a. he took all reasonable steps to ensure that the amount was paid; or
    b. there were no reasonable steps that he could have taken to ensure that the company complied with its obligations.

As to (1) above, in mid-2021, the director negotiated with the Commissioner about the payment of tax owed by the Heinrich group of companies (of which the company was a member). The director's argument was that the result of the negotiation and his conduct was that there was an agreement reached and it effected an accord and satisfaction such that the Commissioner had accepted the promises set out in the agreement in satisfaction of the company's obligations.

In rejecting this argument, Martin SJA said that the agreement with the Commissioner contained a condition that the failure to comply with its requirements would allow the Commissioner to proceed with recovery action. This condition rendered the agreement an accord executory and made it clear that the Commissioner reserved his rights to pursue the parties to the agreement should the conditions in the agreement not be met. It was not a case in which the Commissioner merely accepted the promises made in discharge of the liability.

There was an undertaking in the agreement not to further encumber certain properties, or deal with them in a manner that would diminish their value. This undertaking was breached. In a letter dated 9 March 2022 to the Commissioner, the director's solicitors admitted that $2m

was borrowed against the strength of "the contract and properties, despite the Undertaking".

As the agreement between the parties was that there was to be no discharge until performance was complete, the agreement did not cause the company to comply with its obligations.

In relation to (2) above, the director's argument was that the COVID-19 pandemic and the disruption and delays associated with it caused the company to lose more than $10m, even though it continued to employ people to perform work. The contention was that the effects of the pandemic on the company and the director occurred entirely beyond his control and that, but for the pandemic, the company would have had sufficient income to discharge its debt to the Commissioner and, therefore, there would have been no debt to which a director penalty could attach.

In rejecting the director's argument, Martin SJA said that the argument was confined to the loss of capacity, due to COVID-19 restrictions, for the company to make sufficient money to satisfy its indebtedness to the Commissioner. In the written submissions made on behalf of the director, it was contended that he sought "to have the benefit of the usual interlocutory process that would allow the collation of further evidence, including as to the impacts on the company of the COVID-19 restrictions (such as evidence as to the government directives, evidence from a quantity surveyor and construction expert as to the effects on the business and the contracts that were undertaken and forensic accounting to assess the financial impacts on the company)".

However, Martin SJA said that this argument did not assist the director. It might, if all of the evidence favoured the director on that point, go some way to demonstrating that there were no reasonable steps available to the director to ensure that the company complied with the obligation in s 269-35(2)(a)(i) TAA53. But the argument (and the evidence sought to be obtained) did not provide any basis for a conclusion that there were no reasonable steps able to be taken to achieve any of the matters set out in s 269-35(2)(a)(ii) to (iii) TAA53.

As there was no real, as opposed to a fanciful, prospect of the director succeeding with respect to all or part of the claim, there was no need for a trial of the claim and the Commissioner was entitled to judgment with interest.

TaxCounsel Pty Ltd
ACN 117 651 420

References

1 [2023] AATA 3547.
2 *FCT v Myer Emporium Ltd* [1987] HCA 18.
3 [2024] FCAFC 33.
4 [2024] QSC 51.

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Tax Tips

by TaxCounsel Pty Ltd

Enterprise issues

A recent Full Federal Court decision has considered issues that arise in relation to the GST definition of "enterprise".

Background

An important underlying concept in the GST legislation is that of an "enterprise", which is a defined term.

The broad position is that a supply by an entity that is GST registered will attract GST only if the supply is a taxable supply (ss 9-5 and 9-40 of the *A New Tax System (Goods and Services tax) Act 1999* (Cth) (GSTA99)) and an acquisition by an entity that is GST registered will only give rise to an input tax credit if the acquisition is solely or partly for a creditable purpose (ss 11-5 and 11-20 GSTA99).

One condition that must be met for a supply by an entity to be a taxable supply is that the supply is made in the course or furtherance of an enterprise that the entity making the supply carries on.

Correspondingly, where a supply to a GST registered entity is a taxable supply, the acquiring entity will only be entitled to a GST input tax credit if the acquisition by that entity is for a creditable purpose (ss 11-5 and 11-20 GSTA99). An acquisition of something will be for a creditable purpose to the extent that the acquisition is made by the acquiring entity in carrying on an enterprise (s 11-15 GSTA99).

The term "enterprise" for the purposes of GST is defined in s 9-20 GSTA99. The definition includes an activity or activities done "in the form of a business". The meaning and effect of the quoted words have given rise to some difficulty and were recently considered by the Full Federal Court in *Konebada Pty Ltd ATF the William Lewski Family Trust v FCT*[1] (the *Konebada* case). In its decision, the Full Court dismissed an appeal from a judgment of Hespe J at first instance.

It should be noted that the enterprise concept is also relevant to the operation of the Australian business number legislation.[2] While a company incorporated under the *Corporations Act 2001* (Cth) is entitled to an ABN as a result of its corporate status, for any other kind of entity to be entitled to an ABN it must be carrying on an enterprise in Australia.

This article discusses several issues that arise out of the statutory definition of "enterprise", particularly in light of the decision in the *Konebada* case.

The enterprise concept

For the purposes of the GST and the ABN legislation, an "enterprise" is defined in s 9-20 GSTA99 as follows:

> "**9-20 Enterprises**
>
> (1) An ***enterprise*** is an activity, or series of activities, done:
>
> (a) in the form of a business; or
>
> (b) in the form of an adventure or concern in the nature of trade; or
>
> (c) on a regular or continuous basis, in the form of a lease, licence or other grant of an interest in property; or
>
> (d) by the trustee of a fund that is covered by, or by an authority or institution that is covered by, Subdivision 30-B of the ITAA 1997 and to which deductible gifts can be made; or
>
> (da) by a trustee of a complying superannuation fund or, if there is no trustee of the fund, by a person who manages the fund; or
>
> (e) by a charity; or
>
> (g) by the Commonwealth, a State or a Territory, or by a body corporate, or corporation sole, established for a public purpose by or under a law of the Commonwealth, a State or a Territory; or
>
> (h) by a trustee of a fund covered by item 2 of the table in section 30-15 of the ITAA 1997 or of a fund that would be covered by that item if it had an ABN.
>
> (2) However, ***enterprise*** does not include an activity, or series of activities, done: …"

The Dictionary to the GSTA99 provides that "carrying on" an enterprise includes doing anything in the course of the commencement or termination of the enterprise.[3]

Some general points

It will be noted that the definition of "enterprise" is expressed in exhaustive terms ("[a]n *enterprise* is …").

Also, in accordance with ordinary principles of statutory construction, the defined term "enterprise" would not govern or affect the construction of the definition. In *FCT v Auctus Resources Pty Ltd*,[4] Thawley J (McKerracher and Davies JJ agreeing) said that using the defined term "administrative overpayment" in s 8AAZN(1) of the *Taxation Administration Act 1953* (Cth) or the word "administrative" to interpret the definition supplied by s 8AAZN(3) involved a process of reasoning which was necessarily circular.[5]

It will also be noted that the definition of "enterprise" is effectively in two parts. One part (paras (a) to (c)) describes particular activities that are enterprises if done "in the form of" a business, adventure in the nature of trade etc. The other part (paras (d) to (h)) describes particular categories of entity that are to be treated as carrying on an enterprise because of the kind of entity that they are.

The explanatory memorandum

The explanatory memorandum to the A New Tax System (Goods and Services Tax) Bill 1998 states that "enterprise" is defined very broadly because the GST is "intended to have a broad base. Certain things are included as enterprises so that input tax credits are available to them".

The Commissioner's position

The Commissioner has released a number of rulings that have considered the enterprise concept. For present purposes, reference may made to GSTD 2006/6 which is a binding public ruling. It is stated in that determination that the phrase "in the form of a business" is broad and has as its foundation the longstanding concept of a business. The determination states:

> "11. … The definition clearly includes a business and the use of the phrase 'in the form of' indicates a wider meaning than the word 'business' on its own. This occurs in the case of non-profit entities. In such instances we consider that not all of the main features of a business such as a capacity to earn and distribute profits need to be present before an activity has the form of a business."

In relation to the phrase "in the form of an adventure or concern in the nature of trade", GSTD 2006/6 states:

> "14. As a matter of statutory interpretation the phrase 'in the form of an adventure or concern in the nature of trade' is wider than 'an adventure or concern in the nature of trade'. However, the underlying concept of an adventure or concern in the nature of trade does not logically lend itself, in any meaningful way, to being broadened. In a practical sense, an activity is either an adventure or concern in the nature of trade or it is not."

Some earlier cases

There have been a number of decisions of the AAT and the courts in which the statutory definition of "enterprise" in the GSTA99 has been considered. Before considering the Full Federal Court's decision in the *Konebada* case, several of these cases should be referred to.

Davsa Forty-Ninth

In *Davsa Forty-Ninth Pty Ltd as Trustee for the Krongold Ford Business Unit Trust and FCT*,[6] the AAT said:

> "18. Identifying an enterprise requires a similar enquiry [to that required in relation to what constitutes a business]. The concept includes activities *in the form of a business* and/or *in the form of an adventure in the nature of trade* which are wider than activities that constitute a business simpliciter. While these concepts are wider, and therefore constitute a lower standard to be satisfied, it is still necessary for the activities to have the essence of business activities. When used as a noun the term *form* means, among others, *the visible shape or configuration of something*, the *particular way in which a thing exists or appears, or the type or variety of something* and, depending on the context, can be synonymous with, among others, the terms *shape, condition, mode, manner, way, style, guise, complexion, pattern, model*, and *exemplar*. Similarly, when used as a noun the term *nature* means, among others, *basic or inherent features, character, or qualities of something or the innate or essential qualities or character* of something and, depending on the context, can be synonymous with, among others, the terms kind, sort, ilk, type, species, genus, genre, designation, description, style, manner, character, the like of, and the likes of." (footnotes omitted)

Swansea

The decision of the Federal Court (McKerracher J) in *FCT v Swansea Services Pty Ltd*[7] contains some points that should be noted.

McKerracher J said that, as to investment activity, there was nothing in the legislation that indicated that investment activities would not amount to the carrying on of an enterprise. Further, the relatively low level of the registration turnover threshold ($50,000) in s 23-15 GSTA99 was consistent with eligibility being available even when sales at any given period have been minimal.

His Honour said that, in express terms, one activity alone may qualify as an enterprise and, as to the width of the definition, referred to the following observations of White J in *Toyama Pty Ltd v Landmark Building Developments Pty Ltd*:[8]

> "64. … Section 9-20(1)(a) does not require for there to be an enterprise that there be repeated or continuous activities. One activity done in the form of a business can be an enterprise. However, it is necessary, in order for an entity to make a taxable supply, that the supply be made in the course of furtherance of an enterprise which the entity carries on. The words 'carrying on' would ordinarily imply a repetition of acts. The expression is defined in s 195-1 as including doing 'anything in the course of the commencement or termination of the enterprise'."

McKerracher J observed that it appeared to have been the parliamentary intention that input tax credits may be available in relation to the acquisition of capital items, whereas capital purchases are not deductible for income tax purposes. This was relevant to the Commissioner's contention that the activities of the taxpayer could not amount to an enterprise because they were long-term investment activities. In his Honour's view, it could not be discerned from the legislation or from the explanatory memoranda that parliament's intention was that such "capital" activities would not amount to the carrying on of an enterprise, notwithstanding that such activities may not ordinarily amount to the "carrying on of a business" or the "undertaking of a profit-making scheme". Accordingly, it was not evident on the face of the GSTA99 that investment activities would not amount to the carrying on of an enterprise.

His Honour also said:

> "68. The GST Act definitions of 'enterprise' and 'carrying on an enterprise' appear on their face (consistently

with the Explanatory Memoranda) to be substantially broader than the notion of 'carrying on a business' for the purposes of income tax regulation. It would have been a simple matter for Parliament to confine registration to those entities 'carrying on a business' in the income tax sense had that been its intention. It follows that those income tax cases determining whether there has been a carrying on of a business may need to be considered with some caution in the present analysis."

The Konebada case

As indicated, the concept of "enterprise" for the purposes of GST was most recently considered by the Full Federal Court in the *Konebada* case, which was an appeal from a decision of Hespe J.[9]

The facts

The GST issues in the *Konebada* case arose out of claims by the corporate trustee of the William Lewski Family Trust (Konebada) in respect of input tax credits that related to invoices paid by Konebada for services provided by lawyers and other professionals in relation to issues concerning members of the Lewski family and affiliated entities (the Lewski family group). Irrespective of whether he held the office of director or not, Mr William Lewski at all times controlled the corporate trustee.

Some services related to court or tribunal proceedings to which Lewski family group members were a party or were otherwise involved (litigation services). Members of the Lewski family group were parties to a number of proceedings which resulted in a need for legal representation and advice. Other services were not related to litigation (other services). In the relevant periods, the trustee paid invoices relating to litigation services and other services totalling over $3.6m.

Konebada was a party (the litigation funder) to several deeds dated 16 November 2016, each of which was styled "Litigation Funding Agreement". The recital to each deed stated that the deed recorded the agreement between the litigation funder and the beneficiaries "in relation to the payment of Litigation Costs and Litigation Proceeds arising in connection with the Proceedings". The term "proceedings" was defined to mean the court proceedings described in Sch 2 of the deed and any claim, demand, cause of action or other legal proceedings, whether intermediate, incidental or ancillary, which related to or were connected with such court proceedings.

Clause 2 of each deed provided that the parties acknowledged and agreed that the litigation funder had, up to the date of the deed, paid, and would after that date continue to pay, all litigation costs. "Litigation costs" was defined as all costs and expenses paid or payable by the beneficiaries, or incurred for the benefit of the beneficiaries, that related to or arose in connection with the proceedings.

The deed also provided (in cl 3) that, in consideration for the payment of the litigation costs by the litigation funder in accordance with cl 2, each of the beneficiaries agreed to pay to the litigation funder any litigation proceeds that were paid to it. The term "litigation proceeds" was defined to mean all money paid or payable to the beneficiaries in respect of the proceedings, including (without limitation) amounts paid or payable in connection with (inter alia) the settlement of the proceedings or awarded by the court by way of judgment in favour of the beneficiaries.

The central issue in the proceedings before the Federal Court was whether Konebada was entitled to input tax credits in respect of its payment of invoices for the provision of legal and other professional services. The resolution of this issue involved the determination of two sub-issues:

1. whether Konebada acquired anything by way of taxable supplies; and
2. whether Konebada's acquisitions were made in carrying on an enterprise.

First instance

As to sub-issue (1), Hespe J at first instance held that there were acquisitions by Konebada and the supplies to Konebada were taxable supplies.

In relation to sub-issue (2), Hespe J said that the phrase "in carrying on" an enterprise required more than a temporal nexus (ie acquiring services at the same time as carrying on an enterprise). It required that the goods or services acquired be used (or acquired for use) for the purposes of the enterprise. Her Honour found that Konebada did not carry on a business of providing litigation consulting services or a business of receiving and disseminating advice or formulating and making recommendations based on advice it received to members the Lewski family group in respect of litigation proceedings.

Hespe J did not regard the litigation funding agreements as supporting a finding that Konebada carried on an enterprise of the kind asserted, as its only obligation under those agreements was to pay invoices. Her Honour further observed that the litigation funding agreements did not "evidence a concern in the nature of trade", noting that, given the very limited prospect of the beneficiaries of the trust receiving any funds in respect of the litigation the subject of the agreements, the prospect of Konebada ultimately making a return on any of those agreements "was so remote that it had no meaningful nexus to the services that were supplied".

In relation to Mr Lewski's evidence, Hespe J said that she attached little weight to the evidence of Mr Lewski's ex post facto understanding of the capacity in which he gave instructions and received advice, or to his characterisation of the operations of the trustee in so far as they related to the issues in the case. Her Honour also said that Mr Lewski's evidence:

- was self-serving and uncorroborated by contemporaneous documentary evidence; and
- had to be weighed in light of the objective facts. Those objective facts included the fact that Mr Lewski was a

> registered tax agent with knowledge of GST. Not only was Mr Lewski a party with an interest in the outcome of the proceedings, he also had an educated and technical understanding of the nature of the issues in these proceedings.

Also, the contention that Konebada received advice and then disseminated the advice, or used the advice to formulate its own advice, was not supported by contemporaneous evidence. Further, the arrangements as described by Mr Lewski had an air of artificiality.

For these reasons, Hespe J did not accept that Mr Lewski instructed lawyers and received the litigation services and other services on behalf of Konebada as trustee of the William Lewski Family Trust. Rather, her Honour concluded that he did so for and on behalf of the Lewski family group individual or entity that was party to the proceedings or the transaction or dealing in issue.

Further, Hespe J did not accept Mr Lewski's evidence that the litigation funding agreements were really agreements for the provision of services. That description was not supported by the terms of the agreements, which did not require Konebada to provide any services to the named beneficiary, other than to pay invoices.

It may be noted that, while Hespe J accepted that it was not unusual for intra-family group dealings to be conducted informally, her Honour observed that "if a taxpayer chooses to conduct its affairs informally, there may be practical consequences for its ability to prove its case: … Such may be said to be the case here".

The appeal

As noted above, Konebada appealed to the Full Federal Court from the decision of Hespe J. In a joint judgment, the Full Court (Perram, Abraham and Button JJ) dismissed the appeal.

Konebada's main complaint on the appeal, and virtually the only point advanced by its oral submissions, was that the trustee was denied procedural fairness because Mr Lewski's status as a tax agent was relied on by Hespe J as a reason for rejecting his evidence when this was never put to him in the witness box, and was not a matter that was raised before Hespe J.

The Full Court said:

> "48. We perceive no error, or procedural unfairness, in the way in which the primary judge approached the evidence of Mr Lewski. As the primary judge observed, Mr Lewski's evidence was of his *ex post facto* understanding and was conclusionary or argumentative … It was open to the primary judge, in assessing the weight to be given to such evidence, to take into account the extent to which the person giving evidence of his understanding as to capacity does so from a tutored, or untutored, vantage point. It was open to the primary judge to take into account, in assessing the weight to be ascribed to Mr Lewski's *ex post facto*, conclusionary evidence, that his was not the evidence of a person with no knowledge or capacity to understand the implications (from a GST point of view) of his or her understanding. Taking this matter into account did not involve any implicit, but unarticulated, view on the part of the primary judge that tax agents are unreliable. Nor did it involve any outright rejection of Mr Lewski's evidence."

The Full Court said that there was no error in Hespe J both accepting that family groups may operate informally, and taking into account the lack of documentation in the form of trustee resolutions or board papers when assessing the issue of the capacity in which Mr Lewski acted. As the Commissioner noted in his submissions, Mr Lewski's evidence was that the communications were "oral" and "informal", and that there was no documentation conferring authority on him by the litigant members of the Lewski family group. The court went on:

> "53. … The absence of any documentation of the kind described by the primary judge … was a matter that logically bore on, and the primary judge was entitled to have regard to in addressing, the question of the capacity in which Mr Lewski acted. The primary judge did not (as Konebada submitted) equate the absence of such documentation with positive evidence in support of the conclusion her Honour reached. We also note that there was no evidence of the tax returns of the trust. Had the activities in question been undertaken on behalf of The Trustee, and had they been undertaken in pursuit of a litigation services enterprise operated by The Trustee, one would have expected to see tax returns reflecting the conduct of the asserted enterprise (even if loss-making), accounts of the trust and trust statements recording any distributions to beneficiaries."

The Full Court considered that Konebada's submissions did not establish any basis to impugn the finding of Hespe J that Mr Lewski acted for and on behalf of the members of the Lewski family group who were party to the litigation or transaction at issue.

In the "form of a business"

On appeal, the trustee put its case on the basis of para (a) of s 9-20(1) GSTS99, accepting that, if it were not successful on the "form of a business" limb, it would not be successful on the "nature of trade" limb (para (b)).

The Full Court said that it was common ground that Konebada was carrying on an enterprise which involved the provision of management-related services to certain Lewski family entities which included property syndication. The issue concerned the scope of its enterprise. The trustee contended that, had Hespe J accepted that Mr Lewski was acting on behalf of the trustee, it would have followed that the scope of the trustee's enterprise included the ongoing, regular and repeated acquisition of the service of providing legal and other professional services to beneficiaries, and that the acquisitions were made by the trustee in carrying on its enterprise.

Konebada contended that Hespe J interpreted the requirement that an acquisition be made in carrying on

an enterprise on the basis that it required a commercial purpose, or a purpose of profit or return. Konebada relied on decisions supporting the proposition that not-for-profit bodies may carry on a trade, or conduct a business.

Section 9-20(1)(a) GSTA99 defines "enterprise" as an activity, or a series of activities, done (inter alia) "in the form of a business". Konebada submitted that the apparent legislative intention was to include, within the definition, "activities in the form of a business but not carried on as a business".

The Full Court went on to say:

> "72. The Commissioner did not cavil with Konebada's contention … that it is necessary to identify the scope of the enterprise carried on by a taxpayer. The primary judge did just that.
>
> 73. Her Honour was clearly mindful that activities that are conducted without a view to making a profit may nonetheless constitute the conduct of a business … The primary judge nevertheless considered that the capacity of the enterprise to generate a positive return was a relevant enquiry in determining whether a series of activities constitutes the carrying on of a business. There was no error in that approach where, as here, the activities are said to constitute an enterprise within s 9-20(1)(a) of the GST Act."

The Full Court then said:

> "74. As long as it is borne in mind that the absence of a profit-making prospect is not inevitably and always fatal to a positive conclusion on the question of whether a taxpayer is carrying on an enterprise, an examination of whether the activities of the taxpayer have business-like qualities — including whether they are capable of generating a positive financial return — is a natural and logical enquiry to conduct. As we have set out, the primary judge conducted such an enquiry and did not err in her factual findings.
>
> 75. Konebada stressed that the first limb of s 9-20(1) refers to activities 'in the form of' a business. While it may be accepted that parliament's intention, by the inclusion of those words, was that the definition of 'enterprise' not be limited to circumstances where the activities constitute the carrying on of a business, the words of extension do not have the necessary reach to bring the activities of The Trustee within the definition of 'enterprise'."

In submitting that its activities had the indicia of being carried on "in the form of a business", Konebada relied on the period of time over which the trustee had paid the invoices for provision of legal services to members of the Lewski family group, and the scale of its activities (paying invoices totalling over $3.5m). Konebada also submitted that the activities were carried out in an organised and systematic manner, as evidenced by the scale of the undertaking, and that, to the extent that there was a degree of informality in the documentation, the arrangements could be inferred from conduct.

In rejecting these submissions, the Full Court said:

> "77. We do not accept that these matters establish that Konebada carried on an enterprise of the kind asserted. All the regularity, repetition and funds expended establish is that members of the Lewski Family Group were involved in a wide, and expensive, array of litigation over an extended period of time. Those matters do not, in the context of this case, establish that the activities in question were carried out by Konebada 'in the form of a business'. The submission that Konebada's activities were carried out in an organised and systematic manner was advanced in Konebada's written submissions without any substantiation, and was not addressed orally. It is a contention that is difficult to reconcile with the evidence concerning the informal basis upon which Mr Lewski dealt with the various lawyers on behalf of members of the Lewski Family Group. The only respect in which the operations involving the lawyers were formalised was by entry into the Litigation Funding Agreements. But, as the primary judge found, those agreements were not 'entered into in a systematic and organised manner so as to stamp them with a commercial character' …"

Some observations

As noted above, the words "in the form of" are integral to each of paras (a), (b) and (c) of the definition of "enterprise" in the GSTA99. It is suggested that it is arguable the words should have the same meaning or effect in each of the paragraphs. There is a presumption that, in a statute, the same word is used with the same meaning,[10] and although the presumption readily yields to context, it is suggested that there is no contrary context in the definition of "enterprise", particularly having regard to the fact that the relevant words occur in close proximity.

Taking para (b) of the definition ("in the form of an adventure or concern in the nature of trade"), the Commissioner has, in a binding ruling (GSTD 2006/6), taken the view that the words "in the form of" do not enlarge the concept of an adventure or concern in the nature of trade.

Taking para (c) of the definition ("on a regular or continuous basis, in the form of a lease, licence or other grant of an interest in property"), it is suggested that there would need to be a grant of an interest in property for there to be an enterprise for the purposes of the paragraph. If there is such a grant and the regular or continuous requirement was met, there would be an enterprise and the words "in the form of" would effectively add nothing.

If that is correct, it may be asked why this would not also be the case with para (a) of the definition ("in the form of a business"). In this regard, the Commissioner, in GSTD 2006/6, has effectively given the expression "in the form of" a limited meaning in the context of para (a). If that construction was advantageous to a taxpayer, the Commissioner would, it is suggested, be bound to apply GSTD 2006/6. A taxpayer would, of course, not be bound by the determination.

It is suggested, with respect, that the views of McKerracher J in the *Swansea* case may have been too broadly expressed.

Another practical point to note is that the decision of Hespe J at first instance and the decision of the Full Federal Court on appeal emphasise the need for adequate documentary evidence in relation to a transaction that can be relied on, should some dispute arise.

TaxCounsel Pty Ltd

References

1 [2024] FCAFC 42.

2 *A New Tax System (Australian Business Number) Act 1999* (Cth). The concept is also relevant to certain provisions of the *Income Tax Assessment Act 1997* (Cth) (for the purposes of which the definition in the GSTA99 is relevant).

3 S 195-1 GSTA99.

4 [2021] FCAFC 39.

5 Reference may also be made to *Eichmann v FCT* [2020] FCAFC 155 and *Sunlite Australia Pty Ltd v FCT* [2023] FCAFC 43. Compare *Moulsdale t/a Moulsdale Properties v Commissioners for His Majesty's Revenue and Customs* [2023] UKSC 12.

6 [2014] AATA 337.

7 [2009] FCA 402.

8 [2006] NSWSC 83.

9 *Konebada Pty Ltd ATF the William Lewski Family Trust v FCT* [2023] FCA 257.

10 *Registrar of Titles (WA) v Franzon* [1975] HCA 41; *FCT v Australian Building Systems Pty Ltd (in liq)* [2015] HCA 48.

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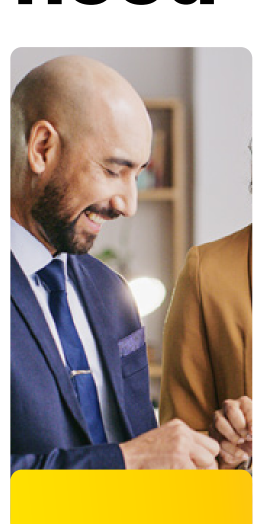

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Mid Market Focus

by Guy Brandon, CTA, HLB Mann Judd

Continuity of ownership test: a different perspective

This article discusses some of the traps when using information in annual reports as a proxy to determine whether the continuity of ownership test has been satisfied.

Introduction

During the Australian Securities Exchange (ASX) listed companies reporting season, reviews of the ability to carry forward tax losses and net capital losses (assuming the tax losses and net capital losses have been correctly calculated in the first instance) are made to determine their ability to be deducted in the current year or carried forward.[1]

A review of the top 20 shareholders may have been made to provide a "back of the envelope" calculation to determine the ability to deduct, or carry forward, tax losses as the tax return(s) may not have been completed.

This "method" is often used when trying to satisfy the continuity of ownership test (COT) by reviewing whether the sum of the shareholders' stakes (those being less than a 10% direct stake in the company and aggregated into a single notional entity[2]) has the rights to more than 50% of the voting power, the company's dividends, and the company's capital distributions.

While this may provide the correct outcome, as will be shown below, it is a shortcut method that may prove materially incorrect.

Deferred tax assets

There are instances where companies may state that a COT review is not necessary as they are not "booking"/not recognising deferred tax assets in respect of carry-forward unused tax losses.[3]

Companies that have material amounts of deferred tax liabilities (exploration companies come to mind due to the immediate deduction of qualifying exploration expenditure) must take care as any deferred tax asset relating to the carry forward of unused tax losses that is used to offset a deferred tax liability is effectively "booking"/recognising that deferred tax asset.

Whether tax losses can be carried forward is critical, as recognising a deferred tax asset that relates to carry forward tax losses may result in a material misstatement of the financial statements if those tax losses are incorrectly carried forward.

Example

Assume that an ASX listed company (the company) is a June balancer. Table 1 shows the top 20 shareholders that are listed in the company's 2023 annual report.[4,5]

That Gamma and Beta, collectively holding 42.44%, may appear prima facie to mean that the company's single notional entity must have 57.56% and therefore the COT is satisfied.

A few issues are worth noting:

- while the 2023 annual report relates to 30 June 2023 for the company, the top 20 shareholders are taken from the latest practicable date prior to the annual report being lodged. In this example, that date is 27 September 2023;
- Table 1 is at a point in time. To determine whether the COT is satisfied for an income year, there must be a comparison of at least two points in time; and
- for which tax loss(es) is the COT thought to have been satisfied (noting that the single notional entity's percentage at an ownership test time can be no greater than the single notional entity's percentage at the start of the test period, ie the start of the tax loss year being reviewed)?

It should be remembered that the concessions in Div 166 ITAA97 for a widely held company (eg an ASX listed company) or an eligible Division 166 company make it easier to apply the rules in Div 165 ITAA97[6] by:[7]

- making it unnecessary for the company to prove that it has maintained the same owners throughout a period, if the company had the same owners at certain test times; and
- making it unnecessary for the company to trace through to the ultimate beneficial owners of:
  - the voting stakes, dividend stakes and capital stakes in the company held by certain entities (whether directly, or indirectly through one or more interposed entities); and

Table 1. 2023 annual report (27 September 2023)

Position	Holder name	Holding	% of shares on issue
1	Gamma	26,408,439	26.41%
2	Beta	16,030,000	16.03%
3	Alpha	8,058,077	8.06%
4	Delta	4,930,260	4.93%
5	Epsilon	4,879,601	4.88%
…	…	…	…
20	Upsilon	171,981	0.17%
		87,472,858	87.47%

- the small voting stakes, dividend stakes and capital stakes in the company.

After reviewing the 2023 annual report, the 2022 annual report is reviewed (see Table 2).

That Alpha and Epsilon, collectively holding 32.46%, may appear prima facie to mean that the company's single notional entity must have 67.54% and therefore the COT is satisfied.

While Tables 1 and 2 show that the single notional entity has more than a 50% shareholding in the company, it could only be used to "determine" whether the COT is satisfied for the 2023 income year. So what about the 2022 tax losses? Let's go back to the 2021 annual report (see Table 3).

That Alpha and Epsilon, collectively holding 29.21%, may appear prima facie to mean that the company's single notional entity must have 70.79% and therefore the COT is satisfied. Note the date – 21 September 2021.

Table 2. 2022 annual report (26 September 2022)

Position	Holder name	Holding	% of shares on issue
1	Alpha	12,149,259	19.28%
2	Epsilon	8,298,860	13.17%
3	Omicron	3,343,546	5.31%
4	Theta	3,206,987	5.09%
5	Xi	2,742,153	4.35%
…	…	…	…
9	Beta	1,719,966	2.73%
…	…	…	…
15	Delta	727,208	1.15%
…	…	…	…
20	Iota	157,114	0.25%
		46,825,399	74.33%

Table 3. 2021 annual report (21 September 2021)

Position	Holder name	Holding	% of shares on issue
1	Alpha	10,934,333	17.36%
2	Epsilon	7,468,974	11.86%
3	Omicron	3,009,191	4.78%
4	Theta	2,886,288	4.58%
5	Xi	2,467,938	3.92%
…	…	…	…
9	Beta	1,547,969	2.46%
…	…	…	…
15	Delta	654,487	1.04%
…	…	…	…
20	Iota	141,403	0.22%
		42,142,859	66.89%

The review so far has only considered the annual reports which can, at best, be used as proxies for year ends, eg 30 June.

In addition to the top 20 shareholders, the annual report details change to share capital during the income year.

Table 4a replicates the issued capital note in the notes to the financial statements.

Table 4b has been extrapolated from Table 4a and identifies the percentage increase in the number of shares, and quantum of share capital,[8] for each allotment.

Tables 4a and 4b detail:

- the number of shares on issue at the start of the income year and at the end of the income year, and capital changes (eg capital raising); and
- the percentage changes in the number of shares and the value of issued capital.

This assists in determining if there has been a corporate change,[9] including where there is an issue of shares in the company that results in an increase of 20% or more in the issued share capital of the company or the number of the company's shares on issue.

It is to be remembered that, for a specific tax loss for a widely held company or an eligible Division 166 company, you need to review at each ownership test time, being:[10]

- the start of the test period;
- the end of each corporate change event; and
- the end of the test period.

From Table 4b:

- tax losses for FY22 and FY23 can be reviewed;
- tax losses incurred prior to FY22 will also use this information to determine if they are still available; and
- the dates to be reviewed are:
  - 1 July 2021 (using 30 June 2021 data);
  - 30 June 2022;
  - 31 January 2023 (allotment increasing the number of shares by 23.81%) (see Table 5); and
  - 30 June 2023 (due to allotment increasing the issued capital value by 21.97%) (see Table 6),

  noting that 27 September 2023 is not a testing date as it does not meet the definition of a "corporate change event".

Additional information

A review of the 2021 to 2023 annual reports has Let's Sing Pte Ltd as a substantial shareholder[11] (having a constant 5,000,000 shares). A further review of Form 603 lodged by Alpha Nominees Pty Ltd on 4 August 2020 lists it holding an initial interest for Let's Sing Pte Ltd of 7.94% in the company.

Table 4a. Issued share capital

		Quantity	Quantity	Value	Value
30 June 2021		63,000,000	63,000,000	$20,000,000	$20,000,000
		–		–	
30 June 2022		63,000,000	63,000,000	$20,000,000	$20,000,000
Allotment	31 January 2023	15,000,000	78,000,000	$3,900,000	$23,900,000
Allotment	30 June 2023	15,000,000	93,000,000	$5,250,000	$29,150,000
30 June 2023		93,000,000	93,000,000	$29,150,000	$29,150,000
Allotment	27 September 2023	7,000,000	100,000,000	$2,590,000	$31,740,000

Table 4b. Percentage increase in the number of shares, and quantum of share capital, for each allotment

		Quantity	% increase in quantity	Value	% increase in value
30 June 2021		63,000,000		$20,000,000	
		–		–	
30 June 2022		63,000,000		$20,000,000	
Allotment	31 January 2023	15,000,000	23.81%	$3,900,000	19.50%
Allotment	30 June 2023	15,000,000	19.23%	$5,250,000	21.97%
30 June 2023		93,000,000		$29,150,000	
Allotment	27 September 2023	7,000,000	7.53%	$2,590,000	8.89%

Table 5. 2020 annual report (25 September 2020)

Position	Holder name	Holding	% of shares on issue
1	Omicron	8,921,874	14.16%
2	Epsilon	7,137,499	11.33%
3	Alpha	5,353,125	8.50%
4	Theta	2,886,288	4.58%
5	Xi	2,467,938	3.92%
...	...	...	...
9	Beta	1,547,969	2.46%
...	...	...	...
15	Delta	654,487	1.04%
...	...	...	...
20	Iota	141,403	0.22%
		42,142,859	66.89%

Table 6. 31 January 2023 – requested from client

Position	Holder name	Holding	% of shares on issue
1	Omicron	25,343,546	32.49%
2	Alpha	12,149,259	15.58%
3	Epsilon	8,298,860	10.64%
4	Theta	3,206,987	4.11%
5	Xi	2,742,153	3.52%
...	...	...	...
9	Beta	1,719,966	2.21%
...	...	...	...
15	Delta	727,208	0.93%
...	...	...	...
20	Iota	157,114	0.20%
		68,825,399	88.24%

Prima facie, reviewing the 2022 tax loss for its ability to be carried forward at 30 June 2023, the respective single notional entities were:

- 1 July 2021: 70.79% (using the 2021 annual report as a proxy);
- 30 June 2022: 67.54% (using the 2022 annual report as a proxy);
- 31 January 2023: 41.29% (per client); and
- 30 June 2023: 73.52% (per client).

It appears that the COT was failed at 31 January 2023 (see Table 6) to the extent that another shareholder(s) does not have at least an 8.72% interest. However, if a shareholder has an interest of between 8.72% but < 10%, this would have already been included in the single notional entity.

But *is* the single notional entity 41.29% at 31 January 2023?

Alpha Nominees Pty Ltd is holding stakes as a nominee. Where this is the case, "each entity for whom a part of the stake is held by the nominee entity, that entity's part of

the stake may be treated instead as a separate stake".[12] At 31 January 2023, Let's Sing Pte Ltd's 5,000,000 shares equate to 6.41%, with the balance of Alpha Nominees Pty Ltd's holding being 9.17%.

Therefore, the single notional entity at 31 January 2023 is 56.87% and the COT is still satisfied for the 2022 tax loss.

However, from the information provided, it can be deduced that:

- Peter Beta has been a substantial shareholder since at least 25 September 2020; but
- Peter Beta's Form 604[13] relating to 27 September 2023 now shows an interest of 25.84% (including his interest with that of the Beta Family Trust and Epsilon Pty Ltd).

Substantial shareholders and controlled test companies

The top 20 shareholders may give a false impression when reviewed in isolation.

A review of the substantial shareholders may give critical information.

Referring back to Table 1, Gamma and Beta have at least 10% of the shareholding in the company.

If Beta and Alpha were associates[14] of each other or were associates of another person, they would be aggregated for the purposes of determining a substantial shareholding. Then, for the purposes of substantial shareholding:

- Gamma 26.41%
- Beta/Alpha 23.09%

This would appear to result in substantial shareholders owning 50.5% in the company. However, the rules for determining substantial shareholdings are different than for the purposes of "controlled test companies" and the tracing rules.[15]

Revisiting the Beta group, it appears that Epsilon Pty Ltd would not hold more than 50% of the voting power in another shareholder, but it is likely that Peter Beta controls more than 25% of the total voting power (together with his associates[16]) in the company.

The single notional entity at 27 September 2023 (see Table 7) would be 47.75%.[17] However, 27 September 2023 is not a corporate change event as the issued shares only increased by 7.53% and the issued capital only increased by 8.89%. Therefore, the 2022 tax losses have not failed the COT at that time as it was not a test date.

However, caution would need to be taken when next reviewing whether the 2022 (and prior) tax losses fail the COT. We will come back to this under the heading below "Tracing rules – one in, all in?".

Who has incurred the tax losses?

When reviewing financial statements, deferred tax assets relating to the carry forward of unused tax losses are consolidated into the parent company's accounts. It must be remembered that not all groups are consolidated for income tax purposes. Therefore, the COT review must be conducted on the company that incurred the tax loss. This is critical in determining how the concessional treatment in Div 166 ITAA97 is to be applied.

Table 7. 30 June 2023 – requested from client

Position	Holder name	Holding	% of shares on issue
1	Alpha	24,624,386	26.48%
2	Gamma	6,811,644	7.32%
3	Omicron	4,838,210	5.20%
4	Eta	4,684,884	5.04%
5	Xi	4,666,056	5.02%
...	...	...	...
10	Epsilon	3,437,222	3.70%
11	Beta	2,811,644	3.02%
...	...	...	...
20	Delta	727,359	0.78%
		86,115,052	92.60%

So far, we have assumed that a listed company has incurred the tax losses (directly, or "group losses" and "transferred losses" as the head of a tax consolidated group). However, the losses may have been incurred by a subsidiary that is not a member of a tax consolidated group.

Div 166 ITAA97 applies to:

- a widely held company at all times during the income year;
- an eligible Division 166 company at all times during the income year; or
- a widely held company for a part of the income year and an eligible Division 166 company for the rest of the income year.

Widely held company

Relevantly for the example,[18] the company is listed on the ASX (or another approved stock exchange).

Eligible Division 166 company[19]

Relevantly for the example is a subsidiary that the ASX company beneficially owns directly, or indirectly through one or more interposed entities, in which:

- its voting stakes carry rights to more than 50% of the voting power in the subsidiary;
- its dividend stakes carry rights to receive more than 50% of any dividends that the subsidiary may pay; or
- its capital stakes carry rights to receive more than 50% of any distribution of capital of the subsidiary.

Which concessional tracing rules are available?

It is important to differentiate between a widely held company and an eligible Division 166 company to determine how the concessional tracing rules[20] apply and in particular whether the interest holding in the loss company is directly,

or indirectly, held. This is particularly important when the loss company is a subsidiary in a non-tax consolidated group.

Assuming a 100% direct interest by the parent in the subsidiary, all of the interests in the parent must therefore be indirect interests in the subsidiary.

The subsidiary is, by definition, an eligible Division 166 company but has no direct shareholders other than the listed parent.

10% tests: single notional entity and top interposed entity

A review of the single notional entity by considering the top 20 shareholders and substantial shareholders presupposes that the listed company incurred the tax losses in its own name or as the head company of a tax consolidated group (either group losses or transferred losses).

If the tax losses were incurred by the subsidiary, ie not being a member of the tax consolidated group, at best given a 100% holding by the parent, the top 20 shareholders and substantial shareholders reflect the indirect shareholding in the subsidiary.[21] If the listed company does not have a 100% holding, the indirect shareholding will be proportionately less.

The effective similarities/differences between these tests (given the same top 20 shareholders and substantial shareholders) are:

- similarities:
  - shares held in the top 20 shareholders and substantial shareholders, where less than 10%, are not subject to the "same shares or interests to be held" provisions;[22] and
  - both tests are subject to the "controlled test companies" provisions;[23] and
- differences: the top interposed entity is subject to the "same shares or interests to be held" provisions.

Tracing rules – one in, all in?

The tracing rules[24] in Subdiv 166-E ITAA97 are intended to be concessional.[25] There may be circumstances where a direct shareholder has fluctuated from having less than 10% shareholding to having at least 10%, ie from being included in the single notional entity to being excluded. In respect of *direct stakes of less than 10% in the tested company*[26] (examples being Peter Beta and Omicron Pty Ltd), the company cannot pick and choose[27] for a particular entity that directly holds less than 10% at a test time to treat it as not being included in the single notional entity at that test time.

If the company wanted to exclude that entity from the single notional entity, it would have to choose for that tracing rule not to apply. This would require tracing under ordinary concepts for those shareholders (not an easy task, but perhaps the only way to satisfy the COT) and that the company believes, on reasonable grounds, that if the tracing rule did not modify how the tests apply to the company in respect of that stake, it would not fail the tests. This is the same for the other tracing rules.

Returning to the Peter Beta group. To the extent that the top five shareholders and their holdings, at 30 June 2024, remain the same as Table 1,[28] the COT would prima facie be failed.

Reviewing Gamma's holdings further to determine what percentage is allowable, straight away there appears to be an issue relating to the same share, same interest rule.[29] Gamma held 2,422,761[30] shares at 21 September 2021. So, while it held 26.41% of the shares at 30 June 2024, pursuant to s 165-165 ITAA97, this percentage drops to 2.42%.[31]

Reviewing the Peter Beta group again, the smallest shareholdings during the test period were:

- Beta 1,547,969 (21 September 2021) 1.55%
- Delta 654,487 (21 September 2021) 0.65%
- Epsilon 3,437,222 (30 June 2023) 3.44%

Therefore, at 30 June 2024, there is a continuing ownership of 55.81%:

- single notional entity 47.75% (noting Delta and Epsilon not included due to s 166-280(2) ITAA97)
- Gamma Pty Ltd 2.42%
- Peter Beta 1.55%
- Delta Pty Ltd 0.65%*
- Epsilon Pty Ltd 3.44%*

* This is on the basis that Peta Beta is the test individual in the family trust election made by Delta Pty Ltd as trustee for the Beta Family Trust.[32] This would need to be reviewed.

Tracing rules: integrity provisions

The Beta group has highlighted some of the circumstances where a tracing rule does not apply.[33] The other test is where an entity (the controlling entity) directly or indirectly holds the voting power in the tested company, or all or some of the rights to the dividends of, or capital in, the tested company and the tested company is sufficiently influenced[34] by the controlling entity. A company is sufficiently influenced "if the company, or its directors, are accustomed or under an obligation (whether formal or informal), or might reasonably be expected, to act in accordance with the directions, instructions or wishes of the entity or entities (whether those directions, instructions or wishes are, or might reasonably be expected to be, communicated directly or through interposed companies, partnerships or trusts)".[35]

Foreign resident shareholder tracing

There is no requirement to trace through a foreign resident shareholder that holds a stake directly and/or indirectly in the loss company of:

- less than 10% (noting the indirect stake being attributed to the top interposed entity[36]); and
- between 10% and 50% (inclusive) and the foreign resident shareholder is a widely held company[37] for the

whole income year, eg it is listed on an approved stock exchange.[38]

The difficulty is where the foreign resident shareholder holds more than a 50% stake. They will need to be traced through as it does not come under "stakes held by other entities".[39]

From experience, it is not a simple task tracing through a foreign company.

Losses schedule

It is to be remembered that the ability for each tax loss to satisfy the COT is considered separately.

The losses schedule, where required to be completed as part of the company tax return, assists the review when determining the quantum of tax losses per relevant loss year. However, the earlier the loss, the more likely it will be included in the, say, 2017–18 and earlier income years. This is for administrative ease, not that those prior losses have somehow been aggregated.

A couple of points are worth noting:

- to extract the earlier years, you will need to go back to the original tax returns or the most recent amendment(s) to determine the quantum of loss for a specific loss year; and
- after completing that process, it is prudent to sum these amounts to determine if they equate to the aggregated amount. There are times where an amendment has not been included, or there has been a change in the loss included on the schedule that has not been declared in an earlier original, or amended, return.

Nominees

Often, the top 20 shareholders have a number of nominee shareholders. To the extent that the nominee holds a stake for more than one entity, each entity's stake may be treated as a separate stake.[40] This may be beneficial when determining the holding percentage of the single notional entity. It may be a trap believing that a nominee entity holds shares for multiple entities with less than 10% shares each.

If the nominee holds less than 10%, this may not be an issue. If it holds at least 10%, how is it known who owns the respective stakes? A review of Forms 603, 604 and 605 may assist here to determine who the nominee is acting for. Where the single notional entity holds less than 50%, it may be critical to determine who the nominee is acting on behalf of as it may be required to determine whether a specific stakeholder (that the nominee is holding shares on behalf of) has satisfied the same interest, same share rule,[41] eg where a nominee acts for a listed company on a foreign stock exchange, having a material stake in the test company, especially if it owns more than 50% of the test company.

Limitation on this article

Due to the nature of this article, the following have not been, but may need to be, considered in relation to the company's ability to carry forward tax losses:

- the savings provisions;[42]
- the business continuity test;[43] and
- companies with shares that have unequal rights.[44]

In closing

If circumstances only allow a preliminary/high-level review to be made from publicly available information, as a minimum, the following should be reviewed:

- the substantial shareholders in each annual report and in Forms 603, 604 and 605;
- the top 20 shareholders in each annual report;
- the issued capital note in each annual report; and
- each Appendix 3B[45] lodged with the ASX.

The quantum (or more likely an approximation) of the tax losses incurred in a particular year may be deduced (but not always) by the information provided in the income tax note and related disclosures, but nothing can compare to a comprehensive review of the tax losses of a company.

The possibility of failing the COT may also be important when determining the amount, and nature, of future capital raising.

While there may be materiality concessions in financial statements during the reporting season, there is no such de minimis treatment in company tax returns.

Guy Brandon, CTA
Tax Consulting Partner
HLB Mann Judd WA

References

1 For the purposes of the tax note to the financial statements (see *AASB 112 – Income Taxes*), including the amount of the resulting deferred tax asset used as an offset of a deferred tax liability or the undisclosed amount of the deferred tax asset.

2 S 166-225 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97).

3 See para 34 of *AASB 112 – Income Taxes*: "A deferred tax asset shall be recognised for the carryforward of unused tax losses … to the extent that it is probable that future taxable profit will be available against which the unused tax losses … can be utilised."

4 The full names of the holders are: Alpha Nominees Ltd; Peter Beta (appointor, guardian and ultimate "controller" of the Beta Family Trust); Gamma Pty Ltd <Delta Family A/C>; Delta Pty Ltd <Beta Family A/C>; Epsilon Pty Ltd (note Beta Family Trust own 100% of this company); Omicron Pty Ltd; Theta Pty Ltd <Theta Investment A/C>; Xi Ltd; Eta <Eta Super Fund A/C>; Norma Iota; and Barry Upsilon.

5 The top 20 shareholders are based on fully paid ordinary shares. Care must be taken where the company has other classes of shares that carry unequal rights to dividends, capital distributions or voting power. Consideration of Div 167 ITAA97 must be had to determine whether the COT can be satisfied.

6 Primarily in s 165-12 ITAA97. There must be persons who, at all times during the ownership test period (ie the start of the loss year to the end of the income year), had more than: 50% of the voting power in the company; rights to more than 50% of the company's dividends; and rights to more than 50% of the company's capital distributions.

7 S 166-3 ITAA97.

8 Share issue costs have not been included.

9 S 166-175 ITAA97.

10 S 166-145 ITAA97. It should be noted that the company's test period is the period consisting of the loss year, the income year, and any intervening period; s 166-5(2) ITAA97.

11 See s 671B of the *Corporations Act 2001* (Cth) and the related Form 603 Notice of initial substantial holder, Form 604 Notice of change of interests of substantial holder, and Form 605 Notice of ceasing to be a substantial holder.

12 S 166-235(7) ITAA97.

13 It should be noted that Form 604 does not need to be provided if there is less than a 1% movement in the shareholding (s 671B(1)(b) of the *Corporations Act 2001*). A change of 0.9% may cause a failure of the COT but that change may not have needed to have been advised to the market.

14 See ss 9 and 10 to 17 of the *Corporations Act 2001* for the definition of "associate".

15 S 166-280 ITAA97.

16 S 318 ITAA36.

17 Shareholders excluding Gamma (26.41%) and Betta/Delta/Epsilon (25.84%).

18 See s 995-1(1) ITAA97 for the definition of a "widely held company".

19 See s 995-1(1) ITAA97 for the definition of an "eligible Division 166 company".

20 Subdiv 166-E ITAA97.

21 Calculated by multiplying the ownership stake held in each entity of the chain. See example 1.5 of the explanatory memorandum to the Tax Laws Amendment (Loss Recoupment Rules and Other Measures) Bill 2005.

22 S 166-272 ITAA97.

23 S 166-280 ITAA97.

24 There are six defined tracing rules: s 166-225 ITAA97 (direct stakes of less than 10% in the tested company); s 166-230 ITAA97 (indirect stakes of less than 10% in the tested company); s 166-240 ITAA97 (stakes held directly and/or indirectly by widely held companies); s 166-245 ITAA97 (stakes held by other entities); s 166-255 ITAA97 (bearer shares in foreign listed companies); and s 166-260 ITAA97 (depository entities holding stakes in foreign listed companies).

25 S 166-275 ITAA97.

26 S 166-225 ITAA97.

27 By the drafting of s 166-225(2) ITAA97, "... each such ..."

28 Also assuming that there is no further corporate change event before 30 June 2024.

29 S 165-165 ITAA97.

30 Using the least shareholding as a proxy for the same share, same interest rule.

31 As noted previously, no consideration has been made for the savings provisions under s 165-12(7) ITAA97. This is a complex area, and it can be difficult to have sufficient evidence to satisfy.

32 S 165-207 ITAA97.

33 S 166-280 ITAA97.

34 Within the meaning in s 318(6)(b) of the *Income Tax Assessment Act 1936* (Cth).

35 For example, para 1.141 of the explanatory memorandum to the Tax Laws Amendment (Loss Recoupment Rules and Other Measures) Bill 2005 states: "... a shareholder may have sufficient influence where under a formal or informal arrangement with other shareholders it is able to control the majority of appointments to the company's board of directors."

36 S 166-230 ITAA97.

37 S 995-1 ITAA97.

38 S 995-1 ITAA97, and Sch 3 to the *Income Tax Assessment (1997 Act) Regulations 2021* (Cth).

39 S 166-245 ITAA97. There may still be concessional tracing where there are bearer shares, or depository entities holding stakes, in foreign listed companies (ss 166-255 and 166-260 ITAA97, respectively).

40 S 166-235(7) ITAA97.

41 S 166-272 ITAA97.

42 S 166-272(8) ITAA97.

43 Subdiv 165-E ITAA97.

44 Div 167 ITAA97.

45 Appendix 3B Proposed issue of securities relates to *ASX Listing Rules*, Ch 3, specifically r 3.10.3.

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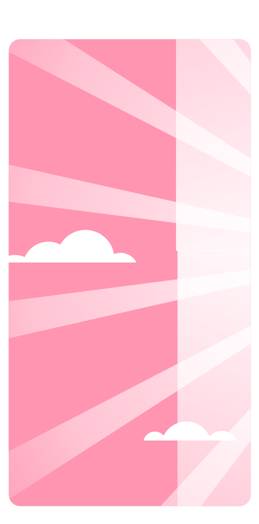
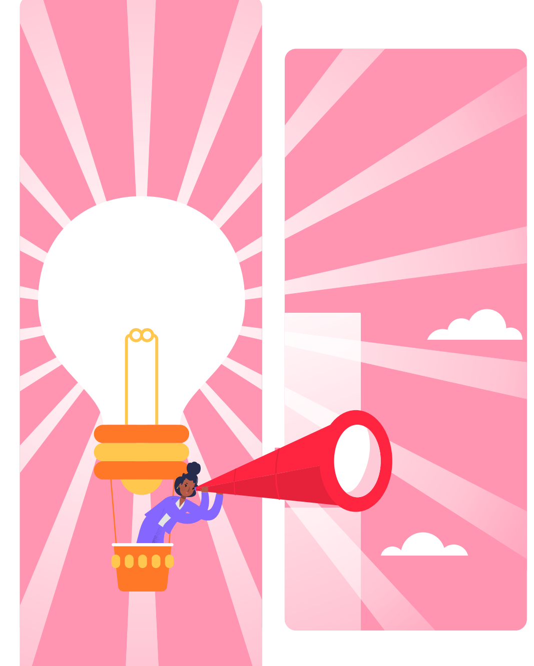

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A career journey beyond borders

The Co-Dux of CommLaw1 in Study Period 1, 2023 describes his international career in accounting and tax.

Fredrick Law
Director
Deloitte Australia, Darwin

Tell us about your career in tax

I am currently a chartered accountant in Australia, Hong Kong and mainland China, and also a chartered financial analyst in the United States. Growing up and being educated where East meets West – Hong Kong – helped me become an energetic, passionate and professional financial accountant and business adviser. Over the past 18 years, I have worked on domestic and cross-border audits and capital market projects in Australia, Hong Kong, mainland China, Taiwan, Singapore, Indonesia, the US and the United Kingdom. These projects encompass audits, group restructuring, tax planning, inbound and outbound mergers and acquisitions, initial public offerings, and debt issuance. I really enjoy simplifying complex matters and presenting them in an insightful and engaging manner for my clients.

In addition to working at Deloitte and KPMG, I have also served as an investor relations director at a technology, media and telecommunications company. I was responsible for managing corporate activities and maintaining relationships with a diverse range of private investors, including private equity, venture capital and other entities.

Why did you study CommLaw1?

I studied CommLaw1 as it is a core subject in my Graduate Diploma of Applied Tax Law. I found it to be a valuable inclusion, as it provided knowledge on how Australia's legal systems ensure that businesses participate legally. When we talk about businesses and how we help them to succeed, we cannot avoid talking about the legal and tax systems – and so it makes sense to understand commercial law in the context of tax.

What was your experience studying the subject?

As a chartered accountant, mastering laws and tax knowledge greatly helps me to advise the accounting and business matters of my clients in Australia. I've been able to apply the knowledge gained in CommLaw1 in my daily work. The program at The Tax Institute Higher Education is very practical and it incorporates a lot of real-life cases in the study materials. I also love the online learning approach, which enables me to plan my study time flexibly according to my busy work schedule.

To what do you attribute your success?

The key to succeed in a subject is to plan the study timetable well. A subject runs for three months, and to maximise my chances of success, I made time for study every week and used the learning objectives to make sure I really understood the concepts. I would recommend a similar approach for anyone else considering additional study.

I personally have never been one to burn the midnight oil just a few days before the exam, and find that, if adequate time is taken throughout the duration of study, it is not necessary.

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

I love sharing business insights with people. I'm looking forward to furthering my postgraduate studies in law, especially in international commercial and taxation aspects. The Tax Institute is providing me with a solid foundation for my ongoing career.

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SMSF succession planning, BDBNs, and more

by Daniel Butler, CTA, Director, DBA Lawyers

Every SMSF member should develop a personal succession plan to ensure that there is a smooth process in place to govern succession to control of the fund that fits in with their other estate and succession planning arrangements. Indeed, in times of uncertainty and heightened risk of illness, this is even more critical than ever. SMSF succession planning broadly aims to accomplish the following outcomes: that the right people receive the intended proportion of SMSF money and assets; and that the right people gain control of the SMSF to ensure that superannuation benefits are paid as intended.

SMSF succession planning

What is succession planning?

Succession planning is a critically important aspect of successfully operating a self-managed superannuation fund (SMSF), although it is often overlooked. Every SMSF member should develop a personal succession plan to ensure that there is a smooth process in place to govern succession to control of the fund that fits in with their other estate and succession planning arrangements. Indeed, in times of uncertainty and heightened risk of illness, this is even more critical than ever.

SMSF succession planning broadly aims to accomplish the following outcomes:

- that the right people receive the intended proportion of SMSF money and assets; and
- that the right people gain control of the SMSF to ensure that superannuation benefits are paid as intended.

An optimal SMSF succession plan should achieve these goals in a timely and legally effective manner, with minimal uncertainty and as tax-efficient as possible. However, it should also be recognised that trade-offs may need to be considered, as it would usually be considered preferable that the "right" people receive a benefit and pay tax, rather than the "wrong" people receiving a benefit in a tax-efficient manner.

Accordingly, there is no easy "one-size-fits-all solution" for SMSF succession. However, a well thought out SMSF succession plan should address the following matters:

- determine the person(s) or corporate entity who will occupy the office of trustee on loss of capacity or death;
- in relation to a corporate trustee, determine who the directors of the SMSF trustee company will be (ie who will have control of the company) on loss of capacity or death of directors/members;
- ensure that the SMSF can continue to meet the definition of an SMSF under s 17A of the *Superannuation Industry (Supervision) Act 1993* (Cth) (SISA);
- determine what each member's wishes are for their superannuation benefits;
- determine to what extent each member's wishes should be "nailed down" through the use of an automatically reversionary pension and/or a binding death benefit nomination (BDBN); and
- determine the tax profile of anticipated benefits payments.

Many people have no succession plan in place for their SMSF, which may result in considerable uncertainty arising in the future with regard to the control of the fund and the ultimate fate of their member benefit.

Succession on loss of capacity

With the passage of time, there is a significant risk that some SMSF members may lose the capacity to administer their own affairs. In the absence of prior planning, this could result in major uncertainty and risk arising in relation to control of the SMSF. Having an enduring power of attorney (EPoA) in place can help overcome this problem, as an EPoA appointment is "enduring", enabling a trusted person (ie the member's attorney under an EPoA) to continue to run the SMSF as their legal personal representative (LPR) in the event of loss of capacity.

It is strongly recommended that every SMSF member implement an EPoA as a part of their personal SMSF succession plan. It would not be an exaggeration to say that being an SMSF member without having an EPoA is a significant risk exposure.

Naturally, given the important responsibilities placed on an attorney, a member must trust their attorney to do the right thing by them. Only a trusted person should be nominated and, insofar as the member retains capacity, the EPoA should be subject to ongoing review to ensure its ongoing appropriateness.

Consideration should also be given as to whether the scope of the appointment should be general in nature (ie a general financial power) or limited to the SMSF or to the SMSF trustee. For example, if the member wishes to preclude their attorney from exercising certain rights in relation to, say, their member entitlements or making or revoking their BDBN, this should be expressly precluded in their EPoA.

It should be noted that, by itself, an EPoA is not a mechanism by which an attorney can actually step into the role of an SMSF trustee or director of an SMSF corporate trustee. An EPoA merely permits the member's attorney to occupy the office of trustee or director of the corporate

trustee to help ensure that the SMSF can continue to operate in a fashion consistent with the member's wishes. This is because a member's attorney appointed under an EPoA is expressly recognised in s 17A SISA for the purposes of the trustee–member rules. However, the attorney must still be appointed in the first place. The appointment mechanism which facilitates the LPR to step into the role of SMSF trustee or director of the corporate trustee is contained in the SMSF deed and the company's constitution. For example, in the context of a corporate trustee, and in the absence of other appointment provisions in the constitution, generally a majority of the company's shareholders must exercise their voting rights to appoint a director.

Succession on death

The death of a member is another case where succession to control of an SMSF should be carefully considered.

Section 17A(3) SISA provides an exception to the trustee–member rules where a member has died. The exception in s 17A(3) provides that a fund does not fail to satisfy the basic conditions of the trustee–member rules by reason only that:

> "(a) a member of the fund has died and the legal personal representative of the member is a trustee of the fund or a director of a body corporate that is the trustee of the fund, in place of the member, during the period:
>
> (i) beginning when the member of the fund died; and
>
> (ii) ending when death benefits commence to be payable in respect of the member of the fund;"

This exception permits an LPR of a deceased member (eg an executor of a deceased person's estate) to be an individual trustee or a director of a corporate trustee in place of a deceased member until the member's death benefits commence to be payable. However, it is important to understand that this provision does not require or create this state of affairs. For example, for s 17A(3) to apply, an LPR must actually be appointed as either:

- a director of the corporate trustee of the fund pursuant to the constitution of the company; or
- an individual trustee of the fund pursuant to the governing rules of the fund.

The operation of the provision in this way has been confirmed in numerous cases, particularly in *Ioppolo & Hesford v Conti*,[1] *Ioppolo v Conti*,[2] and implicitly in *Wooster v Morris*.[3]

In *Ioppolo & Hesford v Conti*, Master Sanderson described the operation of s 17A(3) as follows ([20]):

> "20 … The mechanism of the section is tolerably clear. Section 17A(3) allows for the appointment of an executor as a trustee of the fund but *does not in its terms require such an appointment*. Section 17A(4) provides a period of grace – that is to say it allows a fund six months to organise its affairs so it can remain a SMSF. So in the case of a fund which has two members and which would qualify under s 17A(1), on the death of one of the members it remains a SMSF for six months. If the remaining member has not taken some steps during that period to bring the fund within the terms of s 17A(2) then it will cease to be a SMSF …" (emphasis added)

These cases underscore the fact that a deceased person's LPR (ie their executor) does not automatically step into the role of an SMSF trustee or director on a member's death. Broadly, it depends on the provisions of the SMSF deed (most SMSF deeds do not have a mechanism for this to occur) and whether there are other appropriate legal documents in place to ensure that this occurs.

Successor directors

By ensuring that the company constitution of the SMSF trustee contains successor director provisions, it is possible to plan for succession to the role of a director in advance.

Making a successor director nomination allows a director (ie the principal director making a nomination in accordance with an appropriately drafted constitution) to nominate a person to automatically step into the shoes of the principal's directorship role immediately on loss of capacity, death or a specified event occurring.

The successor director strategy is designed to work in conjunction with a member's overall estate and succession plan to enable an attorney appointed under an EPoA or an executor of a deceased member's will to be automatically appointed as a director without any further steps involved.

Naturally, a successor director strategy relies on the right paperwork being in place, including the right constitution and related successor director nomination form.

Tax considerations on death

The tax profile of death benefits is also a relevant consideration in succession planning.

Where a death benefit lump sum is paid to a tax dependant (ie a "death benefits dependant" under s 302-195 of *Income Tax Assessment Act 1997* (Cth)), the dependant will receive the benefit tax-free (ie as non-assessable non-exempt income). A "dependant" for tax purposes means any of the following (s 302-195):

- the deceased person's spouse or former spouse;
- the deceased person's child, aged less than 18 at the time of death;
- any person with whom the person has an interdependency relationship; or
- any other person who was a dependant of the deceased person just before they died.*

* Note that this limb of the definition imports the common law meaning of dependant, which is accepted to include financial dependency.

Accordingly, adult independent children do not generally qualify as death benefits dependants, and any death benefit payment they receive (usually when there is no surviving

spouse) will be subject to a tax rate of 15% plus applicable levies to the extent that the benefit comprises the taxable component.

When you consider that the average SMSF holds over $1m in assets, the tax exposure of death benefit payments made to adult independent children by an SMSF is likely to be significant.

Planning an exit strategy in light of the "death tax"

Given the impact of the effective "death tax" where the likely recipient(s) of the death benefits will not be tax dependant(s), one tax-effective option is for the member to withdraw the bulk of their superannuation benefits during their lifetime (ie assuming that the member is over age 60 and a relevant condition of release has been met).

Naturally, this is an option that should not be contemplated lightly as the member's entitlements will leave the superannuation environment and there are likely to be very limited opportunities for the member to make further contributions into superannuation. Additionally, it should be borne in mind that such a withdrawal will mean that the relevant money and/or assets will be exposed to the normal tax environment outside of superannuation and it is possible that the member may go on to live a healthy life for many years after the withdrawal.

> "… ample time is required to arrange for an effective transfer of legal title …"

However, if the option is being seriously contemplated, SMSF members/trustees and advisers will need to carefully consider how to best achieve the intended outcome in relation to implementing the withdrawal by paying:

- ordinary pension payments for any pensions that may be in place; and/or
- lump sum payments for the member's accumulation entitlements and amounts arising on commutation of a pension.

While superannuation benefits can be withdrawn by drawing down on a pension account (ie assuming that the pension is an account-based pension with no payment restrictions in place), pension payments can only be paid in cash. Thus, generally this approach will require additional time to realise fund assets, which can be problematic in an economic downturn and where the fund has illiquid investments.

Additionally, pension payments will not address any accumulation account balance that the member has in the fund. (For completeness, it should also be noted that this paying a pension has negative transfer balance cap consequences in relation to there being no debit available to a member's transfer balance account for withdrawals by pension payment, eg if the member wished to preserve their ability to commence retirement phase pensions in the future.)

Thus, to speed up the withdrawal process, an SMSF member looking for a timely exit strategy may wish to arrange for fund assets to be transferred out of the fund, ie by way of a lump sum payment.

Lump sum payments in specie

In view of the above, transferring legal title to relevant fund assets from the SMSF trustee to the member (ie as part of a lump sum payment in kind) is generally considered the most conventional way to achieve a speedy withdrawal of non-cash assets from an SMSF. However, the process of transferring legal title can still take days, weeks or even longer in certain cases, especially if the assets include:

- real estate;
- assets that cannot be readily realised or transferred for various reasons; or
- securities (eg shares or units) where disposal of the securities may be subject to specific requirements or formalities in the applicable constitution or governing rules of the trust or company.

What if time is of the essence?

As noted above, ample time is required to arrange for an effective transfer of legal title especially as you "never know the hour, nor the minute".

If the member dies and the relevant assets remain with the SMSF trustee, the mere existence of a request to cash the relevant fund assets as a lump sum will generally not be accepted by the ATO as a proper basis for treating the benefits as having been paid to the member (ie for legal, tax and accounting purposes). Thus, if time is of the essence in relation to implementing a timely withdrawal of benefits, it is recommended that expert advice is obtained.

Binding death benefit nominations

What is a binding death benefit nomination?

The term "binding death benefit nomination" (BDBN) does not have a fixed, constant or normative meaning. You will not find an entry for "BDBN" in a general dictionary or in a specialised legal dictionary.

Furthermore, the term BDBN is not even used in the SISA or in the *Superannuation Industry (Supervision) Regulations 1994* (Cth) (SISR). Accordingly, whenever someone uses the term "BDBN" (or a similar term), it is worth asking what they mean exactly. Typically, a person uses the term "BDBN" to mean a written nomination as to who should receive the member's benefits on their death. It must be made by a member of a superannuation fund and, when the member dies, it forces the trustee of the fund to pay the member's superannuation death benefits in the manner specified.

Why does a BDBN matter?

When a superannuation fund member dies, various questions need to be answered by the trustee of the fund, including:

- Who is to receive the deceased member's benefit?
- How is the benefit to be paid?
- When is the benefit to be paid?

BDBNs are important as they answer these questions for the trustee. Without a BDBN, a trustee must decide the answer themselves which many find difficult.

Consider a scenario where a person has made a will. The will stipulates that, when the person dies, all of the willmaker's assets are to be paid to their spouse. However, a will typically does not cover superannuation, as superannuation is held on trust and is governed by rules that govern that trust. Typically, the rules that govern how assets held in such trusts are disposed of are called a trust/SMSF "deed" or "governing rules". Accordingly, the will may not ensure that, on the willmaker's death, their superannuation death benefits are paid to their spouse as this will may not satisfy the requirement of the trust's deed or governing rules. Many are surprised by this. Accordingly, the following important concept should be noted: *a person's will typically does not cover superannuation!*

If the willmaker wants to specify to whom the trustee of the superannuation fund must pay their superannuation death benefits in a binding way (as compared to leaving it to the trustee's discretion), typically, they will need to make a BDBN in accordance with their trust's deed or governing rules.

How to make a BDBN

The exact process to make a BDBN depends on the requirements of the fund's specific governing rules. However, best practice typically requires:

- ensuring that a full chain of documents exists and is problem-free;
- executing the BDBN via traditional "wet signature" (although electronic execution might now be possible, it is still novel, so for the time being, it is recommended that BDBNs be executed by the traditional wet signature, hardcopy method), and ensuring that there are two independent adult witnesses to the BDBN; and
- ensuring that the BDBN fully complies with all requirements in the SMSF's governing rules, for example, the governing rules may require that the BDBN be given to the trustee in order to be valid, that various information disclosures be provided to particular parties, and/or that the BDBN be drafted/exist in a particular form.

How long can a BDBN last for?

For many years, a question existed in the SMSF industry: how long can a BDBN last for? More specifically, can a BDBN for an SMSF last for only three years, or can it last indefinitely?

In *Hill v Zuda Pty Ltd*,[4] the High Court conclusively answered this question, stating that the legislation allows for an SMSF BDBN to last indefinitely.

However, there is an important warning: whether the BDBN for a specific fund may last indefinitely depends entirely on the SMSF's governing rules. If a fund's governing rules expressly provide that a BDBN only lasts for three years, then the BDBN can only last for three years. While "three-year" governing rules used to be somewhat common, they have now become rare.

If a fund's governing rules are ambiguous as to how long a BDBN lasts, there is a risk that, if reviewed by a judge in court, the judge might find that this particular fund's BDBN can only last for three years. This occurred in the case of *Donovan v Donovan*.[5] Here, the governing rules provided that:

> "A Member may make a binding death benefit nomination in the form required to satisfy the Statutory Requirements;"

The term "statutory requirements" was defined to mean:

> "… the requirements imposed under any law or by any Statutory Authority which must be satisfied by a superannuation fund in order to qualify for income tax concessions …"

The judge held that:

> "In my judgment it is quite plain that the intent of the deed is to require the nomination to be in the form described in regulation 6.17A(6) [of the SISR, which mentions a three-year limitation]."

Accordingly, there is extreme merit in an SMSF's governing rules expressly clarifying that its BDBNs last indefinitely.

Who can be paid pursuant to a BDBN?

Who can be paid superannuation death benefits pursuant to a BDBN depends on what the superannuation fund's governing rules provide.

If a deceased member has made a valid nomination, the trustee must provide the deceased member's benefit to the person or persons so nominated due to the binding nature of the nomination. To do otherwise would be in breach of the trustee's duties.

Most SMSF governing rules allow superannuation death benefits to be paid to the widest possible range of recipients allowable under the SISA and the SISR. This widest class of possible recipients is broadly:

- all spouses[6] of the deceased;
- all children (regardless of age) of the deceased;
- everyone in an "interdependency relationship" with the deceased;[7]
- everyone financially dependent on the deceased; and
- the LPR of the deceased (eg the executor of the will of the deceased).[8]

It is important to observe who is *not* in this class of potential recipients. For example, typically, grandchildren, siblings or charities cannot directly receive superannuation death benefits. Instead, if a superannuation fund member wishes their superannuation death benefits to be paid to such recipients, the member might wish to:

- make a BDBN in favour of their LPR (their estate); and
- ensure that they (ie the fund member) have made a will specifying that any superannuation death benefits that the LPR receives are then paid to their nominated beneficiary, eg their grandchildren etc.

To illustrate the above, consider the case of *Re Narumon Pty Ltd.*[9] Here, a superannuation fund member made a BDBN directing, among other things, 5% of his superannuation death benefits to be paid to his sister (Mrs Keenan). Mrs Keenan was not financially dependent on the member, nor were the member and Mrs Keenan in an interdependency relationship. Therefore, unsurprisingly, the court noted:

> "Since Mrs Keenan is not a dependant, the nomination of 5% of such benefits to be paid to her will not be binding on the trustee, and it will be a matter for the trustee to deal with that 5% in accordance with clause 31.1 of the 2014 deed [the governing rules]."

Can an attorney make or revoke a BDBN?

Questions regarding the scope of an attorney's powers invariably arise where an attorney is contemplating making, renewing or revoking a BDBN for a member who has lost or is about to lose legal capacity. The proper role of a member's attorney can also become a relevant issue in relation to managing the ongoing appropriateness of a member's existing BDBN, particularly in light of the High Court's recent confirmation that BDBNs for SMSFs can last indefinitely (see *Hill v Zuda Pty Ltd*[10]). Prior to the High Court decision in *Hill v Zuda*, some SMSF members had instructed their attorney to renew their BDBN every three years. These SMSF deeds, EPoAs and BDBNs should be reviewed and revised as soon as possible, given the outcome of the High Court's decision.

Limited authority

As discussed below, there is only limited legal authority for an attorney acting under an EPoA to deal with superannuation in relation to a member's BDBN, given that superannuation is a trust asset subject to the SMSF deed and is not an asset owned by an individual. It is also necessary to consider the following regarding the authority of the attorney:

- the EPoA legislation governing the EPoA instrument in the relevant state or territory;
- the terms of the SMSF deed; and
- the duties and obligations imposed on an attorney.

EPoA financial power

The starting point to understanding the scope of the EPoA's power is that different legislation in each state and territory governs EPoAs. Thus, care must be taken to ensure that the specific power of dealing with superannuation is supported by the EPoA legislation in the relevant state or territory. Note that there is no common law EPoA as these are created by specific state or territory legislation.

Only the *Powers of Attorney Act 2000* (Tas) expressly recognises the power of an attorney under an EPoA to exercise power on behalf of the donor/principal with regard to superannuation. Accordingly, there is a question of whether an attorney dealing with a member's BDBN falls within the scope of general financial powers for EPoAs made outside of Tasmania.

The main legal authority with regard to this point is in *Re Narumon.*[11] In this case, the court held that exercising a member's rights in relation to BDBNs for an SMSF fell within the scope of a financial matter for the purposes of an EPoA made under the *Powers of Attorney Act 1998* (Qld). Bowskill J stated:

> "[69] … It is difficult to see why the exercise of a member's right under a self-managed superannuation fund deed, to require the trustee of the fund to pay benefits, after their death, in a particular way would not be 'a matter relating to the [member's] financial … matters'. Given the breadth of meaning of the word 'financial' (of, pertaining, or relating to finance or money matters) such an act does fall within the meaning of this term." (citations omitted)

Accordingly, in Queensland and Tasmania, there is some authority for the proposition that an attorney making a BDBN may fall within the scope of a general financial power.

While the author considers that there is some likelihood of the courts in jurisdictions outside of Queensland following the reasoning in *Re Narumon* in relation to construing the power of attorney legislation in other jurisdictions, this is certainly not a matter of settled law given the differences in the legislation from one jurisdiction to the next. Accordingly, in addition to seeking legal advice in the particular jurisdiction to see if it is possible for an attorney to make, vary or revoke a BDBN, express wording should also be included in the EPoA instrument and SMSF deed to expressly cover the position.

An appropriate solicitor can assist clients with, among other things, drafting appropriate wording to include in the EPoA for each client's particular circumstances, for example:

- to authorise a spouse to take action in relation to the member's BDBN despite them benefiting under the nomination; or
- to limit the attorney to merely renewing an existing BDBN.

It is recommended that a general-purpose EPoA is not relied on as it is based on a generic template without having appropriate regard to the member's individual circumstances and needs.

Authorised under the SMSF deed

Cases such as *McFadden v Public Trustee for Victoria*[12] and *In the matter of an application by Police Association of South*

Australia[13] illustrate that an attorney under an EPoA is not automatically empowered to deal with a donor/principal's entitlements under a trust. Therefore, the terms of the SMSF deed are critical with regard to what the attorney is authorised to do without this being outside the powers in the deed (ie ultra vires).

In particular, the deed must expressly authorise the attorney to exercise the member's rights and entitlements under the governing rules of the fund, including in relation to any intended dealings with a member's BDBN. In the absence of express power in the SMSF deed, an attorney may not have the requisite power to act as the deed governs what the trustee can and cannot do. Moreover, a trustee that acts without power may be liable for any breach of trust and resulting damages.

Duties of the attorney

The final issue that must be considered is the attorney's fiduciary duties:

- to act in the best interests of the donor/principal;
- to avoid conflicts; and
- to not profit from their position.

Will the attorney be conflicted?

Most importantly, an express conflict authorisation is needed in the EPoA instrument if it is proposed that an attorney make a BDBN on behalf of a member where the BDBN will benefit the attorney personally. (Naturally, this is a common scenario where the attorney is the spouse or an adult child of the member.)

In *Re Narumon*, the relevant SMSF member (Mr Giles) had made a number of BDBNs prior to losing legal capacity. The last nomination that he made was dated 5 June 2013. This nomination required the trustee to pay Mr Giles' death benefit to Mrs Giles (47.5%), Nicholas Giles (47.5%), and Mrs Keenan (5%). The nomination stated that it would cease to have effect after a three-year period ending on 5 June 2016.

On 16 March 2016, the attorneys (aware that the existing nomination was soon to lapse) executed a document entitled "extension of [BDBN]", by which the nomination made by Mr Giles on 5 June 2013 was confirmed and extended for a further three-year period.

At the same time that the "extension of [BDBN]" document was executed, the attorneys made a new nomination on behalf of Mr Giles requiring the trustee to pay the death benefit to Mrs Giles (50%) and Nicholas Giles (50%). The reason for the new nomination being put in place was to expressly address the situation of Mrs Keenan not being a valid dependant of Mr Giles for superannuation law purposes.

In these circumstances, the court held that:

- the attorneys' action in renewing the 2013 nomination was not a conflict transaction due to it being consistent with the member's intentions and prior estate planning; and
- the attorneys' action in making a new nomination was a conflict transaction that was not authorised under the EPoA appointment documentation (that is, Mrs Giles, as an attorney, would have benefited if the second EPoA was valid and that would have been a conflict transaction).

Trusted person

Of course, it goes without saying that the choice of appointing an attorney under an EPoA is a very critical one and only the right "trusted" person should be chosen to act in this role.

Although a member may have some flexibility to substitute their nominated attorney for a different choice prior to losing legal capacity, it is likely to be difficult and costly to dislodge a nominated attorney once a member is incapacitated as, generally, an application would need to be made to a state or territory tribunal under guardianship law, eg to appoint a new administrator and have the EPoA revoked as part of a contested proceeding.

Therefore, every EPoA appointment should be reviewed at least every three years to ensure that it is valid and has express power (if needed, eg for paying the attorney or making, reviewing or revoking a BDBN, as relevant etc) for its ongoing appropriateness, particularly prior to the member losing capacity or reviewing their will and estate plans.

Marsella v Wareham: what this really means for SMSFs

In a nutshell, *Marsella v Wareham (No. 2)*[14] is important because it illustrates how a trustee should *not* behave when exercising a discretion regarding the payment of superannuation death benefits. Below is what the author considers to be best practice.

Facts

Mrs Swanson had two children from her first marriage, including Mrs Wareham. Mrs Swanson's first marriage ended in 1981 when her husband died in a car accident.

In 1984, Mrs Swanson married Mr Marsella.

In 2003, Mrs Swanson established an SMSF. The trustees were Mrs Swanson and her daughter, Mrs Wareham. Mrs Swanson was the sole member.

In 2015, Mrs Swanson executed her last will, naming Mr Marsella as executor.

Mrs Swanson died in 2016 without leaving a valid BDBN.

Under the terms of the SMSF's deed, the trustee had an absolute and unfettered discretion as to how to pay the superannuation death benefits. The possible recipients included Mrs Swanson's:

- spouse (ie Mr Marsella in his personal capacity);
- children (including Mrs Wareham); and
- LPR (ie Mr Marsella in his capacity as Mrs Swanson's executor).

The above is a very common position and the author would expect almost all SMSF deeds to provide this where there is no valid BDBN on death.

Under the specific terms of the SMSF's deed, on her mother's death, Mrs Wareham was left running the SMSF. (It is stressed here that this position, ie that Mrs Wareham was running the SMSF by virtue of being the sole surviving trustee, is *by no means a certainty*. There are plenty of SMSF deeds out there that provide other things.)

On 17 April 2017, Mrs Wareham, as a trustee of the fund, resolved to pay all of the superannuation death benefits to herself personally.

Shortly afterwards, Mrs Wareham's solicitor wrote to Mr Marsella's solicitor and stated:

> "29. … [Your client, ie Mr Marsella] is neither a Member, Trustee or Beneficiary of the Fund, and as such our client [ie the trustees of the fund] is not required to consult with him on any matter relating to the administration of the Fund …"

A week later, Mrs Wareham's solicitor wrote another letter to Mr Marsella's solicitor stating:

> "32. … You refer to a conflict of interest but we fail to see how that allegedly arises. The Trustee is permitted to exercise her discretion, to any eligible object, which includes herself. Our client owes no duty to the estate or other beneficiaries …"

Mr Marsella brought an action in the Supreme Court of Victoria. Mr Marsella claimed that:

- the trustee (ie Mrs Wareham) exercised its discretion without real and genuine consideration to the interests of the dependants of the fund;
- the exercise of the trustee's discretion should be set aside; and
- a different trustee should be appointed.

Mr Marsella was successful in all three of his claims in the Supreme Court.

Mrs Wareham appealed to the Court of Appeal. Her appeal failed entirely.

Best practice

On first blush, it might seem odd that an absolute and unfettered discretion can be challenged in court. However, it is a longstanding principle that a court will interfere in the exercise of a trustee's discretion if:

- the trustee gave reasons and those reasons are not sound;
- the trustee failed to act honestly and in good faith;
- the trustee failed to act on a genuine consideration; or
- the trustee failed to exercise the power with due consideration for its proper purpose.

Similarly, if a trustee's decision is one that no reasonable trustee could make on the material that was before it, a court can infer that the decision breaches one of the above principles.

Many trustees choose not to give reasons. In fact, this occurred in *Marsella v Wareham (No. 2)* where Mrs Wareham's solicitor wrote to Mr Marsella's solicitor:

> "32. … You will know that a discretionary trustee is not required to give reasons for any decision and our client does not do so …"

However, extreme caution should be exercised in this regard:[15]

> "… if a plaintiff puts forward a prima facie case that the trustee's discretion has miscarried, the absence of reasons and the absence of any evidence before the court as to what happened will tend to make that prima facie case 'a virtual certainty'."

Nevertheless, many trustees do not give reasons. This begs the question: if a trustee does not give reasons, how can the trustee show that it:

- acted honestly and in good faith;
- acted on a genuine consideration; and
- exercised the power with due consideration for its proper purpose?

The short answer is that, in addition to closely following the terms of the trust deed, among other things, it is typically best practice to write to all potential recipients inviting them to provide relevant information to the trustee before the trustee makes any decisions. Writing to all potential recipients is an important step as part of what the author considers to be best practice before determining how to exercise a discretion regarding payment of superannuation death benefits. Naturally, it is not the only step. Other crucial steps, of course, are actually properly considering the information received, properly considering the SMSF's governing rules, dealing with potential recipients, and more. However, the author emphasises that typically seeking information from all potential recipients is a *very* important step.

It is also emphasised that writing to each potential recipient can seem unintuitive in the context of an SMSF. Naturally, almost all parties will have a detailed knowledge of other parties' situations. Nevertheless, it is typically an important step on the path to ensuring that trustees are properly exercising the discretion regarding how to pay superannuation death benefits.

Income from superannuation paid to a testamentary trust

The discussion below focuses on the tax treatment of superannuation proceeds that are paid to a testamentary trust and the interaction of Div 6AA of the *Income Tax Assessment Act 1936* (Cth) (ITAA36) which covers excepted trust income. This is an important topic because, unless a minor beneficiary is an excepted person or the distribution is excepted trust income, a minor is generally taxed at the

highest marginal tax rate, plus the Medicare levy, on trust distributions.

Recent change to ITAA36

New s 102AG(2AA) was introduced into the ITAA36 by the *Treasury Laws Amendment (2019 Measures No. 3) Act 2020* (Cth) from 23 June 2020. This measure was first announced in the 2018–19 Federal Budget and was designed to address:[16]

> "… some taxpayers are able to inappropriately obtain the benefit of this lower tax rate by injecting assets unrelated to the deceased estate into the testamentary trust. This measure will clarify that minors will be taxed at adult marginal tax rates only in respect of income a testamentary trust generates from assets of the deceased estate (or the proceeds of the disposal or investment of these assets)."

The explanatory memorandum (EM) includes useful information on considering the potential application of s 102AG(2AA) and understanding the "schemes" that it was designed to catch. The following paragraph and example are the key extracts from the EM:

> "1.13 … These requirements are directed at ensuring that assets unrelated to the deceased estate cannot be injected into the testamentary trust and derive income that is excepted trust income for the purposes of Division 6AA. That is, the requirements ensure that there is a connection between the property from which excepted trust income is derived and the deceased estate that gave rise to the testamentary trust.
>
> …
>
> **Example 1.1 Injected asset**
>
> On 1 July 2019, testamentary trust ABC is established under a will of which a minor is a beneficiary. Pursuant to the will, $100,000 is transferred to the trustee from the estate of the deceased. Shortly after the testamentary trust is established, a related family trust makes a capital distribution of $1,000,000 to the testamentary trust. The resulting $1,100,000 is invested in ASX listed shares on the same day. Dividend income of $110,000 is derived for the 2019–20 income year. The net income of the trust is $110,000 and the minor is presently entitled to 50 per cent of the amount of net income.
>
> The minor's share of the net income of the trust is $55,000. $50,000 is attributable to assets unrelated to the deceased estate and not excepted trust income. $5,000 is excepted trust income on the basis that it is assessable income of the trust estate that resulted from a testamentary trust, derived from property transferred from the deceased estate."

In summary:

- the 2018–19 Budget Paper No. 2 refers to:

  "… assets unrelated to the deceased estate cannot be injected into the testamentary trust …"

- the EM refers to:

  "Shortly after the testamentary trust is established, a related family trust makes a capital distribution of $1,000,000 to the testamentary trust …"

Treatment of superannuation death benefits

In contrast, a superannuation death benefit relates to the deceased member's interest in a superannuation fund. While this is an interest under a trust, the deceased member was entitled to that payment prior to their death and the payment can either be paid to their executors (or LPR) or to a dependant. In short, this is very different to the type of schemes contemplated by s 102AG(2AA).

Both superannuation death benefit payments and insurance proceeds paid to executors following a person's death that form part of their deceased estate have a relevant connection to that person's membership interest or contractual entitlement. These amounts can be contrasted to the situation outlined above in example 1.1 of the EM where a $1m payment was made by a related family trust to a testamentary trust.

These financial entitlements are typically amounts that the deceased estate may be entitled to (eg if the deceased had insurance cover which is paid to their estate or an interest in an SMSF or industry superannuation fund that pays a death benefit to that member's deceased estate (via a BDBN or a discretion exercised by the superannuation fund trustee)). Moreover, these financial entitlements can be contrasted to "schemes" that seek to artificially inflate an estate from property that has no "close or real" connection to the deceased person, such as a $1m family trust distribution to a deceased estate.

Since many do not have an appropriate will or otherwise have a will that is considerably out of date, they should be reviewed. Further, moving forward, wills should be more carefully drafted as many do not provide sufficient guidance on how superannuation and insurance payments should be dealt with. Some, for instance, seek to transfer these amounts directly to a testamentary trust rather than the relevant entitlement forming part of the deceased estate which then converts to a testamentary trust following the finalisation of the administration of a deceased estate.

Note that a deceased estate generally progresses into a testamentary trust once the "date of assent" is arrived at. The date of assent is, broadly, where the assets and liabilities of the estate can be established, and the estate can be ascertained with certainty. Prior to this stage, a potential beneficiary generally has no interest in an unadministered estate.[17]

Finally, there is also the opportunity for the Commissioner to exercise some discretion where he considers that the income from superannuation death benefit payments and insurance amounts do not relate to the property in question. This aspect can give rise to some degree of uncertainty if there is not a sufficient connection between the proceeds and the deceased person, or where appropriate documentation, such as a suitably drafted will, is not in place.

Conclusion

SMSF succession planning needs to be implemented having regard to a multitude of factors, including the member's estate planning, family circumstances, taxation and other circumstances. The right plan should be developed, implemented and reviewed on a regular basis.

Daniel Butler, CTA
Director
DBA Lawyers

References

1 [2013] WASC 389.

2 [2015] WASCA 45.

3 [2013] VSC 594.

4 [2022] HCA 21.

5 [2009] QSC 26.

6 Typically, a person has two spouses where they are legally married to one person (ie the first spouse), cease that relationship but never attend to the divorce paperwork, and then commence living with another person (ie the second spouse) as de facto spouses.

7 An "interdependency relationship" is a defined term (s 10A SISA). It typically requires, among other things, two people to be living together.

8 Note that, where superannuation death benefits are paid to the deceased's LPR, the superannuation death benefits are then subject to the terms of the deceased's will (or, if the deceased died without a will, the superannuation death benefits are subject to the rules of intestacy).

9 [2018] QSC 185.

10 [2022] HCA 21.

11 [2018] QSC 185.

12 [1981] 1 NSWLR 15.

13 [2008] SASC 299.

14 [2019] VSC 65.

15 GE Dal Pont and DRC Chalmers, *Equity and trusts in Australia and New Zealand*, 2nd ed, LBC Information Services, 2000, p 622.

16 Australian Government, Budget 2018-19, *Budget Measures, Budget paper no. 2 2018-19*, p 44.

17 See IT 2622.

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Proper management of a trust: lessons from Owies

by Norman Hanna, Barrister,
Deane Chambers

This article considers one of the trustee's key obligations that must be managed each year, which is the effective exercise of its discretion in determining which beneficiaries of the trust are entitled to the income of the trust. This topic has been of considerable interest since the decision of *Owies v JJE Nominees Pty Ltd*, where the Victorian Court of Appeal held that the trustee had failed to give real and genuine consideration to the beneficiaries under the trust when considering the income entitlements at year end. The article examines the decision, with a focus on the content of the "real and genuine consideration" obligation and how, in practice, the trustee may effectively discharge the exercise of its discretion to distribute income of the trust at year end. The article highlights some of the difficulties that a trustee faces in discharging this obligation in a typical family trust scenario.

Introduction

Quite apart from managing the tax position of a family group or investment structure, advisers have a role in ensuring that decision-making is in order. This may require advising, and reinforcing to, a trustee of the obligations that it has in respect of the effective management of a trust.

The purpose of this article is to consider one of the trustee's key obligations that must be managed year by year, namely, the effective exercise of its discretion in determining which beneficiaries of the trust are entitled to the income of the trust. How a trustee goes about discharging this obligation is a controversial topic. That is especially so where the nature of the trustee's power is described in the deed as "absolute", "unfettered" or "uncontrolled".

Despite such broad powers, the well-established principle from *Karger v Paul*[1] (cited below) sets out the limits or the boundaries on the trustee in relation to the exercise of such discretion.

The Victorian Court of Appeal (the court) decision of *Owies v JJE Nominees Pty Ltd*[2] (*Owies*) is a recent example of where the trustee failed to give real and genuine consideration to the beneficiaries under the trust when considering the income entitlements at year end.

This article examines the *Owies* decision with a focus on the content of the "real and genuine consideration" obligation and how, in practice, the trustee may effectively discharge the exercise of its discretion to distribute income of the trust at year end.

Relevant legal principles

Before considering the *Owies* decision, it is useful to revisit the key principles relating to the effective exercise of a trustee's discretion when distributing income of the trust.

Key principles

The statement of general principle is aptly put by McGarvie J in *Karger v Paul*:[3]

> "In my opinion the effect of the authorities is that, with one exception, the exercise of a discretion in these terms will not be examined or reviewed by the courts so long as the essential component parts of the exercise of the particular discretion are present. Those essential component parts are present if the discretion is exercised by the trustees in good faith, upon real and genuine consideration and in accordance with the purposes for which the discretion was conferred. The exception is that the validity of the trustees' reasons will be examined and reviewed if the trustees choose to state their reasons for their exercise of discretion."

McGarvie J provided further content concerning the obligation to give real and genuine consideration. His Honour noted that there must be the "exercise of an active discretion" and that the obligation to exercise a discretion on real and genuine consideration could also be expressed in terms of whether the trustee had acted "irresponsibly, capriciously or wantonly".[4]

McGarvie J emphasised that, "apart from cases where the trustees disclose their reasons, the exercise of an absolute and unfettered discretion is examinable only as to good faith, real and genuine consideration and absence of ulterior purpose, *and not as to the method and manner of its exercise*" (emphasis added).[5] In that regard, a court is constrained in reviewing a trustee's decision and must not "substitute its own decisions for those properly left to the trustee".[6]

In relation to the "exception" to the general principle where the trustee gives reasons, "the principle seems to proceed on the basis that if trustees of their own volition disclose their reasons they are treated as waiving their immunity and inviting examination and review of the reasons".[7] In circumstances where reasons are disclosed, "they are examined to see whether they satisfy the standard of being valid reasons".[8]

The policy underlying this principle was explained as follows:[9]

"... trustees exercising a discretionary power are not bound to disclose to their beneficiaries the reasons actuating them in coming to a decision. This is a long-standing principle and rests largely, I think, on the view that nobody could be called upon to accept a trusteeship involving the exercise of a discretion unless, in the absence of bad faith, he was not liable to have his motives or his reasons called in question either by the beneficiaries or by the court. To this there is added a rider, namely, that if trustees do give reasons, their soundness can be considered by the court."

It follows that, in cases which are litigated, and bearing in mind that it is the applicant that bears the onus, "any gaps in the evidence could not be filled by a *Jones v Dunkel*[10] inference in circumstances where the trustee was under no obligation to give reasons".[11]

Nature of enquiries made by trustee

A trustee is required to make enquiries about the circumstances of the beneficiary in order to effectively discharge its obligation to give real and genuine consideration to the position of the beneficiaries. Put another way, a trustee must adequately inform itself in order to be in a position to properly exercise the power.[12]

A distinction should be drawn between affording natural justice to a beneficiary versus the trustee making bona fide enquiries to assist in its decision-making process.[13] In relation to the former, the rules of natural justice do not apply in the sense of requiring a potential beneficiary a fair opportunity to make representations to the trustee before the exercise of discretion:[14]

"It was submitted for the plaintiff that it was open to the Court to examine and review whether the trustees had given 'fair consideration' to the exercise of their discretion. In particular it was argued that from the terms of the will and the circumstances of the case it was to be implied that Mrs Karger was to be given a fair opportunity of making representations to them before they exercised the discretion. It was put that this was necessary to ensure that the inquiries of the trustees were adequate. I do not consider that the implication is to be made. I see no good reason for importing rules of natural justice into the exercise of discretion by the trustees of the will ... *In any event the insufficiency of inquiries by the trustees is not a ground on which the exercise of a discretion by the trustees can be examined and reviewed.*" (emphasis added)

One must pause before placing too much reliance on the final sentence above. This is because the court in *Owies* essentially endorsed a positive obligation on the trustee to conduct investigations and adequately inform itself. This was explained as follows:[15]

"97. Although the validity of the outcome of an exercise of power is not to be assessed by notions of fairness or reasonableness, the process must be one in which the trustee is able to exercise the power in a manner that is just, in the sense of it not being arbitrary or capricious, and it must accord with the purpose of the trust. Often that will require ensuring that the trustee is adequately informed so as to put itself in a position to properly exercise the power. As Callaway JA said in *Telstra Super Pty Ltd v Flegeltaub*,[16] 'one cannot ordinarily decide a question of fact in good faith and give it real and genuine consideration without conducting some investigation and in some cases that will entail making an inquiry of a person who is willing to provide information and is in the best position to do so. It is not a matter of natural justice but bona fide inquiry and genuine decision making.'"

The obligation of a trustee to inform itself requires consideration of "the size and scale of the trust, the nature of the relationships that may subsist, and the purpose of the power".[17] This may prove to be a difficult exercise in cases where there are a large number of potential beneficiaries. In such cases, the practical difficulty of undertaking an analysis of the identity and needs of each beneficiary would be "unworkable".[18]

The court went on to explain that having "considered whether or not to exercise the power and understood the range of objects that might benefit, the trustee is required to give adequate consideration as to how to exercise the power".[19] On this point, the statement by Megarry VC in *Re Hay's Settlement Trusts* is instructive:[20]

"The trustee must not simply proceed to exercise the power in favour of such of the objects as happen to be at hand or claim his attention. He must first consider what persons or classes of persons are objects of the power within the definition in the settlement or will. In doing this, there is no need to compile a complete list of the objects, or even to make an accurate assessment of the number of them: what is needed is an appreciation of the width of the field, and thus whether a selection is to be made merely from a dozen or, instead, from thousands or millions. ... Only when the trustee has applied his mind to the 'size of the problem' should he then consider in individual cases whether, in relation to other possible claimants, a particular grant is appropriate. In doing this, no doubt he should not prefer the undeserving to the deserving; but he is not required to make an exact calculation whether, as between deserving claimants, A is more deserving than B."

Is bad faith required?

An interesting issue arises as to whether "bad faith" in the exercise of an absolute discretion needs to be proved before the exercise of a trustee's discretion can be impugned.

The contention that "bad faith" must be shown in cases of absolute discretion derives from the summary of the law in this area adopted by Northrop J from written submissions of counsel in *Clerical, Administrative and Related Employees Superannuation Pty Ltd v Bishop*.[21] The relevant passage in the summary reads as follows:

"The exercise of a discretion by trustees cannot of course be impugned upon the basis that their decision was unfair or unreasonable (see *Dundee General Hospitals Board of Management v Walker* [1952] 1 All ER 896) or unwise (*Gisborne v Gisborne* (1877) 2 App Cas 300 at

p.307). Where a discretion is expressed to be absolute it may be that bad faith needs to be shown (*Gisborne v Gisborne* supra at p.305)."

The summary was approved on appeal to the Full Court of the Federal Court. The relevant point was later adopted by the High Court of Australia in *Attorney-General (Cth) v Breckler*:[22]

"7. … Where a trustee exercises a discretion, it may be impugned on a number of different bases such as that it was exercised in bad faith, arbitrarily, capriciously, wantonly, irresponsibly, mischievously or irrelevantly to any sensible expectation of the settlor, or without giving a real or genuine consideration to the exercise of the discretion. The exercise of a discretion by trustees cannot of course be impugned upon the basis that their decision was unfair or unreasonable or unwise. *Where a discretion is expressed to be absolute it may be that bad faith needs to be shown.* The soundness of the exercise of a discretion can be examined where reasons have been given, but the test is not fairness or reasonableness." (emphasis added; citations omitted)

The passage in *Bishop* and the italicised sentence was examined in some detail by the Victorian Court of Appeal in *Wareham v Marsella*. The court commenced by noting that the authority of the summary cannot be denied but went on to hold as follows:[23]

"93 … But the point as to bad faith is made only tentatively, and it did not need to be decided in any of the cases mentioned, including *Bishop* itself. When one turns to the authority cited for the proposition, *Gisborne v Gisborne*, it is apparent that the relevant observation in the speech of Lord Cairns LC was made in passing in the course of construing a will. The passage reads:

The trustees are not merely to have discretion, but they are to have 'uncontrollable,' that is, uncontrolled, 'authority.' Their discretion and authority, always supposing that there is no *mala fides* with regard to its exercise, is to be without any check or control from any superior tribunal." (citations omitted)

The court went on to note (as McGarvie J did in *Karger v Paul*) that "the requirement of real and genuine consideration is so obvious that it is often not mentioned, these authorities should not be construed as requiring that bad faith be demonstrated in order to impugn the exercise of a trustee's absolute and unfettered discretion" (citations omitted).[24]

The reasoning in *Wareham v Marsella* was cited with approval in *Owies*. It is beyond doubt that "bad faith" need not be proved in cases of absolute discretion.

Owies

Background and facts

Dr John and Dr Eva Owies had three children: Michael, Deborah and Paul. Each member of the family was a beneficiary of a trust (the trust), settled by deed in 1970 (the deed).

JJE Nominees Pty Ltd was the trustee. Dr John and Dr Eva were directors of the trustee from registration until their deaths in 2020 and 2018.[25] On 10 March 2020, Mr Sampson, their solicitor, was validly appointed as a director of the trustee.[26] On 20 November 2019, Michael was appointed a director of the trustee.

The trust had assets with an estimated value of $23m and derived a substantial amount of income each year.[27]

The relationship between the parents and their children was the subject of extensive reasoning. There was a long history of a strained relationship between Deborah and Paul and their parents. The period of estrangement included the period between 2015 to 2019 which was the subject of the litigation. Michael had a much more favourable relationship with his parents but a fractured relationship with his siblings.

From 2011 to 2018, the trustee distributed all of the net income in the following proportions: John (40%); Michael (40%); and Eva (20%). Paul and Deborah did not receive a distribution of income in any of those years.

In 2019, Dr John received 100% of the income of nearly $1m. By that time, Dr Eva had died and he was 96 years old with limited needs. Further, by the end of the 2018 financial year, Dr John was owed $3,837,636.82 by the trust (and Dr Eva was owed $4,568,742.25).

In April 2019, Deborah received a distribution of capital in the form of a residential unit (owned by the trustee) which she resided in (the South Yarra apartment).[28] She had lived in that apartment since 1984. It was valued at around $720,000 to $760,000.

At trial, the plaintiffs (Deborah, Paul and, ultimately, Michael) sought several remedies in relation to the trust's administration. Relevantly, the plaintiffs sought declarations that "the trustee failed to give real and genuine consideration to the objects under the trust, with the consequence that the distributions were made in breach of trust".[29] This ground was pleaded in the alternative to the "distribution ground" which failed at trial and was not appealed.[30]

The trial judge made declarations that the trustee had failed to give proper consideration to Paul and Deborah in 2015 and 2016, and Deborah in 2018. However, the plaintiffs failed in respect of 2017 and 2019. Paul failed in respect of 2018.[31]

Unfortunately for the plaintiffs, they had not pleaded a claim for compensation based on the "no real and genuine consideration" ground. The plaintiffs did not seek orders avoiding the resolutions allegedly made without real and genuine consideration.[32] The trial judge refused leave to amend the pleading which meant relief was refused.[33]

The appeal

Deborah and Paul (the applicants) sought leave to appeal on 11 proposed grounds.[34] Of relevance was the contention that, in respect of 2017 and 2019, the judge erred in concluding that the trustee had given real and genuine consideration

to the position of the applicants and that the trustee had sufficient information as to their circumstances to enable to give them real and genuine consideration in making its decision regarding the trust income.[35]

The applicants also sought relief that the distributions be set aside on the basis that they were void. They sought an order that the trustee pay them the relevant amounts, reflecting a one-third share of the net income for each year in respect of which there was found to be a failure to give real and genuine consideration.[36]

The reasoning

The court held that the trustee had not given real and genuine consideration to the position of the applicants for 2017 and 2019.[37] This section of the article focuses on the following aspects of the court's reasoning in relation to the years in question where the settled pattern of distribution (40/40/20) occurred.[38]

- the nature and purpose of the trust;
- the inadequacy of the enquiries made by trustee; and
- the relevance of the "needs" of the beneficiaries.

The court also held that the breach of trust in failing to give real and genuine consideration to the exercise of the power rendered the distributions made to Dr John, Dr Eva and Michael "voidable rather than void".[39] It is beyond the scope of this article to address this interesting and complex issue.

Purpose of the trust

When considering the nature of the power to distribute annual income, "the starting point must be the nature and purpose of the trust having regard to the terms of the trust deed".[40] The trust was established by settlement. The preamble provided that the settlor settled the sum "being desirous of making provision for the Primary Beneficiaries and the General Beneficiaries".[41] The court appeared to take issue with some of the evidence which described the trust, in the context of Dr John and Dr Eva, as "their trust", rather than one established for the interests of the beneficiaries as a whole.[42]

Clause 3(i) of the deed dealt with the annual income of the trust as follows:

> "(i) The Trustees shall in each accounting period until the Vesting Day pay apply or set aside the whole or such part (if any) as they shall think fit of the net income of the Trust Fund of that accounting period for such charitable purposes and/or to or for the benefit of or for all or such one or more exclusive of the others or other of the General Beneficiaries living from time to time in such proportions and in such manner as the Trustees in their absolute discretion and without being bound to assign any reason therefor (but after considering the wishes of the Guardian) shall think fit;"

The primary beneficiaries were Deborah, Paul and Michael.[43] Dr John and Dr Eva were members of the class of general beneficiaries.

The deed contained broad powers to appoint the income of the trust. Relevantly, cl 17 provided that, subject to any express provision to the contrary, "every discretion vested in the Trustees shall be *absolute and uncontrolled* and every power vested in them shall be exercisable at their absolute and uncontrolled discretion" (emphasis added).[44]

The power in cl 17 was subject to considering the *express* requirement in cl 3 that the wishes of the guardian be considered. Dr John was both the guardian and the appointor.[45]

By cl 22, the appointor had control over the trust, through the "absolute discretion", to remove the trustee and appoint an additional trustee(s).

The "default" position in cl 3(ii) required that, in the event of a failure to apply or accumulate income of the trust fund, the income was to be held on trust in favour of the primary beneficiaries in equal shares. Under cl 4, the primary beneficiaries would take any non-applied or accumulated income (in default) of the whole fund on vesting.

In summary, it was significant that the trust was established to make provision for the primary beneficiaries. The purpose of the trust was therefore to make provision to those beneficiaries in an impartial way. The primary beneficiaries were all members of the same family and were the takers in default, a fact which the court held was also significant:[46]

> "113. In looking at the nature and purpose of the power to distribute income, it is also relevant that the trust deed provides, in default of appointment of income, and assuming they are living, that the three children hold the income pursuant to an express trust in equal shares. The intention that the primary beneficiaries take any non-applied or accumulated income in the same manner as will occur with respect to the whole fund on vesting, reinforces the general default structure of the trust deed as one providing for the benefit of the children in equal shares. That does not mean that the trust deed does not contemplate unequal distributions across the beneficiaries, an outcome made possible by the width of the discretionary powers. However, the exercise of all of the powers has to take into account the purpose of the trust and the default position just described."

Inadequacy of enquiries

The importance of the trustee making adequate enquires was referred to above. In *Owies*, the court reiterated that:[47]

> "111. … An obvious, but unstated, premise on which the trustee would be expected to discharge its duties is that it would generally be informed about the differing circumstances, needs and desires of each beneficiary as an incident of the familial bonds that underpin the trust and explain its purpose."

However, a key reason why the trustee in *Owies* failed in its duty to give real and genuine consideration to the position of the beneficiaries was because it made no enquiries of Paul and Deborah. The long history of the fractured relationship between Paul and Deborah and

their parents meant that there was not a free flow of information across the years.[48] Even where the trustee had historical information regarding the circumstances of the beneficiaries, it could not be assumed to be unchanging.[49]

The breakdown in the family dynamic was not a valid reason that alleviated the trustee from making adequate enquires. The court held that:[50]

> "111. … It is not to be supposed that, when those familial bonds become strained or broken, the purpose of the trust to provide for the family as a whole would change or that the trustee would be relieved of the obligation to properly inform itself."

"Needs" of the beneficiaries

The court took issue with the same pattern of distributions being made year on year with the exception of the extreme distribution to Dr John in 2019. The payout ratio of 40:40:20 (Dr John, Michael, Dr Eva) was said to be "strikingly uniform" and there was no obvious reason why the trustee would favour those beneficiaries in such a way.[51] The distributions made to Dr John and Dr Eva were lent back to the trust even though it was well resourced. This gave rise to substantial loan accounts in their favour.

The court reasoned that the payout ratio could not be explained by "need".[52] In particular, Deborah "had a demonstrable need for income"[53] and her "health and financial situation were parlous".[54] However, despite her needs, she did not receive any income from the trust at all. This raises the issue as to what extent, if any, the needs of the beneficiaries are relevant to the exercise of the discretion.

In addressing this issue, the court held that:[55]

> "121. Although need was not a qualifying factor for a distribution, the purpose of the trust was to make provision for the beneficiaries in the context of a family settlement. Deborah had strong claims to a favourable exercise of the discretion. That does not mean that a distribution had to be made to her; but the failure to do so, and the repetition of the same formula in each year up to and including 2018, strongly points to a lack of due consideration of her position."

The court inferred that the trustee had, by that time, reached a policy of distributions with a settled ratio that was inconsistent with a continuing obligation to consider the distribution of income for each accounting period.[56] The pattern of distributions as a whole was also relevant. In that regard, the trial judge was correct to view each year separately but the court held that this approach "came at the cost of understating the overall picture discernible from the pattern of distributions as a whole".[57]

Concluding remarks

The *Owies* decision illustrates the difficulties that a trustee faces, in a typical family trust situation, when there is a relationship breakdown between the trustee (or the directors of the trustee company) and certain family members who are also beneficiaries of the trust.

Family breakdown may lead to periods of estrangement. In such cases, it may be difficult for the trustee to exercise an "active discretion" when considering the income allocations of the trust by giving real and genuine consideration to the interests of the beneficiaries.

An aspect of the content of the duty to give "real and genuine consideration" is for the trustee to "be informed about the differing circumstances, needs and desires of each beneficiary as an incident of the familial bonds that underpin the trust and explain its purpose".[58] The *Owies* decision illustrates that the trustee is not "relieved of the obligation to properly inform itself" when there is family breakdown.[59]

One observation is that there seems to be a shift towards a greater (or more onerous) obligation on the trustee to adequately informed itself in order to be in a position to properly exercise the power when compared with the articulation in *Karger v Paul*.

> "A trustee must adequately inform itself to be in a position to properly exercise the power."

That said, the *Owies* decision should not be great cause for alarm among trustees and the practitioners that advise them. The reasoning applied by the court is orthodoxy, especially when viewed against the statements of principle in *Karger v Paul*, which Australian courts have consistently cited and applied.

The main reasons for the conclusion reached by the court in *Owies* were that: (1) the trustee was not aware of the circumstances of beneficiaries (Deborah and Paul) and did not make any enquiries; (2) the trustee generally used a set distribution formula of 40/40/20; and (3) the beneficiaries that missed out on any income allocations each year were primary beneficiaries and takers in default.

Thus, a key difficulty that a trustee may face is informing itself about the differing circumstances, needs and desires of each beneficiary of a family trust, especially in cases where there has been a breakdown in communication between family members.

A trustee may wish to take an active step by writing to each beneficiary before year end asking of "their needs, desires, hopes and wishes for the up and coming year". It is not suggested that the trustee must write back or give reasons to the beneficiaries for its decision. However, in such circumstances, a trustee will be more informed of the beneficiaries circumstances and therefore will be in a better position to exercise its discretion.

Norman Hanna
Barrister
Deane Chambers

References

1 *Karger v Paul* [1984] VR 161.

2 [2022] VSCA 142.

3 The principle is established in *Karger v Paul* [1984] VR 161 at 163–165 by reference to extensive authorities cited by McGarvie J in that case.

4 *Karger v Paul* [1984] VR 161 at 164 and 165.

5 *Karger v Paul* [1984] VR 161 at 166.

6 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [83].

7 *Karger v Paul* [1984] VR 161 at 166.

8 *Karger v Paul* [1984] VR 161 at 166.

9 *Karger v Paul* [1984] VR 161 at 165, citing Lord Truro LC in *Re Beloved Wilkes' Charity* [1851] EWHC Ch J52 (*Re Londonderry's Settlement* [1965] Ch 918 at 928-929 per Harman LJ).

10 [1959] HCA 8.

11 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [119].

12 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [97].

13 The similarity between the language used in this area of law vis-à-vis that used in public law was considered briefly in *Owies.* The court at [84] described the similarities as "superficial" and that there was no "ready analogy with deeds of settlement", save that "judicial restraint however, remains a hallmark of both areas of law".

14 *Karger v Paul* [1984] VR 161 at 166.

15 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142.

16 [2000] VSCA 180.

17 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [94].

18 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [95].

19 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [95].

20 [1981] 3 All ER 786 (as cited in *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [96]).

21 *Wareham v Marsella* [2020] VSCA 92 at [94], citing *Clerical, Administrative and Related Employees Superannuation Pty Ltd v Bishop* [1997] FCA 714 (*Bishop*).

22 [1999] HCA 28.

23 *Wareham v Marsella* [2020] VSCA 92.

24 *Wareham v Marsella* [2020] VSCA 92 [94].

25 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [16].

26 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [18].

27 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [1].

28 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [2].

29 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [3].

30 At trial, the first ground was that the trustee had not made a resolution each year. This ground was rejected (and not appealed) on the basis that the financial statements reflected the distributions.

31 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [4]–[5].

32 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142, fn 4.

33 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [5].

34 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [7].

35 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [8]–[9].

36 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [10].

37 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [13](a).

38 This article does not address the 2019 year where the entire income of the trust went to Dr John. The court's reasoning in respect of the extreme circumstances in the 2019 year is unsurprising.

39 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [13](d).

40 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [110].

41 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [110].

42 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [122].

43 As defined in cl 1 of the deed and the persons named in the Schedule.

44 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [24].

45 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [28]. Certain variations amending the description of the guardian and the appointor under the deed were held to be invalid at trial (and were not challenged on appeal), but these are not addressed in this article.

46 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142.

47 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142.

48 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [115].

49 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [117].

50 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [111].

51 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [120].

52 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [120].

53 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [120].

54 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [121].

55 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142.

56 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [125].

57 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [125].

58 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [111].

59 *Owies v JJE Nominees Pty Ltd* [2022] VSCA 142 at [111].

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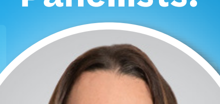

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A Matter of Trusts

by Magdalena Njokos and
Edward Skilton, Sladen Legal

Appointors sacking trustees to appoint themselves

The power to remove and appoint a trustee is widely accepted to be fiduciary in nature, exercised for the benefit of the beneficiaries of the trust, not the benefit of the appointor.

Role of an appointor

Particularly with modern trust deeds, the appointor usually holds a paramount position under the trust, being that it has the power to remove and appoint the trustee. It is worth noting that this power may also rest with persons of other roles/offices such as "guardian" and "principal" but, for the purposes of this article, we will refer to the position as "appointor".

Such a position is considered in depth in the context of succession planning for trusts and can be a useful tool in "passing the baton" in respect of the ultimate control of trusts.

Much has been considered in respect of the rights and responsibilities of trustees in their decision-making, but what about those of the appointor, in particular, when acting on the power to remove a trustee?

Fiduciary relationship between appointors and beneficiaries of trusts

Distinguishing whether appointor powers are personal or fiduciary in nature is critical in determining how appointor decisions are made and the factors to be considered by the appointor in order to be a valid exercise of power and discretion.

There is common law support for the characterisation of the power to appoint trustees as fiduciary in nature. This dates back to a 19th century decision of Kay J, in which it was emphasised that the power to select a trustee should not be made by that person in a manner which resulted in the appointor benefitting.[1]

It would therefore follow that an appointor ought to exercise its power (ie elect to fire/hire the trustee) if the appointor is of the view that the trustee was failing to act in the best interests of the beneficiaries. Absent specific wording in the trust instrument to the contrary, the appointor must exercise that power in the best interests of the beneficiaries.

Further, *Re Burton; Wily v Burton*[2] confirmed that the power of an appointor is not an asset of the appointor, rather a role that is fiduciary in nature, and therefore does not amount to "property" that can pass down to a trustee in bankruptcy. In this case, the trustee in bankruptcy argued that Mr Burton, as appointor and beneficiary of the trust, had the power to direct the trustee to distribute all capital and income to Mr Burton himself. Given this level of control, the trustee in bankruptcy purported to gain control of the trust (where it would likely distribute the assets to Mr Burton himself), therefore opening those assets up to the bankruptcy. The court stated that the power to remove and appoint a trustee was not "property" within the meaning of s 116 of the *Bankruptcy Act 1966* (Cth), and therefore the power of the appointor did not vest in the bankruptcy trustee. It is worth noting that there is ongoing debate in the family law context regarding the extent to which the control of trusts is considered a resource of a party to family law proceedings.

Appointors appointing themselves/a related company as trustee

Certain cases have noted that it would be an improper exercise of the appointor's power to remove the trustee in order to appoint themselves as trustee, in particular, if such power is not exercised in the interests of the beneficiaries of the trust.

In the case of *Baba v Sheehan*,[3] it was alleged that the appointment by an appointor of an entity constituted a fraud on a power. The appointor had appointed not himself as trustee but instead a company that he controlled. Parker J expressed doubt that an appointor should be prohibited from appointing themselves as trustee and that, in this case, the fact that the newly appointed trustee was a separate legal entity would in any event preclude it from being considered under any such rubric prohibition.[4]

On appeal (which was dismissed), the appellants sought to appeal on the sole ground that the judge erred in failing to hold that the purported removal and appointment was void as a fraud on the appointor's power under the trust deed, contending that the power had been exercised for an extraneous purpose. There was further analysis on the purpose of the power and the purpose and intention of the appointment of the new trustee:[5]

> "50. …Thus, the effect of replacing Smart Street with Silktote was to remove from Mr Baba and Mr Carney any capacity to have a say in the affairs of the Trust and to limit those who have such a say to Mr Sheehan and his wife. If that were the purpose and intention of Mr Sheehan in exercising the power, it would be for a foreign purpose and be void and ineffective. However, if Mr Sheehan, as Appointor, in good faith formed the view

that it was in the interests of all of the Unitholders that Smart Street be replaced with Silktote because Silktote was better qualified to manage the affairs of the Trust and the Trust Business, there would be no fraud on the power."

Putting aside the concerns that were considered in respect of the variation powers under two trust deeds, *Mercanti v Mercanti*[6] also considered whether the appointor should be empowered to appoint a company, which they controlled, to be the trustee. Following a dispute between a father and his son, the father and his wife as shareholders of two trustee companies purported to remove the son as a director of both companies. The son as appointor purported by notice in writing to remove the two trustee companies and appoint a company that the son controlled as trustee of both trusts.

The judgment of Buss P in this case noted that the exercise of the appointor power to change trustees to a trustee controlled by the son was not a fraud on the appointor power. The exercise of this power was held to be consistent with the control of the trust to preserve the status quo. It was also held that the son did not act dishonestly or in bad faith:

"320. In general:

(a) if the holder of a power created by a trust deed is entitled, on proper construction of the trust deed, to exercise the power for his or her own benefit, then the power will be personal as distinct from fiduciary;

(b) if the holder of a power created by a trust deed is not entitled, on a proper construction of the trust deed, to exercise the power for his or her own benefit, but is bound to exercise the power for the benefit of other persons or entities, then the power will be fiduciary as distinct from personal."

Conclusion

Common law has proven that the role of appointor is primarily a fiduciary role. A valid exercise of powers would therefore require the appointor to act in good faith, in accordance with the trust deed, while taking into considering all relevant matters pertaining to the power/decision being exercised.

While an appointor holds a paramount power under the trust deed, care needs to be taken when considering the removal of a trustee by an appointor to ensure that the appointor is not merely acting so as to put themselves in control of the trust. Rather, before any such removal, the appointor ought to consider the following key questions:

- What actions of the trustee have triggered the appointor to consider the removal of the trustee?
- Is the trustee's removal necessary to protect the assets of the trust?
- Is the trustee's removal necessary to protect the interests of the beneficiaries?
- Is the removal in accordance with the trust deed?
- Is the new proposed trustee better suited to manage the administration of the trust on behalf of the beneficiaries?

Magdalena Njokos
Special Counsel
Sladen Legal

Edward Skilton
Principal Lawyer
Sladen Legal

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1 *In re Skeats' Settlement; Skeats v Evans* (1889) 42 Ch D 522.
2 [1994] FCA 1146.
3 [2019] NSWSC 1281 at [42].
4 Ibid at [67].
5 [2021] NSWCA 58.
6 [2016] WASCA 206.

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Cumulative Index

The following cumulative index is for volume 58, issues (1) to (10). Listed below are the pages for each issue:

Vol 58(1): pages 1 to 56
Vol 58(2): pages 57 to 118
Vol 58(3): pages 119 to 168
Vol 58(4): pages 169 to 220
Vol 58(5): pages 221 to 300
Vol 58(6): pages 301 to 362
Vol 58(7): pages 363 to 406
Vol 58(8): pages 407 to 468
Vol 58(9): pages 469 to 531
Vol 58(10): pages 533 to 592

15-year exemption
small business CGT concessions, impact of death 288–290
50% CGT discount
consolidated groups, discretionary trusts within 347
contracts, timing issues 180, 181
family home becomes investment property 76
sale of shares in family trust 22
100-point innovation test 238
183-day test 10, 192

A

Absence rule
main residence CGT exemption 76, 255, 261, 262, 267
Absentee owner surcharge 102–104
Absolute entitlement
bare trusts 514
Accounting
foreign trusts 196
labour costs, construction or creation of capital assets 9, 10
livestock in Australia 509–511
loans and gifts 339, 340
sale and purchase agreements 39, 41, 43, 44
Accounting standards
general insurance contracts 174
Active assets
sale, small business CGT concessions 21
Adjacent land
main residence CGT exemption 255, 256
Administrative penalties
default assessments 476
Advancements
resulting trusts and 502–504, 506
Affordable housing – see **Housing affordability**
Aggregated turnover
connected entities
– Commissioner's discretion, control 174, 175
– concept 70
Agreement
acquisition of CGT asset, timing 180–183
Allocation of profits
professional practices 33
Amended assessments
property development profits 178, 179
Amnesty
payroll tax, medical practices 304
small business lodgment penalty 11, 33, 34
And for no other purpose
definition 176, 177
Announced but unenacted measures 32, 302, 366
Annual property tax 6
Annual reports
using to determine continuity of ownership 549–554
Anti-avoidance rule
intangible assets 26–30
Appointor
removal/appointment of trustees 575, 576
Archer Brothers principle 194
Arm's length concept
proposed OECD Two-Pillar Solution 472
superannuation fund 129–133
Army reserve transfer
early retirement scheme payment 373
Asprey report 189, 197, 511
Assessments – see also **Default assessments**
asset betterment 12, 13
Asset betterment assessments 12, 13
Asset protection
discretionary trusts 340, 341, 487, 488
– consolidated groups 345–348
– testamentary trusts 148, 149, 152
Assets – see also **Depreciating assets**
instant asset write-off 33, 174, 304
small business CGT concessions, asset sale versus share sale 21, 22
Associated transactions
landholder duty 210, 211
Associates
payments to
– low corporate tax jurisdictions 82, 84, 85
– R&D claims 438, 439
Audits
Project Wickenby 65
AusIndustry
R&D claims 435–438
Australian beneficiaries of foreign trusts
conduit foreign income 195
foreign income tax offset 200
foreign source income 189–201
tax rates 191, 192
Australian Capital Territory
non-foreign discretionary trust amendments 104
property taxes 6
Australian residents
foreign companies, central management and control 122
foreign source income 156, 157, 189–201
throwback interest 156, 189, 200
working overseas, residence status 477
Australian tax system
complexity and cost 60
statutory interpretation 172
taxation of gifts 443, 444
Australian Taxation Office
central management and control 122
deductibility of expenditure, approach to losses 539
digital services 176
dispute resolution 175
fraud prevention 175, 226
hybrid mismatch rules 540
individuals, ATO focus on claims 37
information-gathering powers 125
intangible assets 10
interest charges, deductions denied 368
main residence exemption in relationship breakdown 479
non-arm's length capital gains 158–160
objections, communication protocols 227, 228
R&D claims 435–440
reimbursement agreements 34, 35
risk framework, worker classification 371
Small Business Litigation Funding Program 119
SMSFs, voluntary disclosure service 106, 107
superannuation
– death benefits 342
– non-arm's length expenses 96, 98
trust vesting 498
Australian Treasury
2023 Intergenerational Report 224
Modernising individual tax residency 125
tax adviser misconduct 124, 125

B

Backpacker tax 102
Bad debt deduction
non-receipt rule, deferred consideration 334
Balance sheets
sale and purchase agreements 40–42
Banking industry
Know Your Customer 492
Bankruptcy
testamentary discretionary trusts 152, 153
trustees 488, 504
Bare trusts
absolute entitlement 514
CGT exposure 513
confused with resulting trusts 513
undocumented 513
whether deed can be prepared later 514
BAS agents – see **Tax practitioners**
Base erosion and profit shifting
anti-abuse tax (US) 85
country-by-country reporting 474
Global Anti-Base Erosion Rules 472
Benchmark interest rate
Div 7A 57
FBT 538
Beneficial enjoyment of trust property 199
Binding death benefit nominations 47–49, 141–143, 148, 491, 497, 506, 561–564
Bitcoin 62
Board of Taxation
individual tax residency rules 125
Review of corporate tax residency 122
tax consolidated groups, CGT roll-overs 137
Bonus deduction
SME energy incentive 174
Books of accounts
loans and gifts 339, 340
Bracket creep 536
Breed stock
record-keeping 511
"Bright line" test 125
Build-to-rent projects
foreign investment application fees 368
Building expenditure
income characterisation 37
Burden of proof
default assessments 307, 308
foreign trusts, financial accounting 196
lost trust deeds 14–19
payment, advance or deposit 68, 69
trust beneficiaries, amounts received by 372
Burnout
self-coaching strategies 204–206
Business activity statements
small business lodgment amnesty 33, 34
Business practice case
international tax evasion 65, 66

C

Capacity
loss of
– gifts made by attorney 109–111
– succession, SMSF members 559, 560
– superannuation conditions of release 91–93
Capital account or revenue account
labour costs, construction or creation of capital assets 9, 10
Capital assets
breeding stock 511
labour costs, creation or construction 8–10
Capital expense/capital nature
non-arm's length expenses 50
Capital gains
foreign trusts
– Australian beneficiaries of 156, 157, 190, 194–197
– transferor trust rules 192, 195–197
Capital gains tax
CGT improvement threshold 1
contracts, timing issues 180, 181
deferred consideration 327
– buyers 332
– market value substitution rule 332
– non-receipt rule 333–335
– sellers 331, 332
dwelling acquired by deceased estate 418–420
fairness fund payment, taxi industry 177, 178, 306
family law settlements 317, 318
main residence CGT exemption 76–79
non-arm's length income interaction 158–160
retiring partner 125, 126
vacant land 231
Capital gains withholding
foreign residents 368
Capital raisings
funded by franked distributions 35
Car museum
luxury car tax, quotable purpose 176, 177
Carry-forward of losses
deferred tax assets 549
who has incurred tax losses 552
Carrying on a business
vacant land deduction exclusion 232
versus working from home 77, 78
Cars – see **Motor vehicles**
Central management and control
ATO guidance 122
Centrelink pensions
default assessments 307, 308
CGT assets
asset sale compared with share sale 21, 22
owned by deceased individual 288, 289
CGT events
event A1 43, 180, 199, 254, 265, 267, 271, 272, 332, 336, 419, 420, 479, 480, 513
event B1 254, 265, 419, 479
event C1 254, 262, 265, 419
event C2 22, 199, 252–254, 265, 334, 419
event D1 180, 479

event D2 ... 479
event D3 ... 479
event E1 ... 254, 265, 347, 419, 513
event E2 ... 254, 265, 419
event E4 ... 157
event E4 to E8 ... 199
event E5 ... 265, 419, 514
event E5 to E7 ... 252
event E6 ... 252, 253
event E7 ... 265
event F1 ... 479
event F2 ... 254, 265, 419
event H1 ... 419
event H2 ... 177, 178, 199, 306
event I1 ... 254, 265, 268, 270, 273
event I2 ... 254, 265, 268, 273
event K3 ... 250, 253, 254, 265, 419
event K4 ... 254, 265, 419
event K6 ... 195, 265, 419
event L3 ... 136, 137

CGT improvement threshold ... 1

CGT main residence exemption – see **Main residence CGT exemption**

CGT roll-overs
family law settlements ... 318
family law superannuation splits ... 349, 350
relationship breakdown
– main residence CGT exemption ... 263, 264, 267, 268, 479–482
– sale of jointly owned property ... 78
sale and purchase agreements ... 44, 45
SMEs, tax consolidation ... 135–137

"Change-of-use" duty
commercial and industrial property (Vic) ... 454

Charities
community, deductible gift recipients ... 174

Children – see also **Minors**
death benefits ... 144
definition of "child" ... 142, 145
superannuation dependants ... 142, 144
testamentary discretionary trusts ... 150, 151, 153

Clean energy
electric vehicle customs and excise duty (Vic) ... 322

Clear and convincing proof – see **Evidence**

Clothing
work-related expenses ... 37

Code of Professional Conduct ... 127, 128, 310, 368, 427–431
breach reporting measures ... 430
disqualified entities providing tax agent services ... 427–431
Minister to amend ... 431
new notification obligations ... 375–378

Commercial and industrial property
tax reform (Vic) ... 453, 454

Commercial transactions
residential property, losses on purchase and sale ... 314

Commissioner of Taxation
compliance, vacant land deductions ... 235, 236
corporate limited partnerships, "crediting" an amount ... 474
default assessments ... 383–386, 476
depreciating assets, composite items ... 227, 414, 415
discretion, connected entities ... 174, 175
electric vehicles, home charging rate ... 414
fairness fund payment, taxi industry ... 306
input tax and fuel credits, time limits ... 475, 476
international tax evasion ... 65, 66
new appointment ... 363
Project Wickenby ... 65
risk assessment, foreign incorporated companies ... 122
royalties, software and intellectual property rights ... 412–414
self-education expenses ... 474, 475
Tax Summit address ... 175, 176

Commonwealth income support payments
superannuation conditions of release ... 94

Commonwealth penalty units ... 368, 538

Community charities
deductible gift recipients ... 174

Companies
acquisition of dwelling from, CGT relationship breakdown roll-over relief ... 481, 482
family trust elections ... 422, 423
interposed entity elections ... 423, 424

Company directors
penalties ... 541, 542
retirement, superannuation conditions of release ... 89
SMSF succession ... 560

Compassionate grounds
superannuation conditions of release ... 93, 94

Compliance
intangible assets ... 10
professional practices ... 33
reimbursement agreements ... 34, 35

Composite assets
depreciating assets ... 227, 414, 415

Conditions of release
superannuation
– compassionate grounds ... 93, 94
– first home super saver ... 94
– health-related ... 91–93
– preservation components ... 87
– retirement ... 88–91
– severe financial hardship ... 94
– spouse contribution splitting ... 95
– transition to retirement pension ... 93

Conduit financer arrangements
third party debt test ... 280

Conduit foreign income
received by Australian beneficiaries ... 195

Conflict transactions
gifts made by attorney ... 109–111

Connected entity
aggregated turnover ... 70
– Commissioner's discretion, control ... 174, 175
– concept of control ... 71–74
definition ... 70, 71

Consolidated entity disclosure statement ... 63

Consolidated groups
continuity of ownership test ... 552, 553
discretionary trusts ... 345–348
– CGT discount ... 347
– flexible distributions ... 346
– head company status ... 347
– income accumulation ... 346
– losses ... 347
– recommendations ... 347, 348
– subsidiary members ... 347
SMEs, CGT roll-overs ... 135–137

Constitutional validity
electric vehicle customs and excise duty (Vic) ... 320–323

Consultation
integrity provisions, design ... 410

Continuity of ownership test
deferred tax assets ... 549
determination from annual reports ... 549–554
foreign resident shareholder tracing ... 553
losses schedule ... 554
nominee shareholders ... 554
single notional entity ... 550–554
tracing rules ... 552, 553

Contractors
concept of, Federal Budget reform possibilities ... 534
employee or independent contractor ... 1, 370, 371, 450–452

Contracts
timing issues ... 180–183

Contribution splitting
spouse, superannuation conditions of release ... 95

Control – see also **Central management and control**
connected entities ... 71–74

Controlled foreign company regime
intangible integrity measure ... 84
third party debt test ... 280

Controlled test companies
substantial shareholders ... 552, 553

Copyright
software and intellectual property rights ... 413

Corporate collective investment vehicles
tax treatment ... 306, 307

Corporate limited partnerships
"crediting" an amount ... 474

Corporate tax entities
loss carry back rules ... 33, 185, 186

Corporate tax rates
low corporate tax jurisdictions ... 27, 28, 84, 85
multinational enterprises ... 538

Corporate tax residency
foreign incorporated companies ... 122
proposed amendments ... 35

Corpus of the trust estate ... 194

Cost of living tax cuts ... 412

Country-by-country reporting
public release ... 474

COVID-19 impacts
Australian musicians ... 381
maintainable earnings of businesses ... 39, 40
residential property, losses on purchase and sale ... 314

Cross-border arrangements
intangible assets ... 10
intangible integrity measure ... 82–86
software arrangements ... 412–414

Crypto economy
bitcoin ... 62

Customs and excise duty
electric vehicle charge (Vic) ... 304, 320–323
zero or low emissions vehicles (Vic) ... 409

D

Death – see also **Deceased estates**
before administration ... 250, 251
foreign residents, life events test ... 267
of transferor, foreign trusts ... 196
small business CGT concessions, impact on ... 288–290

Death benefits
BDBNs ... 47–49, 141–143, 148, 561–564
"fast death tax" ... 341–343
SMSFs
– beneficiaries ... 142, 143
– payments ... 141–145
– taxation ... 145
– timing of payments ... 143
– type of payment ... 143, 144
superannuation conditions of release ... 91

Death tax ... 244, 341–343, 561

Debt
sale and purchase agreements ... 40, 41

Debt creation rules
thin capitalisation ... 274, 277, 282, 283

Debt deductions
limitation ... 282, 283

Debt forgiveness
foreign trusts ... 198, 199
non-receipt rule, deferred consideration ... 334

Deceased estates – see also **Death**
dwelling acquired by, CGT ... 418–420
foreign resident beneficiaries ... 247–249
foreign trusts ... 197
legacies ... 250, 251
life and remainder interests ... 251, 252
main residence CGT exemption ... 249, 250, 264–266
present entitlement ... 243–247
residency ... 247–249
taxation ... 243–252
testamentary discretionary trusts ... 147
trusts
– guardianship ... 489, 490
– lost deeds ... 492, 493
– SMSF trust deed ... 491

Deductibility of expenditure
ATO approach to losses ... 539
ATO interest charges ... 368
car expenses, work-related ... 415
deferred consideration ... 328, 329
depreciating assets ... 227
intangible assets ... 26–30, 84, 85
litigation settlement ... 11, 12
overtime meal allowances ... 63
rental properties ... 67, 68
residential property, losses on purchase and sale ... 312–315
self-education ... 226, 474, 475
temporary full expensing ... 32
throwback interest, Australian beneficiaries ... 156, 200
travel expenses ... 64, 65
vacant land ... 231–236

Deductible gift recipient provisions
community charities ... 174
meaning of "school" ... 8

Deemed market value cost base ... 79

Default assessments
Centrelink pensions ... 307, 308
discharging onus of proof ... 383–386, 476
gambling/taxable income ... 308, 309

Deferred consideration
CGT consequences ... 327
– buyers ... 332, 335
– market value substitution rule ... 332
– non-receipt rule ... 333–335
– sellers ... 331–335
deductions ... 328, 329
earnouts distinguished ... 325–327
non-arm's length dealing ... 332, 333
ordinary income
– annuity ... 327, 328
– or employment income ... 329–331
share sales ... 325–335
TOFA rules ... 331–333
– balancing adjustment ... 332, 334
usage ... 325

Deferred tax assets
carry-forward of losses ... 549
continuity of ownership test ... 549

Demolition
established house, vacant land deductions ... 233
main residence CGT exemption ... 262, 263

Department of Industry, Science and Resources ... 435

Dependant
definition ... 148, 560

Depreciating assets
composite assets ... 227, 414, 415
technology investment boost ... 33
temporary full expensing ... 32

Deregistration
tax agents ... 127, 128, 310

Digital currency ... 62

Digital games tax offset ... 35, 36

Directors
penalties ... 541, 542
retirement, superannuation conditions of release ... 89
SMSF succession ... 560

Disability pensions ... 152

Disclaimers
trusts ... 500, 501, 507

Disclosure of information
consolidated entity disclosure statement ... 63
country-by-country reporting ... 474

Discount capital gain – see **50% CGT discount**

Discretionary trusts
amounts received by beneficiaries, penalties ... 372
appointment of new trustee ... 490
asset protection ... 340, 341
– consolidated groups ... 345–348
consolidated groups
– CGT discount ... 347
– flexible distributions ... 346
– head company status ... 347
– income accumulation ... 346

– losses 347
– recommendations 347, 348
– subsidiary members 347
deceased individuals, CGT assets owned by 289, 290
distributions 487–507
Div 7A loan issues 228, 229
family provision claims 498
family trust distribution tax 177
family trust elections 422–424
foreign surcharge provisions 102–104
lost trust deeds 14–19, 207, 208, 491–493
tax consolidated groups 345–348
testamentary trusts 147–154
trustee discretion 568–572
trustee duties 388–390

Dishonesty
Code of Professional Conduct 376

Disputes
resolution, ATO 175
trusts 488, 492, 495, 498

Disqualified entities
Code of Professional Conduct 427–431
reporting obligations 428–430

Distribution resolutions
trust income 446–449

Dividend traps
consolidated groups, discretionary trusts within 345

Dividends
family law settlements 317

Division 7A
benchmark interest rate 57
family law settlements 318
loan issues 228, 229
loan repayments 34
trust reforms 34
unpaid present entitlements 34

Divorce — see also **Relationship breakdown**
foreign residents, life events test 267
sale of jointly owned property 78
testamentary discretionary trusts 153

Documentation
books of accounts 339, 340
family law superannuation splits 349, 350
lost trust deeds 14–19, 207, 208, 337–339, 492, 493
production 301
roll-overs, sale and purchase agreements 44, 45
superannuation conditions of release 87
– retirement 90, 91
– temporary incapacity 93
– termination of employment 89–91
trust beneficiaries, rights to 390
trust relationship, ownership of land 513–515

Domestic minimum tax
multinational enterprises 538

Domestic travel expenses 63

Domicile test
individual taxpayers 477

Double tax agreements
Australia–Finland 102
Australia–Germany 102
Australia–NZ 102
Australia–South Africa 102
dual tax residents 192
royalties, software and intellectual property rights 412–414
state surcharges, validity 102–104

Double taxation
intangible assets anti-avoidance provision 29

Dual tax residents
trust distributions 192

Due diligence
sale and purchase agreements 39–46

Dwellings — see also **Main residence CGT exemption; Residential property**
foreign investments, fees for established dwellings 368

E

Early access
superannuation benefits 87

Early retirement scheme payment
army reserve transfer 373

Early-stage innovation companies
incurred expenses 369, 370
investor benefits 238

Earnings
sale and purchase agreements 39, 40

Earnouts
deferred consideration distinguished 325–327, 329, 330
sale and purchase agreements 42, 43

Education — see also **Tax education**
self-education expense deductions 226

Electric vehicles
customs and excise duty (Vic) 304, 320–323, 409
electric car discount 36
home charging rate 414

Employee
concept of, Federal Budget reform possibilities 534
definition 88
or independent contractor 1, 370, 371, 450–452

Employee bonus
assessable income 169

Employee declarations
FBT 62, 307, 539

Employers
FBT, electric car discount 36
SG contributions 36, 37

Employment
receipt of gain or reward 89
volunteering 88

Employment income
deferred consideration 329–331

Enduring power of attorney
gifts made by attorney 109–111
SMSF succession planning 559, 560, 563, 564

Energy incentive
SME bonus deduction 174
SME business boost 33, 63, 304

Engineering, procurement and construction contracts 64, 65

Enterprise
definition of "GST" 543–548

Enterprise value
sale and purchase agreements 39

Equitable life and remainder interests
deceased estates 251, 252

Equity value adjustments
sale and purchase agreements 40

Errors
GST, correcting by taxpayer 125

Estate planning — see **Succession and estate planning**

Ethics
increased regulation of tax profession 304

Evidence
car expenses, work-related 415
discretionary trusts 341
intangible assets 10
international tax evasion 65, 66
lost trust deeds 14–19, 207, 208, 337–339
tax agent, judicial review proceedings 126, 127
trust beneficiaries, amounts received by 372
trust relationship 514

Excepted trust income
minor beneficiaries 150, 151

Excise
definition 320

Executors
testamentary discretionary trusts 147

Expenses incurred
early-stage innovation companies 369, 370

Exploit
definition 27, 84

Express trusts 513, 514

F

Fairness
taxation of gifts 443

Fairness fund payment
taxi industry 177, 178, 306

Fame of an individual
use of for a fee 63
use of images 63

Family home
main residence CGT exemption 76

Family law
asset protection 340, 341
settlements, unrealised tax liabilities 317, 318
superannuation splits 349, 350
testamentary discretionary trusts 153, 154
trust assets 504–506

Family living expenses
superannuation conditions of release 94

Family provision claims
discretionary trusts 498

Family trust distribution tax 177, 422–424

Family trust elections 177, 201, 422–424

Family trusts — see **Discretionary trusts**

Farming
tax accounting, livestock 509–511
vacant land deduction exclusion 232

"Fast death tax"
superannuation 341–343

Federal Budget 2016–17 79

Federal Budget 2017–18 266

Federal Budget 2018–19 231, 566

Federal Budget 2022–23
SME business boosts 33

Federal Budget 2023–24
announced but unenacted measures 32, 302
business measures 32–36
global minimum tax 538
Medicare amendments 8
non-arm's length expenses 50, 51
retrospectivity 366
superannuation 36, 37, 225

Federal Budget 2024–25
pre-Budget submission 534

Federal–state taxation
vertical fiscal imbalance 322

Fiduciary trustee duties
lost trust deeds 337–339

Field non-manual fly-in fly-out employees 540, 541

Fifty per cent CGT discount
consolidated groups, discretionary trusts within 347
contracts, timing issues 180, 181
family home becomes investment property 76
sale of shares in family trust 22

Financial accounting
foreign trusts 196
labour costs, construction or creation of capital assets 9, 10
sale and purchase agreements 39, 41, 43, 44

Financial hardship
superannuation conditions of release 94

"Financial resource"
tax losses 317

Finland
Australia–Finland DTA 102

First home super saver scheme
superannuation conditions of release 94

Fixed ratio test
earnings-based method 274
thin capitalisation 274–278

Fixed trusts
superannuation funds, non-arm's length expenses 97, 100, 101

Fly-in fly-out employees
FBT
– employee declarations 307
– field non-manual fly-in fly-out employees 540, 541
travel expenses 64, 65, 119

Food
GST
– combination of foods 469
– prepared meals 228

Food and drink expenses
living-away-from-home allowance 539

Foreign currency 62
foreign trusts 192

Foreign hybrid mismatch rules
intangible integrity measure 84

Foreign income tax
intangible integrity measure 84

Foreign income tax offset
Australian beneficiaries 200
mismatches 201

Foreign investments
fees
– application fee increases 412
– build-to-rent projects 368
– established dwellings 368

Foreign pension funds
foreign trusts 197

Foreign resident companies
central management and control 122

Foreign residents
capital gains withholding 368
deceased estates, beneficiaries 247–249
main residence CGT exemption 78, 79, 266–272
– disposal of dwelling acquired from deceased person 268
– individuals 267
– inheritance of dwelling from deceased Australian resident 272
– inheritance of dwelling from deceased foreign resident 271
– life events exemption 267, 268
– relationship breakdown 268, 269
shareholder tracing 553, 554

Foreign source income
Australian beneficiaries, foreign trusts 156, 157, 189–201
employee bonus 169
temporary residents 192
voluntary disclosure 193

Foreign surcharge purchaser duty
NSW, validity 102–104

Foreign tax elections
sale and purchase agreements 45

Foreign trusts
Australian resident beneficiaries 156, 157, 189–201
– conduit foreign income 195
– death of transferor 196
– debt forgiveness 198, 199
– deceased estates 197
– family trust elections 201
– financial accounting, burden of proof 196
– foreign currency 192
– foreign pension funds 197
– in specie distributions 199, 200
– loans 199
– migration to Australia 196
– non-resident family trusts 196
– post-marital and family relief trusts 196
– testamentary trusts 197
– transferor trust rules 192, 195–197
– unpaid present entitlements 198, 199

Franked distributions
funded by capital raisings 35
in specie 368, 369

Fraud
ATO prevention 175, 226
international tax evasion 65, 66
Project Wickenby 65

Fraud and Criminal Behaviours Group 175

Freezing orders
family trust distribution tax 177

Fringe benefits tax
electric car discount 36
electric vehicles, home charging rate 414
employee declarations 62, 307, 539

Federal Budget reform possibilities ... 534
living-away-from-home allowance, reasonable amounts ... 538, 539
otherwise deductible rule ... 64, 65, 119
– field non-manual fly-in fly-out employees ... 540, 541
PAYG instalments ... 307
record-keeping
– adequate alternative ... 539
– exemption ... 539
small business lodgment amnesty ... 33
statutory or benchmark interest rate ... 538

Frozen food
GST, prepared meals ... 228

Fuel tax credits
time limits ... 475, 476

Funding resolution
SMSF loan agreement ... 131

Future earnings
sale and purchase agreements ... 42, 43

G

Gainfully employed
definition ... 88

Gambling income
default assessments ... 308, 309

General class investors
thin capitalisation ... 275

General insurance
accounting standards ... 174

General interest charge ... 177

Genuine redundancy payment
army reserve transfer ... 373

Germany
Australia–Germany DTA ... 102
royalty barrier rule ... 85

Gifts
books of account ... 339, 340
classification ... 442
deductible gift recipients ... 174
– meaning of "school" ... 8
made by attorney ... 109–111
taxation ... 442–444

Gig economy
definition of "worker" ... 534

Global Anti-Base Erosion Rules ... 472

Global minimum tax
multinational enterprises ... 538

Global tax evasion ... 65, 66

Goods and services tax
adjustments ... 35
cars, quotable purpose ... 176, 177
definition of "enterprise" ... 543–548
errors, correcting by taxpayer ... 125
food
– combination of foods, supplies of ... 469
– prepared meals ... 228
input tax and fuel credits, time limits ... 475, 476
instalments ... 35
payment, advance or deposit ... 68, 69
sale of land, taxable supply ... 415, 416
small business entity status ... 70
technical amendments ... 125

Goodwill
CGT, retiring partner ... 126
consolidated groups ... 136

Graziers
tax accounting, livestock ... 509–511

Group ratio test
thin capitalisation ... 274, 278, 279

Guardianship
trusts ... 489, 490

H

Hardship
superannuation conditions of release ... 94

Harmonisation
definition of "worker" ... 534
property taxes ... 6

Health conditions
terminal, superannuation conditions of release ... 91, 92

Henry review ... 443

High Court of Australia
statutory interpretation by ... 172

High net wealth individuals
foreign trusts, Australian beneficiaries of ... 189–201

Holiday home
family member occupation ... 77

Home charging rate
electric vehicles ... 414

Housing affordability
foreign investment application fees ... 368
foreign residents, CGT main residence exemption ... 266
residential properties ... 6

Hybrid mismatch rules ... 540

I

Implied trusts ... 513, 514

In specie distributions
foreign trusts ... 199, 200
franking credits ... 368, 369

Incapacity
superannuation conditions of release ... 91–93

Income
definition in trust deeds ... 447, 448
fairness fund payment, taxi industry ... 177, 178, 306
fame of an individual ... 63
intangible assets, indirect derivation ... 28

Income accumulation
discretionary trusts ... 346

Income characterisation
building expenditure ... 37

Income-earning activities
self-education expenses ... 474, 475

Income equalisation clause
trust deeds ... 447, 448

Income inclusion rule ... 472

Income splitting
minors ... 150

Income streams
transfer balance cap
– defined benefit ... 306
– effect of ... 36

Income tax returns
small business lodgment amnesty ... 11, 33
unlodged, sale and purchase agreements ... 45

Incurred expenses
early-stage innovation companies ... 369, 370

Independent contractor
or employee ... 1, 370, 371, 450–452

Indictable offences
registered tax agents ... 376

Individuals
ATO focus ... 37
deceased, CGT assets owned by ... 288, 289
fame
– use of for a fee ... 63
– use of images ... 63
rates of tax ... 412
residency tests ... 10, 11, 35, 125

Industrial and commercial property
tax reform (Vic) ... 453, 454

Information disclosure
country-by-country reporting ... 474
SMSFs, voluntary disclosure ... 106, 107

Information-gathering
ATO powers ... 125

Information-sharing
tax practitioners ... 432

Inheritance
superannuation fund ... 88

Innovation
early-stage innovation company scheme ... 238–240
R&D claim improvement ... 434–**440**

Input tax credits
adjustments ... 35
technical amendments ... 125
time limits ... 475, 476

Insolvency
testamentary discretionary trusts ... 152, 153
trustees ... 487, 505

Inspector-General of Taxation
Small Business Litigation Funding Program ... 119

Instant asset write-off
small business entities ... 33, 174
small-to-medium businesses ... 304

Insurance
accounting standards ... 174
permanent incapacity, condition of release ... 91

Intangible assets
anti-avoidance rule ... 26–30, 82–86
associate payments, low corporate tax jurisdictions ... 82, 84, 85
cross-border arrangements ... 10
definition ... 27
definition of "royalty" ... 83
denial of deductions ... 60, 84, 85
ordinary meaning ... 83
right to exploit ... 83, 84
royalty withholding tax ... 27, 84

Intangible-related payments
significant global entities ... 82–86

Integrity measures
design ... 410
intangible assets anti-avoidance rule ... 26–30, 82–86
multinational enterprises ... 304
reporting obligations imposed by ... 410
thin capitalisation ... 62, 63, 304
transparency ... 63
vacant land deductions ... 231–236

Intellectual property
anti-avoidance rule ... 27, 28
definition of "royalty" ... 83
intangible integrity measure ... 82
royalty withholding tax ... 412–414

Interdependency relationship
definition ... 144, 145, 148
superannuation dependants ... 142, 144, 148

Interest charges
ATO deductions denied ... 368
Australian resident beneficiaries ... 156, 189, 200

Interest expenses
vacant land deductions ... 234

Intergenerational Report ... 224

International tax
multinational enterprises ... 538

International tax evasion ... 65, 66

International tax treaties
state surcharges, validity ... 102–104

Interposed entity elections
family trust elections ... 422–424

Investments
foreign investment application fees ... 368, 412
landholder duty ... 210, 211
SME business boosts ... 33

Investors
early-stage innovation company scheme ... 238, 240

J

James review ... 427, 432

JobKeeper
Australian musicians ... 381
expenditure on salaries ... 438
overpayment ... 309, 310

Judicial review proceedings
tax agent ... 126, 127

K

Know Your Customer ... 492

L

Labour costs
construction or creation of capital assets ... 8–10

Land
commercial and industrial property (Vic) ... 453, 454
owned by trustee ... 513–515
sale of land
– contracts, timing issues ... 183
– taxable supply ... 415, 416
vacant land deductions ... 231–236

Land tax surcharge
commercial and industrial property (Vic) ... 454
foreign discretionary trusts ... 102–104

Landholder duty
associated transactions ... 210, 211

Leases
vacant land deductions ... 231–236

Legacies
deceased estates ... 250, 251

Legal personal representative
definition ... 145
superannuation dependants ... 142

Legal practice
CGT, retiring partner ... 125, 126

Legal professional privilege
tax adviser misconduct ... 124

Legislation
retrospectivity ... 366
technical amendments ... 125

Letter of wishes ... 341

Life and remainder interests
deceased estates ... 251, 252

Life events test
foreign residents ... 267

Life insurance
foreign trusts ... 197

Limited recourse borrowing arrangements
SMSFs, nil cashing ... 90

Liquidation
sale of business ... 22

Litigation
settlement amount, deductibility ... 11, 12
Small Business Litigation Funding Program ... 119

Livestock
tax accounting ... 509–511

Living-away-from-home allowance
FBT
– employee declarations ... 307
– reasonable amounts ... 538, 539

Loan agreements
SMSFs, non-arm's length income ... 129–133

Loan repayments
Div 7A ... 34

Loan scheme
upfront duty payments (Vic) ... 454

Loans
books of account ... 339, 340
definition of "loan" ... 221
Div 7A issues ... 228, 229
FBT, statutory or benchmark interest rate ... 538
foreign trusts ... 199, 200

Lodgment penalty amnesty
small business ... 11, 33, 34

Look-through earnout rights ... 41, 42

Loss carry back rules
claiming tax offset ... 185, 186
temporary measures ... 33

Loss of capacity
gifts made by attorney ... 109–111

Loss or outgoing
holding land ... 234
residential property, purchase and sale ... 312–315

Losses
carry back rules
– claiming tax offset ... 185, 186
– temporary measures ... 33
carry-forward
– deferred tax assets ... 549
– who has incurred tax losses ... 552
continuity of ownership test ... 549–554
"financial resource" ... 317
private or domestic nature ... 539

Lost trust deeds ... 14–19, 207, 208, 337–339, 492, 493

Low corporate tax jurisdiction
definition ... 27, 28, 84
intangible assets ... 26–30, 82, 84, 85

Low-income threshold
Medicare amendments ... 8

Lump sum death benefits
payments ... 143
SMSF members ... 560, 561
taxation ... 144

Luxury car tax
car museum, quotable purpose ... 176, 177

M

Main residence CGT exemption
absence rule 76, 255, 261, 262, 267
adjacent land 255, 256
building separate to the land 257
deceased estates 249, 250, 264–266, 418–420
demolition 262, 263
family home becomes investment property 76
family law settlements 318
foreign residents 78, 79, 266–272
– disposal of dwelling acquired from deceased person 268
– individuals 267
– inheritance of dwelling from deceased Australian resident 272
– inheritance of dwelling from deceased foreign resident 271
– life events exemption 267, 268
– relationship breakdown 268, 269
owning two or more dwellings 257, 258
relationship breakdown
– CGT roll-overs 263, 264, 267, 268, 479–482
– foreign residents 268, 269
– sale of jointly owned property 78
requirements 254, 255
special disability trusts 266
tax concessions 76–79
two buildings on the land 256, 257
using dwelling to derive income 258–262
– deceased estates 264, 265
working from home versus carrying on a business 77, 78

Maintainable earnings
sale and purchase agreements 39, 40

Market value
SMEs, CGT roll-overs 135, 136

Market value substitution rule 129, 137
CGT, deferred consideration 332

Marriage breakdown — see **Relationship breakdown**

Maximum net asset value test 21, 22

Meal allowances
expenses, reasonable amounts 63

Medical conditions
terminal, superannuation conditions of release 91, 92

Medical practices
payroll tax changes 304, 409

Medicare levy 8, 412

Member Spotlight
Kylie Thompson 381
Max Hendriks 485

Mental incapacity
gifts made by attorney 109–111

Mergers
superannuation funds 306

Mergers and acquisitions
sale and purchase agreements 39–46

Mid-year economic and fiscal outlook, 2023–24 368

Mindfulness
self-coaching 204–206

Minors — see also **Children**
testamentary trusts 150–152, 565, 566

Mirror taxes 320, 322, 323

Misconduct
tax advisers 124, 125
tax agents 368
tax practitioners 428

Motor vehicles
electric vehicles
– customs and excise duty (Vic) 304, 320–323
– electric car discount 36
– home charging rate 414
FBT
– cents per kilometre 538
– statutory or benchmark interest rate 538
quotable purpose 176, 177
work-related expenses
– ATO focus on claims 37
– cents per kilometre rate 37
– deductibility 415

Multinational enterprises
corporate tax rate 538
country-by-country reporting, public release 474
hybrid mismatch rules 540
minimum tax 538
OECD Two-Pillar Solution 472
reallocation of taxing rights for MNE groups 472
tax integrity measures 304
thin capitalisation rules 274–283, 304

Multinational Tax Integrity Package 366

Museums
cars, quotable purpose 176, 177

Musicians
JobKeeper payments 381

N

Net cash/debt adjustment
sale and purchase agreements 40, 41

Net income
definition 447

Netherlands
royalty withholding tax 85

New South Wales
annual property tax 6
non-foreign discretionary trust amendments 104
surcharge purchaser duty, validity 102–104

New Zealand
Australia–NZ DTA 102

Non-arm's length arrangements
deferred consideration 332, 333
SMSF property development profits 64, 101

Non-arm's length expenses
SMSFs
– amendments 304
– pending changes 392–394
– staff discount policies 516, 517
superannuation funds
– amendments 96, 97
– fixed trusts 97, 100, 101
– general fund expenses 98, 99
– in specie contribution value 98
– non-fixed trusts 97
– private companies 97, 100, 101
– proposed changes 50, 51, 60
– services provided in capacity of trustee 99, 100
– specific assets 97, 98

Non-arm's length income provisions
CGT interaction 158–160
staff discount policies, SMSFs 516, 517
superannuation 37, 50, 51, 96–101, 129–133, 224

Non-receipt rule
CGT, deferred consideration 333–335

Non-resident companies
central management and control 122

Non-resident trusts — see **Foreign trusts**

Non-residents — see **Foreign residents**

O

Objections
ATO communication protocols 227, 228

OECD
base erosion and profit shifting 472
base erosion and profit shifting project 474
earnings-based best practice model 62
Pillar One 60, 472
Pillar Two 60, 84–86, 304, 366, 472, 535, 538
Transfer Pricing Guidelines 472

Offences
indictable 376

Offshore estates
testamentary trusts 197

Offshore receipts in respect of intangible property rule (UK) 85

Onus of proof
default assessments 307, 308, 383–386, 476

Ordinary concepts test
residence status, individual taxpayers 477

Ordinary family or commercial dealings 35, 201

Ordinary income
fame of an individual 63
gifts constituting 442, 443

Otherwise deductible rule
FBT, fly-in fly-out employees 64, 65, 119, 307, 540, 541

Overdue tax returns
small business lodgment amnesty 11

Overseas R&D activities 436, 437

Overseas travel expenses 63

Overtime meal allowances
expenses, reasonable amounts 63

Ownership interest
deceased estates 418–420
dwelling, CGT relationship breakdown roll-over relief 479–482

P

Partnerships
CGT, retiring partner 125, 126
corporate limited partnerships, "crediting" an amount 474

Pasturalists
tax accounting, livestock 509–511

Patent box regimes
intangible integrity measure 82, 84, 85

Payday superannuation 36, 37, 224, 304

PAYG instalments 35
FBT 307

PAYG withholding
director penalties 541, 542
employee or independent contractor 370, 371, 450–452

Payroll tax
medical practices 304, 409

Penalties
Commonwealth penalty unit increase 368, 538
company directors 541, 542
default assessments 476
disqualified entities, reporting 430
family law superannuation splits 350
small business lodgment amnesty 11, 33, 34
tax adviser misconduct 124
tax promoter penalty laws 124, 225, 304, 306, 409, 410
trust beneficiaries, recklessness 372
unregistered tax agents 371, 372

Pensions
death benefit payments 143–145, 561, 566
foreign trusts 197
transition to retirement 93

Permanent incapacity
superannuation conditions of release 91

Permanent retirement
superannuation conditions of release 89, 90

Personal services income
fame of an individual 63

Policy
collaborative development 60

Post-marital and family relief trusts 196

Prepared food
GST 228

Present entitlement
deceased estates 243–247
trust income, resident beneficiaries 198

Preservation age
superannuation 88
transition to retirement pension 93

Preserved benefits
superannuation, components 87

Primary production
tax accounting, livestock 509–511
vacant land deduction exclusion 232

Private companies
dividends, family law settlements 317
superannuation funds, non-arm's length expenses 97, 100, 101

Probate of wills 147

Productivity
self-coaching 204–206

Professional practices
allocation of profits 33
increased regulation 304
legal practice, retiring partner 125, 126

Project Wickenby 65

Promoter penalty laws 124, 225, 304, 306, 409, 410, 428, 432

Property — see also **Residential property**
commercial and industrial, tax reform (Vic) 453, 454
definition 150, 152, 153

Property development
assessable income 178, 179
profits diverted to SMSFs 64, 101

Property investments
build-to-rent projects, lower fees 368
transfer duty 210, 211

Property taxes
harmonisation 6

Protective trusts
testamentary discretionary trusts 151, 152

Proximity
trust beneficiaries 497

Public interest
unregistered tax agent 371, 372

Public interest register
Tax Practitioners Board 429

PwC
measures 225, 226, 368, 375, 377
tax leaks 124

Q

Qualified domestic minimum top-up tax 472
intangible integrity measure 84

Queensland
non-foreign discretionary trust amendments 104

Quotable purpose
definition 176

R

Rates of tax
family trust distribution tax 422–424
foreign trusts, Australian beneficiaries 191, 192, 200
individuals 412
lump sum death benefits 144
minor beneficiaries of trusts 150, 151
multinational enterprises 538
pension benefits 145

R&D activities
claims, improvement 434–440
tax incentives 369

Real and genuine consideration
trust beneficiaries 568–572

Record-keeping
breeding stock 511
FBT 62
– adequate alternative 539
– exemption 539
loans and gifts 339, 340
lost trust deeds 14–19, 207, 208, 337–339
R&D claims 434–436, 440
trust beneficiaries, amounts received by 372
trusts 488, 489

Redundancy
army reserve transfer 373

Reforms — see also **Tax reforms**
fraud prevention 175, 226
minor beneficiaries of trusts, concessions 150, 151
tax adviser misconduct 124, 125
Tax Practitioners Board 226
taxation of gifts 443, 444
trust issues 34

Refunds
surcharge duty/land tax 102, 103

Reimbursement agreements
ATO guidance 34, 35
being a party to 221

share buy-back ... 66, 67
trusts ... 501, 502, 506

Reimbursements
or receipt of gain, whether employment ... 89

Relationship breakdown — see also **Divorce**
family law settlements ... 317, 318
family law superannuation splits ... 349, 350
family trusts, trustee duties ... 568–572
main residence CGT exemption ... 263
– CGT roll-overs ... 263, 264, 267, 268, 479–482
– foreign residents ... 268, 269
sale of jointly owned property ... 78
testamentary discretionary trusts ... 153, 154

Release authority
withdrawal of superannuation funds, tax liability ... 286

Rental properties
absence rule ... 76
ATO focus on rental income claims ... 37
deductibility of expenses ... 67, 68
family home becomes investment property ... 76
later used as home ... 77

Reporting obligations
country-by-country reporting ... 60, 474
disqualified entities ... 428–430
gifts ... 444
integrity provisions imposing ... 410
tax practitioners ... 427–432
transparency ... 63

Research and development — see **R&D**

Residency
deceased estates ... 247–249
individual taxpayers ... 477

Residency assumption
foreign source income ... 189, 195

Residency tests
foreign companies ... 122
individuals ... 10, 11, 35, 125

Resident
definition ... 122

Resident beneficiaries
conduit foreign income ... 195
foreign source income ... 156, 157, 189–201
present entitlement to trust income ... 198
tax rates ... 192, 193

Residential property
foreign investment fee increases ... 412
housing affordability ... 6
losses on purchase and sale, allowable deduction ... 312–315
main residence CGT exemption ... 76–79

Residential vacant land
whether deductible ... 233

Restricted non-preserved benefits
superannuation ... 87

Resulting trusts
advancements and ... 502–504, 506
bare trusts confused with ... 513

Retirement
army reserve transfer ... 373
CGT, retiring partner ... 125, 126
definition ... 88
superannuation conditions of release ... 88–91
transition to retirement pension ... 93

Retrospectivity
medical practices, payroll tax ... 304
proposed measures ... 304
thin capitalisation ... 366
uncertainty caused by ... 366

Reversionary pensions
death benefit payments ... 143, 144

Reward or receipt of gain
whether employment ... 89

Risk assessment
foreign incorporated companies ... 122
professional practice profits ... 33
reimbursement agreements ... 34, 35
sale and purchase of business ... 43

Roll-overs
sale and purchase agreements ... 44, 45

Royal commission on taxation ... 510

Royalties
intangible integrity measure ... 83
software and intellectual property rights ... 412–414

Royalty withholding tax ... 27, 29, 82, 84, 85

S

Sale and purchase agreements
completion ... 41, 42
earnouts ... 42, 43
enterprise value ... 39
equity value adjustment ... 40
financial accounting ... 39
foreign tax elections ... 45
locked box mechanism ... 42
maintainable earnings ... 39, 40
net cash/debt adjustment ... 40, 41
roll-overs, documenting ... 44, 45
tax warranties ... 43, 44
unlodged returns ... 45
value assignment ... 41, 42
working capital ... 40–42

Sale of business
sale and purchase agreements ... 39–46
small business CGT concessions ... 21, 22

Sale of land
contracts, timing issues ... 183
taxable supply ... 415, 416

Scheme
definition ... 131

School
meaning ... 8

Scrip-for-scrip roll-overs
sale and purchase agreements ... 44, 45
SMEs, tax consolidation ... 135, 136

Secrecy provisions
need for reform ... 124, 125

Self-assessment
individuals, residency tests ... 10, 11

Self-coaching
time management and productivity ... 204–206

Self-dealing
trustee duties to not engage in ... 389, 390

Self-education
expense deductions ... 37, 226, 474, 475

Self-employed
definition ... 88

Self-managed superannuation funds
BDBNs ... 47–49, 148, 491, 497, 506, 561–564
conditions of release
– compassionate grounds ... 93, 94
– first home super saver ... 94
– health-related ... 91–93
– preservation components ... 87
– retirement ... 88–91
– severe financial hardship ... 94
– spouse contribution splitting ... 95
– transition to retirement pension ... 93
death benefit payments ... 141–145, 566
death of member, succession ... 560
family law, splitting notices ... 349, 350
“fast death tax” ... 341–343
inheritance of fund ... 88
limited recourse borrowing arrangements ... 90
non-arm’s length expenses
– amendment ... 304
– pending changes ... 392–394
non-arm’s length income, loans ... 129–133
preservation components ... 87
property development profits diverted to ... 64, 101
property investments, transfer duty ... 210, 211
staff discount policies ... 516, 517
succession planning ... 559–561
voluntary disclosure to ATO ... 106, 107

Senate Economics Legislation Committee ... 392, 428

Separation
foreign residents, life events test ... 267

Settlement proceedings
deductibility of expenditure ... 11, 12

Share buy-back
reimbursement agreements ... 66, 67

Share sale agreements
deferred consideration ... 325–335

Shareholders
continuity of ownership test
– foreign residents ... 553, 554
– nominees ... 554
– single notional entity ... 553
– substantial ... 552, 553
control, connected entities ... 71–74

Shares
small business CGT concessions
– share sale compared with asset sale ... 21, 22
– shares owned by deceased ... 289

Sharing economy
definition of “worker” ... 534

Shortfall interest charge ... 177

Significant global entities
intangible assets anti-avoidance rule ... 26–30, 82–86

Single entity rule ... 136, 346

Single notional entity
continuity of ownership test ... 550–554

Skills and training boost ... 33

Small business
disposal via asset sale or share sale ... 21, 22
energy incentive ... 33, 63, 174, 304
Federal Budget 2023–24 measures ... 32, 33
instant asset write-off ... 33, 174, 304
lodgment penalty amnesty ... 11, 33, 34
pooling rules ... 33
skills and training boost ... 33, 62
Small Business Litigation Funding Program ... 119
tax debt ... 175
technology investment boost ... 33, 62
temporary full expensing ... 32

Small business CGT concessions
asset sale compared with share sale ... 21, 22
connected entities ... 70
death
– 15-year exemption ... 288–290
– deceased individuals, CGT assets owned by ... 288, 289
– impact on ... 288–290
– shares owned by deceased ... 289
family law settlements ... 318
scrip-for-scrip roll-overs ... 44, 45

Small business entities
aggregated turnover ... 70
tax concessions ... 70

Small Business Litigation Funding Program ... 119

Small-to-medium businesses
energy incentive ... 33, 63, 174, 304
instant asset write-off ... 304
tax consolidation, CGT roll-overs ... 135–137

Software arrangements
character of payments ... 413
intellectual property rights, royalties ... 412–414

Sole or primary use test ... 453

South Africa
Australia–South Africa DTA ... 102

South Australia
non-foreign discretionary trust amendments ... 104
stamp duty ... 6

Special disability trusts ... 152

Specific entitlement
capital gains and franked distributions ... 447

Spouses
BDBNs ... 47–49, 562, 563
CGT relationship breakdown roll-over relief ... 479, 480
superannuation contribution splitting ... 95
superannuation dependants ... 142

Staff discount policies
SMSFs ... 516, 517

Stamp duty
commercial and industrial property (Vic) ... 453, 454
harmonisation ... 6
South Australia ... 6

Start-ups
early-stage innovation company scheme ... 238–240

Statutory interest rate
FBT ... 538

Statutory interpretation
by High Court of Australia ... 172
intangible assets anti-avoidance rule ... 26–30

Streaming rules
capital gains and franked distributions ... 447
deceased estates ... 243

Structure in use or available for use
vacant land deductions ... 233

Student accommodation
commercial property (Vic) ... 453

Subject to tax rule ... 472

Substantial and permanent structure
vacant land deductions ... 233

Substantial shareholders
controlled test companies ... 552, 553

Succession and estate planning
BDBNs ... 47–49, 141–143, 148, 561–564
books of accounts ... 339, 340
“fast death tax” ... 341–343
gifts ... 339, 340
gifts made by attorney ... 109–111
inheritance of superannuation fund ... 88
loans ... 339, 340
lost trust deeds ... 337–339
SMSFs ... 559–561
testamentary discretionary trusts ... 147–154
trusts ... 488, 497, 500

Superannuation
balances above $3m, 15% levy ... 225, 285–287
– indexation ... 536
BDBNs, death benefits ... 47–49, 141–143, 148, 561–564
certainty for superannuants ... 224
complexity and cost of system ... 60
concessions, amendments ... 225
conditions of release
– compassionate grounds ... 93, 94
– first home super saver ... 94
– health-related ... 91–93
– preservation components ... 87
– retirement ... 88–91
– severe financial hardship ... 94
– spouse contribution splitting ... 95
– transition to retirement pension ... 93
employee or independent contractor ... 1, 370, 371, 450–452
family law, splitting notices ... 349, 350
“fast death tax” ... 341–343
inheritance of fund ... 88
non-arm’s length income rules ... 37, 50, 51, 96–101, 129–133
payday superannuation ... 36, 37, 224, 304
proposals for change ... 224
reform possibilities ... 534
SG contribution shortfall ... 36
transfer balance cap
– defined benefit income streams ... 306
– effect on income streams ... 36

Superannuation benefits
documentation ... 87
early access ... 87

Superannuation death benefits
BDBNs ... 47–49, 141–143, 148, 561–564
“fast death tax” ... 341–343
payments ... 141–145
taxation ... 144
treatment of payments ... 566

Superannuation dependant
definition ... 144

Superannuation earnings ... 285–287

Superannuation guarantee shortfall ... 36

Superannuation trustee
services provided to fund, non-arm’s length expenses ... 99, 100

Surcharge purchaser duty
NSW, validity 102–104
Switch-over rule 472

T

Tasmania
non-foreign discretionary trust amendments 104
Tax Academy 302, 303
Tax accounting – see **Accounting**
Tax advisers
misconduct 124, 125
Tax agents
Code of Professional Conduct, significant breaches of 376, 377
deregistration 127, 128, 310
judicial review proceedings 126, 127
misconduct 368
new notification obligations 375–378
not fit and proper person 310
unregistered entity 371, 372
Tax avoidance
promoter penalty laws....124, 225, 304, 306, 409
Tax Avoidance Taskforce 175
Tax concessions – see also **Small business CGT concessions**
main residence CGT exemption 76–79
small business entities 70
superannuation 225
Tax consolidation – see **Consolidated groups**
Tax credits
input tax and fuel, time limits 475, 476
Tax cuts
cost of living 412
Tax debts
freezing orders issued 177
Tax education
CommLaw1 Dux Award, study period 1, 2023
– Fredrick Law 557
CommLaw2 Dux Award, study period 3, 2022
– Chris Green 139
Corporate Tax Dux Award, study period 1, 2023
– Vincent Oldani 425
Corporate Tax Dux Award, study period 3, 2022
– Tanim Islam 24
CTA1 Foundations Dux Award, study period 2, 2023
– Daksh Aggarwal 379
CTA2A Advanced Dux Award, study period 3, 2022
– Bryan Hartanto 81
CTA3 Advisory Dux Award, 2023
– Mitchell Bird 241
Graduate Certificate in Applied Tax Law 25
Graduate Diploma of Applied Tax Law 25, 139
Tax Academy 302, 303
Tax for Trusts Dux Award, study period 1, 2023
– Yuxi Dedic 187
Tax for Trusts Dux Award, study period 2, 2023
– Marianne Dakhoul 483
Tax exploitation schemes 124, 225, 304
Tax incentives
R&D activities 369, 434, 435
Tax Knowledge Exchange database 303
Tax liabilities
increases and reductions 366
unrealised, family law settlements 317, 318
Tax losses – see **Losses**
Tax offsets
digital games 35, 36
foreign income
– Australian beneficiaries 200
– mismatches 201
loss carry back rules 185, 186
R&D tax incentives 369
Tax practitioners
advising individuals 37
Code of Professional Conduct 427–431
Federal Budget 2023–24 measures 32, 33
reporting obligations 427–432
Tax Practitioners Board
appointments 428, 431
deregistration of tax agent 127, 128, 310
independence 427
James review 427
judicial review proceedings 126, 127
new notification obligations 375–378
operational changes 432
powers 432
public interest register 429
reforms 226
sanctions regime 368
tax adviser misconduct 124, 125
unregistered entity 371, 372
Tax rates – see **Rates of tax**
Tax reform
commercial and industrial property (Vic) 453, 454
Tax reforms – see also **Reforms**
short consultations 304
thin capitalisation 60, 62
transparency 63
Tax returns
GST, taxpayers correcting errors 125
small business lodgment amnesty 11
unlodged, sale and purchase agreements 45
Tax risk – see **Risk assessment**
Tax sharing agreements
consolidated groups, discretionary trusts within 345, 346
Tax thresholds 412
Tax warranties
sale and purchase agreements 43, 44
Taxable superannuation earnings
new 15% tax 225, 285–287, 304
Taxable supply
sale of land 415, 416
Taxation of financial arrangements
deferred consideration 331–333
Taxi industry
fairness fund payment 177, 178, 306
Taxpayer liabilities
increases and reductions 366
Technology investment boost 33
Temporary full expensing measure 32
Temporary incapacity
superannuation conditions of release 92, 93
Temporary residents
foreign source income 192
Terminal medical condition
life events test 267
superannuation conditions of release 91, 92
Termination of employment
documentation 90, 91
retirement 89
Testamentary discretionary trusts
benefits 147
commencement 149, 150
family law disputes 153, 154
insolvency 151–153
minors 150, 151
protective trusts 151, 152
wills 147–149
Testamentary trusts
offshore estates 197
superannuation proceeds paid to 565, 566
The Tax Institute
Annual General Meeting 222
CPD events 5, 303, 470, 471
goal setting 171
Local Tax Clubs 170
member involvement 408
membership benefits 471
membership renewal 5, 471
pre-Federal Budget submission 534
Scott Treatt, CEO 222, 223
shaping the tax system 409
Tax Knowledge Exchange database 303
Tax Policy & Advocacy team 432
– role of TPA 535
The Tax Summit 2023 ....4, 120, 121
– Commissioner's address 175, 176
volunteering 5, 471
Thin capitalisation rules
debt creation rules 274, 277, 282, 283
debt deductions, limitation 282, 283
fixed ratio test 275–278
general class investors 275
group ratio test 278, 279
multinational enterprises 274–283, 304
retrospectivity 366
third party debt test 274, 279, 280
transfer pricing 280–282
Third party debt test
thin capitalisation 274, 279, 280
Throwback interest
Australian resident beneficiaries 156, 189, 200
Time management
self-coaching strategies 204–206
Timing issues
absence rule 262
contracts 180–183
death benefit payments 143
Div 7A loan repayments 34
fuel tax credits 475, 476
input tax credits 475, 476
sale and purchase agreements, completion 41, 42
SMSFs, exit strategy 561
superannuation benefits, access 90
superannuation guarantee contributions 36
temporary full expensing measure 32
Total superannuation balance
above $3m, 15% levy 225, 285–287, 304
– indexation 536
Tracing rules
continuity of ownership test 552, 553
Trading stock
cars, quotable purpose 176, 177
goods taken from 363
livestock, tax accounting 509–511
property development profits 178, 179
Transfer balance account
transition to retirement pension 93
Transfer balance cap
income streams
– defined benefit 306
– effect on 36
need for simplification 536
Transfer duty
commercial and industrial property (Vic) 453, 454
Transfer pricing
proposed OECD Two-Pillar Solution 472
thin capitalisation changes 280–282
Transferor trust rules 192, 195–197
Transition to retirement pension
superannuation conditions of release 93
Transitional compliance approach
fame of an individual 63
Transparency
proposed reforms 63
Travel expenses
FBT, fly-in fly-out employees 64, 65, 119, 540, 541
reasonable amounts 63
Treaties – see **Double tax agreements**
Trust beneficiaries
Australian, resident and non-resident trusts 189–201
distribution resolutions 446–449
lost trust deeds 337–339
penalties, recklessness 372
proximity 497
rights to documents 390
trustee obligations to 568, 569, 572
Trust deeds
absence of 513–515
administrative provisions 489–492
definition of "income" 447, 448
distribution resolutions 446–449
lost 14–19, 207, 208, 337–339, 492, 493
scope of trustee powers 490
Trust disclaimers 500, 501, 507
Trust distributions
discretionary trusts 487–507
Trust estate
amount of property of 190
beneficiary of 191
corpus, ordinary meaning 194
definition 190, 191
income of 446
Trust income
Australian beneficiaries, foreign source income 156, 157, 189–201
distribution resolutions 446–449
present entitlement to 67, 447
superannuation proceeds paid to 565, 566
taxation regime 446, 447
Trust property
beneficial enjoyment 199
Trust vesting
ATO position 498
Trustee duties
acting in best interests of beneficiaries 389
beneficiary rights to trust documents 390
knowing terms of trust deed 492, 493
no conflict rule 388, 389
real and genuine consideration 568–572
self-dealing, rule against 389
Trustees
appointment of new trustee 490, 575, 576
bankruptcy and insolvency 487, 488, 504, 505
BDBNs 47–49
discretion, exercise of 493–497, 568–572
lost trust deeds, consequences for 207, 208, 337–339, 492, 493
power to remove 575, 576
record-keeping 488, 489
services provided to superannuation fund 99, 100
testamentary discretionary trusts 147
Trusts
acquisition of dwelling from, CGT relationship breakdown roll-over relief 481, 482
asset protection benefits 487, 488
disclaimers 500, 501, 507
disputes 488, 492, 495, 498
Div 7A reforms 34
estate planning 497, 500
express and implied trusts 513, 514
guardianship 489, 490
management 568–572
reimbursement agreements 34, 35, 501, 502, 506
resulting trusts 502–504
taxation benefits 487
vesting 498

U

Undertaxed payment rule 472
United Kingdom
offshore receipts in respect of intangible property rule 85
United States
base erosion anti-abuse tax 85
Unpaid present entitlements
Div 7A loan issues 34, 228, 229
foreign trusts 198, 199
Unrealised gains
taxation 536
Unrealised tax liabilities
family law settlements 317, 318
Unrestricted non-preserved benefits
superannuation 87

V

Vacancy fees
foreign investment increases 412
Vacant land
deductions 231–236
whether adjacent land 256

Value of businesses
sale and purchase agreements....39–46
Vertical fiscal imbalance 322
Vesting
trusts...... 498
Victoria
annual property tax......6
commercial and industrial property......453, 454
electric vehicle customs and excise duty...... 304, 320–323
fairness fund payment, taxi industry......177, 178, 306
foreign surcharge purchaser duty......103, 104
Voluntary disclosure
foreign source income...... 193
SMSFs...... 106, 107
Volunteering
whether employed......88

W
Wealthy individuals
foreign trusts, Australian beneficiaries of......189–201
Weekender
family member occupation......77
Wellness......58
Western Australia
non-foreign discretionary trust amendments......104
Whistleblower reforms 226, 430, 432
Wills
BDBNs, importance of...... 562
deceased estates, taxation 243
definition of "income"......243, 244
dwelling acquisition rule, CGT......418–420
protective trusts......151, 152
superannuation death benefits 141
testamentary discretionary trusts......147–149
Withholding tax
foreign residents...... 368
royalties...... 27, 29, 82, 84, 85
– software and intellectual property rights......412–414
superannuation death benefits 144
Work-related expenses
ATO focus on claims......37
motor vehicles
– cents per kilometre rate......37
– deductibility...... 415
– electric vehicles, home charging rate...... 414
self-education......37, 226, 474, 475
Worker
concept of...... 534
Working capital
sale and purchase agreements......40–42
Working from home
versus carrying on a business...... 77, 78
work-related expenses......37
Work–life balance......58

Z
Zero or low emissions vehicles
customs and excise duty (Vic)...... 320–323, 409
electric car discount......36

Legislation

A New Tax System (Australian Business Number) Act 1999 548
A New Tax System (Goods and Services Tax) Act 1999 ......62, 125, 416
Div 99 ......57, 68
Div 129 35
s 9-5 543
s 9-20 543
s 9-20(1)(b) 546
s 9-40 543
s 11-5 543
s 11-15 543
s 11-20 543
s 11-25 476
s 11-30 476
s 13-10(b) 228
s 23-15 544
s 29-10(1) 476
s 29-10(2) 476
s 29-40 75
s 38-2 228
s 38-3(1)(c) 228, 469
s 129-20(1) 38
s 195-1 ......416, 548
Sch 1 ...... 228, 469
A New Tax System (Goods and Services Tax) Bill 1998 544
A New Tax System (Goods and Services Tax) Regulations 2019 62
A New Tax System (Luxury Car Tax) Act 1999 125
s 9-5(1) 176
A New Tax System (Wine Equalisation Tax) Act 1999 125
Acts Interpretation Act 1901
Pt 5 172
s 15AA 172
s 15AB 378
s 37 378
Administration and Probate Act 1919 (SA)
s 69 491
Administrative Appeals Tribunal Act 1975
s 43 385
Administrative Decisions (Judicial Review) Act 1977 126
Anti-Money Laundering and Counter-Terrorism Financing Act 2006 343
Bankruptcy Act 1966
s 5 152
s 58 152
s 116 ......152, 488, 575
s 116(2) 507
s 116(2)(a) 152
Civil Aviation Act 1988
s 30DE(2) 378
Commonwealth of Australia Constitution Act
s 51(ii) 324
s 90 320–323
s 99 324
s 114 321
Commonwealth Places (Mirror Taxes) Bill 1998 ......322, 324
Commonwealth Places Windfall Tax (Collection) Act 1998 324
Commonwealth Places Windfall Tax (Imposition) Act 1998 324
Controlled Substances Act 1984 (SA)
s 32(1)(b) 376
Conveyancing Act 1919 (NSW)
s 54A 183
Coronavirus Economic Response Package (Payments and Benefits) Act 2020
s 9(1) 309
s 9(2) 309
s 9(4) 309
Corporations Act 2001 ...... 99, 339, 431, 543
Ch 2M 63
s 9 555
s 10 to 17 555
s 197 390
s 254T 348
s 671B 555
s 671B(1)(b) 555
s 708(8) 210
s 1305 372
s 1322(4) 507
Crimes Act 1914 538
s 4AA 538
s 4G 376
Crimes and Other Legislation Amendment (Omnibus No. 1) Bill 2024 538
Defence Act 1903
s 58B 373
Disability Services Act 1986
s 8(1) 144
Duties Act 1997 (NSW) 104
s 104JA(1) 149
Duties Act 2000 (Vic) 103
s 3 210
s 3(1) 211
s 34(1)(b) 513
s 44 318
s 77 210
s 78(1)(a)(ii)(C) 210
Duties Act 2001 (Qld) 104
Duties Act 2001 (Tas) 104
Duties Act 2008 (WA) 104
Evidence Act 1995
s 128 127
Evidence Act 1995 (NSW) 207
s 140 208
s 140(1) 17
Evidence Act 2008 (Vic) 207
s 140 ......15, 208
s 140(1) 15
Fair Work Act 2009 450
Fair Work Legislation Amendment (Closing Loopholes No. 2) Act 2024
s 15AA(1) 450
Family Law Act 1975 ...... 142, 144, 148, 153, 504
s 4 ......505, 508
s 75(2) 153, 317
s 79 ......153, 505
s 79(1) 508
s 87 479
Family Law (Superannuation) Regulations 2001 349
Financial Sector (Collection of Data) Act 2001 275
Financial Transaction Reports Act 1988 343
Foreign Acquisitions and Takeovers Fees Imposition Act 2015 412
Foreign Acquisitions and Takeovers Fees Imposition Amendment Bill 2024 412
Sch 1 412
Sch 2 412
Franchise Fees Windfall Tax (Collection) Act 1997 ......322, 324
Franchise Fees Windfall Tax (Imposition) Act 1997 ......322, 324
Fringe Benefits Tax Assessment Act 1986 62
s 31(2) 307
s 31A 307
s 31E 307
s 31G 539
s 52 ......64, 541
s 52(1) 540
s 58GA 75
s 135C 539
Fuel Tax Act 2006 475
Subdiv 41-A 476
Subdiv 42-A 476
s 43-5 476
s 65-5(1) 476
s 65-5(2) 476
s 65-5(3) 476
Income Tax Assessment (1936 Act) Regulations 2015 436
reg 14 441
reg 17 ......202, 203
Income Tax Assessment (1997 Act) Regulations 2021 276
reg 995-1.06 91
Sch 3 555
Income Tax Assessment Act 1922 512
s 17 509–511
Income Tax Assessment Amendment Act 1979 201
Income Tax Assessment Amendment Bill (No. 5) 1978 ...... 157, 189, 195
Div 6 189
Income Tax Assessment Bill 1936 512
Income Tax Assessment (Cents per Kilometre Deduction Rate for Car Expenses) Determination 2023 38
Income Tax Assessment Regulations 1997
reg 303-10.01 273
Income Tax Rates Act 1986
Sch 10
– Pt 1 507
Income Tax (Transitional Provisions) Act 1997 ...... 37, 62, 174
Subdiv 40-BB 38, 75
Subdiv 328-E 38
s 118-110 273
s 118-195 265
s 328-180 38
s 328-181 ......37, 38
Industry Research and Development Act 1986
s 27A 440, 441
s 28A 441
s 28C 436, 437, 441
s 28C(1)(a) 369, 437
s 28C(2) 441
s 28D 436, 441
International Tax Agreements Act 1953 412
s 3(4) 192
Interpretation Act 1987 (NSW)
Sch 4 376
ITAA36 70
Pt III
– Div 6 ...... 190, 192, 202, 229, 252, 446, 447, 487
– Div 6AA 150, 193, 565
– Div 6AAA 448
– Div 6E 447
– Div 7A 34, 38, 57, 199, 228, 229, 304, 318, 339, 422, 439, 476, 538
– Subdiv EA 229
– Div 16G 274, 283
Pt IVA 28, 29, 35, 82, 270, 342, 347, 392, 410, 413, 472, 502
Pt X 448
s 6 122
s 6(1) 10, 83, 190, 191, 203, 280, 412, 420, 477
s 6(1)(d) 23
s 6B 192, 200
s 6B(2A)(a)(ii) 192
s 21 202
s 23AK 202
s 23L 202
s 24H 202
s 25(1) 201
s 25A 315
s 26(a) 180, 315
s 26(b) 201
s 26AAA 133, 181
s 26AAA(1)(b) 183
s 26AAA(1)(c) 183
s 26AAA(2) 183
s 26AH 197
s 28 510
s 32 510
s 44 229
s 47 194
s 47A 199
s 52 315
s 70B 334
s 82KZM 75
s 82KZMD 75
s 90 277
s 94M 474
s 95 ......195, 202, 447, 448
s 95(1) 190, 195, 247, 252
s 95(2) 252
s 95(3) 252
s 95A 201
s 95A(1) 245, 246, 447
s 95A(2) 446
s 97 ......156, 192, 195, 372, 446, 448, 508
s 97 to 99A 196, 202
s 97(1) 334, 446, 507
s 97(1)(a) 446, 500
s 97(1)(b) 446
s 97(1)(c) 446
s 97(2) 449
s 97(3) 449
s 98 ......156, 195, 449
s 98(4) 194, 195
s 99 ...... 156, 249, 447, 487
s 99(4) 252
s 99(5) 252
s 99A 192, 195, 245, 249, 447
s 99A(2)(a) 507
s 99B 156, 157, 189–201, 253
s 99B(1) 156, 190–192, 194, 195, 199
s 99B(2) 156, 191, 193, 195, 196, 199, 253
s 99B(2)(a) 157, 194
s 99B(2)(b) 194, 195
s 99B(2)(c) 195

s 99B(2)(c)(i) ... 195, 202
s 99B(2)(d) ... 196
s 99C ... 156, 189, 191–194, 197–199, 253
s 99C(1) ... 198
s 99C(2) ... 156, 198, 199
s 99C(2)(c) ... 156, 199
s 99C(2)(d) ... 199
s 99C(2)(e) ... 199
s 99D ... 249
s 99D(1) ... 249
s 99D(2) ... 249
s 100A ... 34, 35, 66, 67, 201, 221, 249, 253, 347, 439, 501, 502
s 100A(8) ... 67
s 100AA ... 244
s 100AB ... 245, 246
s 100AB(5) ... 246
s 101 ... 201, 447
s 102 ... 201, 449
s 102AA(1) ... 150
s 102AA(4) ... 150
s 102AAL ... 197
s 102AAM ... 157, 200, 203
s 102AAM(1A)(a) ... 200
s 102AAM(1C) ... 203
s 102AAM(5) ... 190, 203
s 102AAU(2) ... 202
s 102AAZB ... 202
s 102AAZD ... 156, 196
s 102AG(2)(a) ... 150, 507
s 102AG(2AA) ... 151, 566
s 109(3) ... 229
s 109D ... 229
s 109D(1) ... 448
s 109D(3) ... 229, 339
s 109E(1) ... 38
s 115-30(1) ... 197
s 159GZZZP ... 67
s 160ZZM ... 264
s 161AA ... 203
s 167 ... 12, 383, 386
s 170 ... 75, 201
s 170(1) ... 177, 441
s 170(10AA) ... 202, 333
s 177M ... 82
s 214A ... 200
s 260 ... 28
s 262A ... 440
s 264 ... 127
s 317 ... 202, 203
s 318 ... 83, 555
s 318(6)(b) ... 555
s 320 ... 202, 203
s 342(a) ... 196
Sch 2F ... 278
– Subdiv 272-A ... 424
– s 271-90 ... 177
– s 272-5(1) ... 253
– s 272-10(2) ... 424
– s 272-87 ... 423
– s 272-87(3) ... 424
– s 272-90 ... 422, 424
– s 272-90(4) ... 422, 424
– s 272-90(5) ... 422–424
– s 272-95(1)(a) ... 424

ITAA97 ... 8, 62, 106
Pt 2-40 ... 373
Pt 3-1 ... 254
Div 26 ... 82
Div 36 ... 276
Div 40 ... 22, 33, 136, 227, 276
Div 43 ... 227, 276
Div 70 ... 22
Div 115 ... 180
Div 128 ... 251, 253, 420
Div 149 ... 195
Div 152 ... 75, 135, 288
Div 160 ... 38, 75
Div 166 ... 549, 552
Div 167 ... 554, 555
Div 170 ... 186
Div 230 ... 83, 331, 333, 335
Div 245 ... 335
Div 293 ... 394
Div 296 ... 225, 285, 286, 536
Div 615 ... 135, 137
Div 770 ... 200
Div 820 ... 62, 274–276, 281
Div 832 ... 540
Div 855 ... 195, 241
Subdiv 40-D ... 276
Subdiv 40-E ... 276
Subdiv 40-H ... 276
Subdiv 40-I ... 276
Subdiv 83-C ... 373
Subdiv 115-C ... 252, 447, 448, 497
Subdiv 118-B ... 254, 262, 273, 482
Subdiv 118-I ... 46, 326, 335
Subdiv 122-A ... 135, 196
Subdiv 122-B ... 135
Subdiv 124-M ... 44, 135–137
Subdiv 124-N ... 135
Subdiv 126-A ... 263, 264, 268, 318, 480, 482
Subdiv 152-A ... 21
Subdiv 152-C ... 23
Subdiv 152-D ... 23
Subdiv 165-E ... 555
Subdiv 166-E ... 553, 555
Subdiv 207-B ... 252, 447, 448
Subdiv 230-C ... 336
Subdiv 295-C ... 51, 394
Subdiv 302-B ... 145, 197
Subdiv 302-C ... 145
Subdiv 305-B ... 197
Subdiv 328-D ... 33, 75
Subdiv 328-F ... 75
Subdiv 815-B ... 280, 281
Subdiv 820-EAA ... 62, 282
Subdiv 855-B ... 196
Subdiv 900-B ... 63
Subdiv 960-D ... 192
Subdiv 960-S ... 202
s 4-5 ... 236
s 6-5 ... 63, 315, 413, 442
s 6-5(1) ... 84
s 6-10 ... 158
s 6-25 ... 229
s 8-1 ... 8, 9, 97, 125, 183, 200, 226, 235, 236, 315, 369, 474, 475, 539, 541
s 8-1(1)(a) ... 226, 314
s 8-1(1)(b) ... 226
s 8-1(2)(b) ... 314, 315, 539
s 10-5 ... 191
s 15-2 ... 331
s 15-20 ... 413
s 15-75 ... 202
s 20-25 ... 335
s 25-5 ... 98, 200
s 25-35 ... 334
s 25-35(1)(a) ... 334
s 25-35(1)(b) ... 334
s 25-90 ... 282
s 26-102 ... 231–236
s 26-102(1) ... 232–234, 236
s 26-102(1)(a) ... 234
s 26-102(1)(b)(i) ... 236
s 26-102(2) ... 236
s 26-102(3) ... 232, 236
s 26-102(4) ... 234–236
s 26-102(5) ... 236
s 26-102(6) ... 236
s 26-102(7) ... 236
s 26-102(8) ... 232, 236
s 26-102(9) ... 232, 235, 236
s 26-110 ... 26–29, 82–85
s 26-110(1) ... 82
s 26-110(2) ... 26, 29, 83
s 26-110(2)(b) ... 82, 83
s 26-110(2)(c)(ii) ... 84
s 26-110(3)(b) ... 84
s 26-110(4)(b)(i) ... 84
s 26-110(4)(b)(ii) ... 84
s 26-110(4)(b)(iii) ... 84
s 26-110(5)(b) ... 84
s 26-110(6) ... 83
s 26-110(6)(a) ... 83
s 26-110(6)(b) ... 83
s 26-110(7) ... 83
s 26-110(7)(a) ... 83
s 26-110(7)(b) ... 83
s 26-110(8) ... 84
s 26-110(9) ... 30, 84
s 26-110(10) ... 84
s 26-110(10)(e) ... 84
s 40-30 ... 30
s 40-30(4) ... 227, 414
s 40-35 ... 227, 414
s 40-82 ... 38
s 40-85(1) ... 38
s 40-285 ... 38
s 40-285(1) ... 38
s 40-295 ... 38
s 40-880(2A) ... 75
s 59-30 ... 202
s 66-272(8) ... 555
s 70-10(1) ... 178
s 70-35(1) ... 178
s 83-175(1) ... 373
s 102-5 ... 158, 195, 196, 246
s 102-5(1) ... 158, 334
s 103-5 ... 202
s 103-10(2) ... 327
s 103-25 ... 482
s 103-25(2) ... 255
s 104-10 ... 272
s 104-10(1) ... 183
s 104-10(2) ... 183
s 104-10(3) ... 183
s 104-25 ... 23
s 104-35(1) ... 183
s 104-35(2) ... 183
s 104-55 ... 348
s 104-80 ... 253
s 104-150 ... 419
s 104-155 ... 177
s 104-155(3) ... 178
s 104-160 ... 270
s 104-215 ... 253
s 104-510 ... 138
s 108-55(2) ... 257
s 109-5 ... 183, 272
s 110-25(2) ... 327
s 110-25(4) ... 236
s 110-45(3) ... 335
s 110-55 ... 236
s 110-55(2) ... 327
s 112-20 ... 251, 448
s 112-20(1)(c) ... 133
s 115-25(1) ... 183
s 115-40 ... 180, 181
s 115-115 ... 79
s 115-215 ... 195
s 115-220 ... 195
s 115-222 ... 195
s 115-228 ... 449
s 115-228(1) ... 252
s 116-10 ... 335
s 116-20(1) ... 327
s 116-20(1)(a) ... 327
s 116-20(2) ... 178
s 116-30 ... 252, 332, 334, 448
s 116-30(2)(b)(i) ... 133
s 116-30(3A) ... 336
s 116-45 ... 333
s 116-45(1)(b) ... 333
s 118-20 ... 200
s 118-25(4) ... 79
s 118-30 ... 273
s 118-110 ... 79, 253, 255, 267, 315
s 118-110(2) ... 253
s 118-110(2)(a) ... 273
s 118-110(3) ... 79, 269, 272
s 118-110(4) ... 79, 272, 420
s 118-110(5) ... 79, 267
s 118-115 ... 255, 256
s 118-120 ... 255
s 118-120(5) ... 256
s 118-120(6) ... 256, 257
s 118-125 ... 255
s 118-130 ... 255, 420
s 118-135 ... 79, 420, 482
s 118-140 ... 79, 250, 258, 261
s 118-145 ... 79, 255, 258, 261, 262, 264, 265, 267, 268, 270–272, 420
s 118-145(1) ... 420
s 118-145(2) ... 79
s 118-145(3A) ... 272
s 118-145(4) ... 272
s 118-147 ... 261
s 118-147(3) ... 261
s 118-147(4) ... 261
s 118-150 ... 79, 255, 262, 263
s 118-165 ... 79, 255, 272
s 118-170 ... 257, 258, 272
s 118-178 ... 263, 268, 269, 480, 481
s 118-180 ... 263, 482
s 118-180(2) ... 482
s 118-185 ... 79, 258, 259, 262, 265
s 118-185(3) ... 272
s 118-190 ... 79, 259, 264, 265, 272
s 118-190(1)(c) ... 272
s 118-190(2) ... 260, 261
s 118-190(3) ... 265
s 118-190(4) ... 265
s 118-192 ... 78, 79, 260, 262, 265, 270
s 118-192(2) ... 261
s 118-195 ... 253, 255, 264, 265, 420
s 118-195 to 118-210 ... 79
s 118-195(1)(c) ... 268
s 118-195(1A)(a) ... 268
s 118-195(1A)(b) ... 268
s 118-197 ... 264
s 118-200 ... 264, 272
s 118-200(1) ... 272
s 118-200(2) ... 272, 273
s 118-200(3) ... 273
s 118-200(4) ... 273
s 118-205 ... 265
s 118-205(4) ... 272, 273
s 118-210 ... 265, 266, 418
s 118-210(1) ... 418, 419
s 118-210(2) ... 419, 420
s 118-210(2)(c) ... 420
s 118-210(3) ... 420
s 118-210(4) ... 420
s 118-210(5)(a) ... 273, 420
s 118-210(5)(b) ... 419
s 118-210(6) ... 273, 420
s 118-222 ... 266
s 118-230 ... 265
s 118-245(3) ... 272
s 118-300 ... 197
s 118-305 ... 197
s 118-565 ... 326
s 118-565(1) ... 43
s 118-565(1)(a) ... 326
s 118-565(1)(f) ... 326, 327, 330
s 118-565(1)(g) ... 326, 327
s 122-20 ... 137
s 122-20(3) ... 137
s 122-50(1) ... 137
s 124-780(2)(a)(i) ... 137
s 124-780(2)(c) ... 45, 46
s 124-780(3)(d) ... 46
s 124-780(5)(a) ... 137
s 124-783(7) ... 46
s 124-785(2) ... 137
s 124-875(1) ... 137
s 126-5 ... 79, 269
s 126-5(1) ... 267, 482
s 126-5(2) ... 482
s 126-5(4) ... 482
s 126-5(5) ... 482
s 126-5(6) ... 482
s 126-15 ... 482
s 126-15(1) ... 482
s 126-140(2) ... 350
s 128-15 ... 265
s 128-15(4) ... 251
s 128-20 ... 264
s 152-10 ... 22, 137
s 152-10(1)(a) ... 22
s 152-10(1)(d) ... 22
s 152-10(1A) ... 22
s 152-10(2) ... 22
s 152-10(2A) ... 23
s 152-15 ... 75
s 152-20 ... 256
s 152-35 ... 22
s 152-40 ... 22, 30, 75
s 152-40(3)(b) ... 22
s 152-55 ... 290
s 152-60 ... 23, 290
s 152-80 ... 288–290
s 152-80(2) ... 290
s 152-80(3) ... 288
s 152-110 ... 289, 290
s 152-110(1)(d) ... 289, 290
s 152-125 ... 289
s 165-12 ... 554
s 165-12(7) ... 555
s 165-165 ... 553, 555
s 165-207 ... 555
s 166-3 ... 554
s 166-5(2) ... 554
s 166-145 ... 554
s 166-175 ... 554
s 166-225 ... 554, 555
s 166-225(2) ... 555
s 166-230 ... 555
s 166-235(7) ... 555
s 166-240 ... 555
s 166-245 ... 555
s 166-255 ... 555
s 166-260 ... 555
s 166-272 ... 555
s 166-275 ... 555
s 166-280 ... 555

s 166-280(2) ... 553
s 202-75(3) ... 38
s 207-35(1) ... 448
s 207-58 ... 449
s 207-122(b)(i) ... 369
s 207-150 ... 67, 508
s 207-150(1) ... 67
s 207-155 ... 67
s 230-25 ... 335
s 230-25(3) ... 335
s 230-45 ... 331
s 230-50(1) ... 333
s 230-60 ... 332
s 230-60(1) ... 331
s 230-435 ... 332
s 230-435(1)(b) ... 334, 335
s 230-440(1) ... 336
s 230-445 ... 332, 334
s 230-450 ... 333
s 230-455 ... 333
s 230-460(13) ... 336
s 230-465 ... 334
s 230-505 ... 327, 331–333, 335
s 230-505(2) ... 331, 336
s 230-505(3) ... 333
s 230-505(7) ... 331
s 230-510 ... 332, 333
s 245-10 ... 335
s 245-85 ... 335
s 290-60(3) ... 38
s 290-65(1A) ... 38
s 295-550 ... 64, 96, 97, 129, 158, 392, 516
s 295-550(1)(b) ... 392
s 295-550(1)(c) ... 392
s 295-550(5) ... 129, 131, 132
s 295-550(5)(a) ... 131, 132
s 295-550(5)(b) ... 132
s 296-15 ... 286
s 302-195 ... 145, 560
s 307-15 ... 342
s 307-230(1)(d) ... 286
s 325-125 ... 236
s 325-130 ... 236
s 328-110 ... 70
s 328-115 ... 70
s 328-120(2) ... 75
s 328-125 ... 70, 71, 174
s 328-125(2) ... 74, 174, 175
s 328-125(2) to (4) ... 72
s 328-125(4) ... 174, 175
s 328-125(5) ... 74
s 328-125(6) ... 71–74, 174
s 328-180 ... 37
s 328-185 to 328-210 ... 38
s 328-185(1) ... 38
s 328-215(4) ... 38
s 355-25 ... 441
s 355-210(1)(a) ... 441
s 355-210(1)(d) ... 441
s 355-210(1)(e) ... 441
s 355-405 ... 441
s 355-710(1) ... 441
s 355-710(2) ... 441
s 355-710(3) ... 441
s 360-40(1) ... 238, 369
s 360-40(1)(a) ... 238
s 360-40(1)(e) ... 238
s 360-45 ... 238
s 615-5(1)(a) ... 137
s 615-5(1)(b) ... 137
s 615-20(2) ... 138
s 701-1 ... 138, 348
s 701-25 ... 138
s 701-35 ... 138
s 701-60 ... 138
s 703-10(1) ... 137
s 703-15 ... 348
s 703-20 ... 348
s 703-30 ... 348
s 705-45(2) ... 136
s 705-60 ... 332
s 705-65(5B) ... 336
s 705-70(1AA) ... 332
s 705-70(1AB) ... 332
s 705-112 ... 283
s 707-320 ... 348
s 721-15(3) ... 348
s 768-5(2) ... 195
s 768-910(2) ... 192
s 770-10 ... 197
s 770-10(1) ... 334
s 770-15 ... 197
s 770-130 ... 200
s 770-190 ... 201
s 786-970 ... 192
s 802-17 ... 195
s 815-130 ... 10
s 815-140 ... 280–282
s 820-37 ... 275
s 820-40(1) ... 275
s 820-40(3)(a) ... 275
s 820-46(2) ... 275
s 820-46(3) ... 283
s 820-46(4) ... 283
s 820-47(2)(a) ... 283
s 820-47(4) to (7) ... 283
s 820-48 ... 283
s 820-50(1)(a) ... 283
s 820-50(1)(b) ... 283
s 820-50(1)(d) ... 276
s 820-50(3) ... 283
s 820-51(1) ... 283
s 820-51(2) ... 283
s 820-52 ... 283
s 820-52(2) ... 283
s 820-52(3) ... 283
s 820-52(6) ... 283
s 820-52(8) ... 283
s 820-53 ... 283
s 820-53(1) ... 283
s 820-54 ... 283
s 820-54(5) ... 283
s 820-55(3) ... 283
s 820-57 ... 283
s 820-58 ... 283
s 820-59(4) ... 283
s 820-59(5) ... 283
s 820-310 ... 30
s 820-423A(2) ... 283
s 820-423A(5) ... 283
s 820-423D ... 283
s 820-427(4) ... 283
s 820-427A(2) ... 280
s 820-427A(3) ... 283
s 820-427A(3)(d) ... 283
s 820-427C ... 283
s 820-427D ... 283
s 820-590(3) ... 283
s 820-590(4) ... 283
s 820-590(7) ... 283
s 820-590(8) ... 283
s 820-592 ... 283
s 820-594 ... 283
s 820-920 ... 283
s 820-985 ... 283
s 832-320 ... 540
s 832-320(3) ... 540
s 832-325 ... 540
s 832-625(3) ... 29
s 832-625(3)(b) ... 29, 30
s 855-10 ... 190, 195, 247, 248, 497
s 855-15 ... 253, 273
s 855-40 ... 248, 497
s 855-50 ... 196
s 900-115 ... 415
s 950-100(1) ... 190
s 950-258(2) ... 84
s 960-50(1) ... 202
s 960-50(6) ... 202
s 960-100 ... 236
s 960-115 ... 186
s 960-130 ... 348
s 960-130(1) ... 348
s 960-135 ... 348
s 960-258 ... 30, 82
s 960-258(1) ... 84
s 960-258(2) ... 28, 84
s 960-258(2)(d) ... 30
s 960-258(4) ... 82, 84
s 960-258(5) ... 84
s 960-555 ... 86
s 995-1 ... 91, 197, 200, 202, 264, 432, 555
s 995-1(1) ... 133, 232, 275, 482, 555

Judiciary Act 1903
s 39B ... 126
Land Tax Act 1956 (NSW) ... 104
Land Tax Act 2004 (ACT) ... 104
Land Tax Act 2005 (Vic) ... 103
Land Tax Act 2010 (Qld) ... 104
Legal Profession Act 1987 (NSW)
s 79A(2)(a) ... 376, 377
Life Insurance Act 1995
s 9 ... 202
Limitation of Actions Act 1958 (Vic) ... 496
New Business Tax System (Integrity and Other Measures) Bill 1999 ... 180
Powers of Attorney Act 1980 (NT) ... 111
Powers of Attorney Act 1998 (Qld) ... 48, 111, 563
s 73 ... 48
Powers of Attorney Act 2000 (Tas) ... 111, 563
Powers of Attorney Act 2003 (NSW) ... 111
Powers of Attorney Act 2006 (ACT) ... 111
Powers of Attorney Act 2014 (Vic)
s 67 ... 111
Powers of Attorney and Agency Act 1984 (SA) ... 111
Probate and Administration Act 1898 (NSW)
Pt 2
– Div 3 ... 154
Property Law Act 1969 (WA) ... 111
Radiocommunications Act 1992 ... 83
Recovery of Imposts Act 1963 (NSW) ... 323
s 2(1) ... 324
s 2(2) ... 324
Retail Leases Act 2003 (Vic) ... 454
Social Security Act 1991 ... 152
s 1209M ... 155
Stamp Duties Act 1923 (SA) ... 104
Statute Law Revision Act 1981 ... 172
Succession Act 1981 (Qld)
s 33R ... 154
Succession Act 2006 (NSW) ... 49, 148
Superannuation (Better Targeted Superannuation Concessions) Imposition Bill 2023 ... 285
s 5 ... 285
Superannuation Guarantee (Administration) Act 1992 ... 370
s 12 ... 451
s 12(1) ... 450
s 12(3) ... 370
Superannuation Industry (Supervision) Act 1993 ... 64, 148, 349
s 10 ... 48, 148
s 10A ... 567
s 15A ... 88, 89
s 17A ... 141, 559, 560
s 17A(1) ... 560
s 17A(1)(f) ... 101
s 17A(1)(g) ... 101
s 17A(2) ... 560
s 17A(2)(c) ... 101
s 17A(2)(d) ... 101
s 17A(3) ... 560
s 17A(4) ... 560
s 17B ... 99, 393
s 34(1) ... 350
s 55A ... 49
s 59 ... 47
s 59(1A) ... 149, 498
s 129 ... 106
Superannuation Industry (Supervision) Regulations 1994 ... 106, 148, 561
Div 7A.2 ... 349, 350
reg 1.03 ... 350
reg 1.03C ... 91
reg 1.04AAAA ... 142, 144, 148
reg 6.01 ... 88
reg 6.01(2) ... 92
reg 6.01(5) ... 94
reg 6.01A ... 91
reg 6.17 ... 498
reg 6.17A ... 47, 143, 145, 149
reg 6.17A(6) ... 498, 562
reg 6.17A(7) ... 498
reg 6.19A ... 93
reg 6.21 ... 47, 145
reg 6.44 ... 95
reg 7A.02 ... 350
Supreme Court (General Civil Procedure) Rules 2015 (Vic)
order 54 ... 491
r 54.02 ... 16, 507
Tax Agent Services Act 2009 ... 226, 304, 375, 427, 535
Pt 3 ... 127
Subdiv 60-G ... 433
s 2-5 ... 433
s 3-5 ... 378
s 20-5(1)(a) ... 310
s 20-25 ... 433
s 30-10 ... 310
s 30-10(2) ... 378
s 30-10(15) ... 432
s 30-10(16) ... 432
s 30-10(17) ... 433
s 30-12 ... 433
s 30-20(1)(d) ... 433
s 30-35(1)(ba) ... 378, 433
s 30-35(2)(ba) ... 378, 433
s 30-35(3)(ba) ... 378, 433
s 30-35(4)(b) ... 375
s 30-40(1) ... 375, 432
s 30-40(2) ... 375
s 30-40(3) ... 375
s 45-5 ... 428
s 45-5(2) ... 432
s 45-5(6) ... 432
s 45-10(1) ... 432
s 45-10(2) ... 432
s 45-10(3) ... 432
s 45-20 ... 432
s 50-5(1) ... 371
s 60-25(4) ... 433
s 60-25(5) ... 433
s 90-1(1) ... 376, 432
s 90-1(2) ... 432
Tax Agent Services (Code of Professional Conduct) Determination 2023 ... 431
Tax Agent Services Regulations 2022 ... 226
Tax and Superannuation Laws Amendment (2015 Measures No. 6) Bill 2015 ... 326, 327, 335
Tax Laws Amendment (2011 Measures No. 5) Bill 2011 ... 245
Tax Laws Amendment (2013 Measures No. 2) Act 2013 ... 307
Tax Laws Amendment (Loss Recoupment Rules and Other Measures) Bill 2005 ... 555
Tax Laws Amendment (Research and Development) Bill 2010 ... 441
Tax Laws Amendment (Small Business) Bill 2007 ... 75
Tax Laws Amendment (Taxation of Financial Arrangements) Bill 2008 ... 331–333, 336
Taxation Administration Act 1953 ... 286, 370, 541
Pt IIA ... 200
Pt IVC ... 383, 384
Pt IVD ... 432
s 8AAD ... 200
s 8AAZLGA(2) ... 441
s 8AAZN(1) ... 543
s 8AAZN(3) ... 543
s 8C ... 375
s 8K ... 377
s 8K(1) ... 378
s 8N ... 377
s 8T ... 377
s 8U ... 377
s 8V(1) ... 377
s 8V(2) ... 377
s 14ZZJ ... 385
s 14ZZK ... 384, 385, 415
s 14ZZK(b)(i) ... 385, 386
s 14ZZO ... 12, 384, 385
s 14ZZO(b)(i) ... 386
Sch 1
– Div 290 ... 306, 410, 432
– Div 358 ... 252
– s 12-35 ... 373, 450
– s 269-35(2) ... 541
– s 269-35(2)(a)(i) ... 542
– s 269-35(2)(a)(ii) to (iii) ... 542
– s 284-90 ... 441
– s 284-90(1C) ... 86
Taxation Administration (Country by Country Reporting Jurisdictions) Determination 2024 ... 477
Taxation (Interest on Overpayments and Early Payments) Act 1983 ... 200

Treasury Laws Amendment (2018 Superannuation Measures No. 1) Act 2019 ... 101
Treasury Laws Amendment (2019 Measures No. 3) Act 2020 ... 151, 566
Treasury Laws Amendment (2019 Tax Integrity and Other Measures No. 1) Act 2019 ... 231
Treasury Laws Amendment (2022 Measures No. 4) Act 2023 ... 62
Sch 1 ... 38
Sch 4 ... 38
Sch 5 ... 38
Treasury Laws Amendment (2023 Measures No. 1) Act 2023 ... 375, 428–432
s 28(1) ... 378
s 28(2) ... 378
Sch 3
– Pt 5 ... 375
Treasury Laws Amendment (2023 Measures No. 1) Bill 2023
Sch 3 ... 428
Sch 5 ... 35
Treasury Laws Amendment (2023 Measures No. 2) Act 2023
Sch 4 ... 35
Treasury Laws Amendment (2023 Measures No. 2) Bill 2023 ... 8
Treasury Laws Amendment (A Tax Plan for the COVID-19 Economic Recovery) Bill 2020 ... 185
Treasury Laws Amendment (Better Targeted Superannuation Concessions and Other Measures) Bill 2023
Sch 1 to Sch 3 ... 536
Treasury Laws Amendment (Better Targeted Superannuation Concessions) Bill 2023 ... 285, 286
Treasury Laws Amendment (Cost of Living — Medicare Levy) Bill 2024 ... 412
Treasury Laws Amendment (Cost of Living Tax Cuts) Bill 2024 ... 412
Treasury Laws Amendment (Foreign Investment) Bill 2024 ... 412
Treasury Laws Amendment (Making Multinationals Pay Their Fair Share — Integrity and Transparency) Act 2023 ... 538
Treasury Laws Amendment (Making Multinationals Pay Their Fair Share — Integrity and Transparency) Bill 2023 ... 62, 86, 274–277, 279–283
Treasury Laws Amendment (Measures for Consultation) Bill 2022 ... 427
Treasury Laws Amendment (Measures for Consultation) Bill 2023 ... 26, 50, 51, 98, 101
Treasury Laws Amendment (Measures for Future Bills) Bill 2023 ... 274, 276, 278, 282
Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures) Act 2019 ... 266
Treasury Laws Amendment (Support for Small Business and Charities and Other Measures) Bill 2023 ... 174, 392, 393, 517
Sch 7 ... 304, 392
Treasury Laws Amendment (Tax Accountability and Fairness) Bill 2023 ... 432
Sch 3
– Pt 2 ... 433
Treasury Laws Amendment (Tax Integrity and Other Measures) Bill 2018 ... 22
Treasury Laws Amendment (Tax Integrity and Other Measures No. 2) Act 2018 ... 30
Trustee Act 1925 (NSW) ... 14
s 46 ... 247
s 63 ... 16, 17, 491, 507
s 81 ... 507
s 86A ... 17–19, 507
s 86A(1) ... 18
s 86B(1) ... 19
Trustee Act 1936 (SA)
s 91 ... 491
Trustee Act 1958 (Vic) ... 14
s 63 ... 16, 208, 507
s 63A ... 507
Trustees Act 1962 (WA)
s 92 ... 19
Wills Act 1997 (Vic)
s 48 ... 154
Wills Act 2000 (NT)
s 43 ... 154
Wills Act 2008 (Tas)
s 58 ... 154
Zero and Low Emission Vehicle Distance-based Charge Act 2021 (Vic)
s 7(1) ... 320, 321

Rulings and other materials

ASX Listing Rules
Ch 3
– r 3.10.3 ... 555
Australian Accounting Standards Board
AASB 17 ... 174
AASB 112 ... 554
AASB 116 ... 511, 512
AASB 141 ... 511, 512
Australian Taxation Office
CR 2022/63 ... 330
GSTD 2006/6 ... 544, 547
GSTD 2009/1 ... 202
GSTR 2009/4 ... 35
ID 2003/635 ... 333
ID 2003/636 ... 333
ID 2003/1112 ... 262
ID 2003/1113 ... 262
ID 2004/66 ... 202
ID 2004/882 ... 272
ID 2006/34 ... 272
ID 2009/34 ... 272
ID 2009/63 ... 328
ID 2010/55 ... 253
ID 2010/85 ... 508
ID 2010/211 ... 202
ID 2011/93 ... 190
ID 2013/64 ... 336
IT 2167 ... 260, 272
IT 2346 ... 197
IT 2504 ... 197
IT 2512 ... 202
IT 2622 ... 197, 244, 247, 252, 567
IT 2650 ... 10
IT 2673 ... 79, 259
IT 2681 ... 10
LCR 2021/2 ... 50, 96–101, 393, 394, 516, 517
LCR 2021/3 ... 136
LCR 2023/D1 ... 306, 307
LI 2023/D13 ... 125
LI 2023/D18 ... 307
LI 2023/D19 ... 307
LI 2023/D20 ... 307
LI 2023/D21 ... 307
LI 2023/D22 ... 307
LI 2023/D23 ... 307
MT 2024/D1 ... 475
PBR 1012616654481 ... 202
PBR 1051346488294 ... 252
PBR 1051437446368 ... 344
PBR 1051485266678 ... 329, 330
PBR 1051583203973 ... 333
PBR 1051593007881 ... 79
PBR 1051618374747 ... 202
PBR 1051630156354 ... 252
PBR 1051630967428 ... 202
PBR 1051652180989 ... 333
PBR 1051659115719 ... 327, 329, 330
PBR 1051693349071 ... 202
PBR 1051714149928 ... 424
PBR 1051760637680 ... 252
PBR 1051830400148 ... 202
PBR 1051910296871 ... 202
PBR 1051914995135 ... 344
PBR 1051943938848 ... 253
PBR 1051970330207 ... 202
PBR 1052020105622 ... 325–327
PBR 1052020371737 ... 325–327
PBR 1052059680727 ... 202
PBR 1052085239358 ... 253
PBR 1052091672127 ... 344
PBR 1052097327812 ... 344
PBR 1052162946778 ... 344
PCG 2017/13 ... 38
PCG 2017/D11 ... 63
PCG 2018/9 ... 122
PCG 2018/9DC1 ... 122
PCG 2019/5 ... 253, 266
PCG 2020/5 ... 51, 393, 516
PCG 2021/4 ... 33
PCG 2021/D4 ... 27
PCG 2022/2 ... 34, 502
PCG 2023/1 ... 37
PCG 2023/2 ... 370, 371, 450–452
PCG 2023/D1 ... 37
PCG 2023/D2 ... 10, 27, 86
PCG 2024/2 ... 414
PS LA 2003/8 ... 33
PS LA 2003/12 ... 507
PS LA 2005/24 ... 35
PS LA 2006/8 ... 366
PS LA 2007/11 ... 366
PS LA 2007/21 ... 191
PS LA 2010/4W ... 38
PS LA 2023/2 ... 227, 228
QC 45254 ... 344
QC 58416 ... 253
SGR 2005/1 ... 370
SMSFRB 2020/1 ... 101
TA 2015/2 ... 35
TA 2018/2 ... 10, 27
TA 2020/1 ... 27
TA 2021/1 ... 190
TA 2022/1 ... 502
TA 2022/2 ... 10
TA 2023/2 ... 64
TA 2023/3 ... 368, 369
TA 2023/4 ... 369, 438, 441
TA 2023/5 ... 369
TA 2023/6 ... 369, 370
TD 51 ... 255
TD 92/147 ... 263, 272
TD 92/171 ... 255, 256
TD 92/174 ... 258
TD 95/10 ... 194
TD 1999/43 ... 258
TD 1999/53 ... 264
TD 1999/66 ... 79, 260, 261
TD 1999/67 ... 256
TD 1999/68 ... 256
TD 1999/69 ... 257
TD 1999/70 ... 272
TD 1999/71 ... 272
TD 1999/74 ... 272, 419
TD 2016/19 ... 334
TD 2017/13 ... 257
TD 2017/22 ... 195
TD 2017/23 ... 157, 190, 195, 248
TD 2017/24 ... 157, 190, 195, 202, 247
TD 2021/9 ... 441
TD 2022/11 ... 34, 229
TD 2022/12 ... 249, 497
TD 2022/13 ... 248, 497
TD 2023/3 ... 63
TD 2023/4 ... 63
TD 2023/5 ... 174, 175
TD 2023/7 ... 363
TD 2023/D1 ... 158–160
TD 2023/D2 ... 70–75, 179
TD 2024/1 ... 538
TD 2024/2 ... 539
TD 2024/D1 ... 540
TR 93/30 ... 259
TR 97/7 ... 315, 539
TR 98/17 ... 10
TR 2004/4 ... 234
TR 2004/15 ... 122
TR 2004/D25 ... 272, 514
TR 2005/3(W) ... 200
TR 2005/9 ... 507
TR 2006/14 ... 251–253
TR 2007/D10 ... 325, 326, 328, 335
TR 2010/1 ... 36, 98
TR 2010/3 ... 229
TR 2010/3W ... 38
TR 2012/D1 ... 446, 448, 449
TR 2013/2 ... 8
TR 2014/3 ... 264
TR 2017/D1 ... 227
TR 2018/5 ... 122
TR 2018/6 ... 498
TR 2020/1 ... 226
TR 2021/5 ... 441
TR 2021/D4 ... 27, 86
TR 2022/4 ... 221, 253, 502
TR 2022/4A1 ... 221
TR 2023/1 ... 10, 11, 35, 202, 266
TR 2023/2 ... 8, 9, 10
TR 2023/3 ... 231–236
TR 2023/4 ... 370, 450–452
TR 2023/D1 ... 226
TR 2023/D2 ... 227
TR 2024/1 ... 414, 415
TR 2024/2 ... 474
TR 2024/3 ... 474, 475
TR 2024/D1 ... 412, 413, 472
Double tax agreements
Australia–Finland
– art 23 ... 102
Australia–Germany
– art 24 ... 102
Australia–NZ
– art 24 ... 102
Australia–South Africa
– art 23A ... 102
International Accounting Standards
IAS 16 ... 511, 512
IAS 41 ... 511, 512
OECD
Model Tax Convention on Income and on Capital ... 192
– art 12 ... 27
State Revenue Office Victoria
Revenue Ruling DA 057 ... 211
Tax Professionals Board
TPB(PN) 5/2022 ... 428
TPB(I) D51/2023 ... 428–430, 432

Cases

A
Active Sports Management Pty Ltd and Industry Innovation and Science Australia [2023] AATA 4078 ... 440
Addy v FCT [2019] FCA 1768 ... 10
Addy v FCT [2021] HCA 34 ... 102, 103
Adnunat Pty Ltd v ITW Construction Systems Australia Pty Ltd [2009] FCA 499 ... 343
Advanced Holdings Pty Ltd as Trustee for The Demian Trust v FCT [2020] FCA 1479 ... 128
Advanced Holdings Pty Ltd as Trustee for The Demian Trust v FCT [2021] FCAFC 135 ... 490
Al-Freah v Thompson [2023] QCA 175 ... 183
Alcan (NT) Alumina Pty Ltd v Commr of Territory Revenue [2009] HCA 41 ... 30
Allders International Pty Ltd v Commr of State Revenue (Vic) [1996] HCA 58 ... 322, 323
Allen (Trustee), in the matter of Allen's Asphalt Staff Superannuation Fund v FCT [2011] FCAFC 118 ... 202
Allen v Carbonel [1975] HCA 14 ... 183
Anderson v Commr of Taxes (Vic) [1937] HCA 24 ... 172
Annalong Pty Ltd v FCT [1972] HCA 45 ... 183
Application by Ellasil Pty Ltd [2023] VSC 69 ... 490
Application of NBT Pty Ltd [2023] NSWSC 919 ... 343
Archer Bros Pty Ltd v FCT [1953] HCA 23 ... 202
Archer Capital 4A Ltd as Trustee for the Archer Capital Trust 4A v Sage Group Plc [2015] FCA 960 ... 181
Ascot Investments v Harper [1981] HCA 1 ... 508
Atkins & Hunt [2020] FamCAFC 252 ... 153
Attorney General v Blake [2001] 1 AC 268 ... 390
Attorney-General (Cth) v Breckler [1999] HCA 28 ... 507, 570
Attorney-General v Milne [1914] AC 765 ... 172
Auctus Resources Pty Ltd; FCT v [2021] FCAFC 39 ... 543
Austin v Commonwealth of Australia [2003] HCA 3 ... 172
Australasian Annuities Pty Ltd (in liq) v Rowley Super Fund Pty Ltd [2015] VSCA 9 ... 390, 391
Australian Broadcasting Commission v Australasian Performing Right Association Ltd [1973] HCA 36 ... 507

Australian Building Systems Pty Ltd (in liq); FCT v [2015] HCA 48 ....202, 548
Australian Trade Commission v WA Meat Exports Pty Ltd (1987) 75 ALR 287 132
Automotive Invest Pty Ltd v FCT [2023] FCAFC 129 176
AXA Asia Pacific Holdings Ltd; FCT v [2010] FCAFC 134 ....131, 133
Aymsheen Pty Ltd v Chief Commr of State Revenue [2023] NSWSC 1237 323

B

B&F Investments Pty Ltd as trustee for the Illuka Park Trust v FCT [2023] FCAFC 89....35, 66, 221, 378, 508
Baba v Sheehan [2019] NSWSC 1281 575
Baba v Sheehan [2021] NSWCA 58.... 575
Bains and FCT [2023] AATA 2477 ....177, 306
Baird v Baird [1990] 2 AC 548 49
Balken & Vyner [2020] FamCA 955 341
Bamford; FCT v [2010] HCA 10....202, 244, 446, 447
Barber v Law Society of NSW (No. 2) [2001] NSWSC 861 376
Barker v FCT [2015] QCA 215....202
Barnes v Addy (1874) LR 9 Ch App 244....389
Barp Nominees Pty Ltd [2016] NSWSC 990....17, 18, 343
Barton; FCT v (1957) 96 CLR 359 30
BBlood Enterprises Pty Ltd v FCT [2022] FCA 1112 ....35, 69, 502
BCI Finances Pty Ltd (in liq) v Binetter [2018] FCAFC 189 390
Bechtel Australia Pty Ltd v FCT [2023] FCA 676 .... 64, 118
Bechtel Australia Pty Ltd v FCT [2024] FCAFC 33....540
Beloved Wilkes' Charity, Re [1851] EWHC Ch J52....573
Bendel and FCT [2023] AATA 3074 ....228, 304
Blair v Duncan [1902] AC 37 155
Blake; FCT v [1984] 2 Qd R 303 445
Boardman v Phipps [1966] 3 All ER 721....390, 391
Boros v Pages Property Investment [2021] NSWCA 288 391
Bosanac v FCT [2019] HCA 41....386, 387
Bosanac v FCT [2022] HCA 34....503, 513–515
Bowerman and FCT [2023] AATA 3547.... 312–315, 539
BPFN and FCT [2023] AATA 2330 129
Brailey Holdings Pty Ltd ACN 001 190 441, In the application of [2018] NSWSC 1493....19
Breen v Williams (1996) 186 CLR 71....30, 86
Brewing Investments Ltd; FCT v [2000] FCA 920 202
Brown v FCT [2002] FCAFC 75 ....442, 445
Brunton v Commr of Stamp Duties for NSW [1913] AC 747....172
Buddhist Society of Western Australia Inc v FCT (No. 2) [2021] FCA 1363 8
Bullhead Pty Ltd v Brickmakers Place Pty Ltd (in liq) (2018) 58 VR 91.... 391
Burton v FCT [2019] FCAFC 141.... 334
Burton, Re; Wily v Burton [1994] FCA 1146....153, 507, 575
Byrnes v Kendle [2011] HCA 26.... 507
Bywater Investments Ltd v FCT [2016] HCA 45 122

C

Calverley v Green [1984] HCA 81.... 343, 514
Calvert v Wainwright [1947] KB 526....444
Campbell and FCT [2019] AATA 2043 ....157, 190, 196
Cantor Management Services Pty Ltd v Booth [2017] SASCFC 122 47
Capital Duplicators Pty Ltd v Australian Capital Territory (1992) 177 CLR 248.... 321, 323
Cardaci v Filippo Primo Cardaci as executor of the estate of Marco Antonio Cardaci [No. 5] [2021] WASC 331 ....489, 490
Carter; FCT v [2022] HCA 10 500
Chadwick v Pearl Life Insurance Co [1905] 2 KB 507 328
Chan v Zacharia [1984] HCA 36....390
Chase v Chase [2020] NSWSC 1689.... 338
Chevron Australia Holdings Pty Ltd v FCT [2017] FCAFC 62 ....132, 175
Chief Commissioner of State Revenue v Shell Energy Operations No. 2 Pty Ltd [2023] NSWCA 113 322
Civil Aviation Safety Authority v Alligator Airways Pty Ltd (No. 3) [2012] FCA 601 377
Cleeve Group Pty Ltd, Re [2022] VSC 342....16, 339
Clerical, Administrative and Related Employees Superannuation Pty Ltd v Bishop [1997] FCA 714....569, 570
Clifford and Tax Practitioners Board [2023] AATA 2068 126
Colonial Mutual Life Assurance Society Ltd v FCT (1953) 89 CLR 428....328, 329
Commissioner of Stamp Duties (Qld) v Livingston [1964] UKPC 2....48
Commonwealth Bank of Australia v Smith [1991] FCA 375 391
Condon v FCT [2023] FCA 561....12, 386, 387
Consolidated Media Holdings Ltd; FCT v [2012] HCA 55....30
Construction, Forestry, Maritime, Mining and Energy Union v Personnel Contracting Pty Ltd [2022] HCA 1....450, 452
Container Homes Designer Domain Pty Ltd and FCT [2023] AATA 1815....68
Cooper Brookes (Wollongong) Pty Ltd v FCT [1981] HCA 26 ....30, 172
Copley and FCT [2024] AATA 8....415
Copperart Pty Ltd v FCT [1993] FCA 462 133
Cowan v Scargill [1985] Ch 270 391
Cridland v FCT (1977) 140 CLR 330....30
Cromwell & Cromwell [2006] FamCA 1454....317
CVMW and FCT [2023] AATA 4039....372

D

D'couto and Tax Practitioners Board [2023] AATA 3485 309
Dagenmont Pty Ltd v Lugton [2007] QSC 272....343
Dalco; FCT v [1990] HCA 3 386
Davis v FCT (1989) 89 ATC 4377 30
Davsa Forty-Ninth Pty Ltd as Trustee for the Krongold Ford Business Unit Trust and FCT [2014] AATA 337....544
De Vries v Timbercorp Finance Pty Ltd (in liq) [2021] VSCA 265 343
DEK Technologies Pty Ltd as trustee for DEK Technologies Unit Trust, Application of [2023] NSWSC 544 ....16, 17, 19
Desalination Technology Pty Ltd; FCT v [2015] FCAFC 96 .... 439, 441
Di Lorenzo Ceramics Pty Ltd v FCT [2007] FCA 1006....340
Dickenson's Arcade Pty Ltd v Tasmania [1974] HCA 9....320
Diesel Holdings Pty Ltd v Waters [2023] VSC 455 378
Directed Electronics OE Pty Ltd v OE Solutions Pty Ltd (No. 8) [2022] FCA 1404.... 391
DiStefano and FCT [2023] AATA 1697....67
Dixon; FCT v [1952] HCA 65....442, 444, 445
Donovan v Donovan [2009] QSC 26....48, 49, 143, 562
DR McKendry Nominees Pty Ltd [2015] VSC 560.... 339
Drew v Nunn (1879) 4 QBD 661 111
Duke Group Ltd (in liq) v Pilmer [1998] SASC 6529 391
Duke Group Ltd (in liq) v Pilmer [1999] SASC 97.... 391
Duke of Westminster; IR Commrs v [1936] AC 1....172
Dundee General Hospitals Board of Management v Walker [1952] 1 All ER 896.... 569

E

Edmunds v Pickering (1999) 75 SASR 407.... 391
Egerton-Warburton v DCT [1934] HCA 40 ....328, 329
Eichmann v FCT [2020] FCAFC 155....548
Ellison v Sandini Pty Ltd [2018] FCAFC 44 264
Estate of JR Cawthen and FCT [2008] AATA 1168....272
Evans v Friemann [1981] FCA 85....420
Everett; FCT v [1980] HCA 6....446

F

Farah Constructions Pty Ltd v Say-Dee Pty Ltd [2007] HCA 22 391
Farrant v Blanchford (1863) 1 De GJ & Sm 107.... 391
Fay v Moramba Services Pty Ltd [2009] NSWSC 1428 508
Fidge and FCT [2023] AATA 4245....373
Finch v Telstra Super Pty Ltd [2010] HCA 36.... 507
Firebird Global Master Fund II Ltd v Republic of Nauru [2015] HCA 43 30
First Provincial Building Society Ltd v FCT [1995] FCA 1101 179
Fischer v Nemeske Pty Ltd [2015] NSWCA 6....343
Fordyce v Ryan [2016] QSC 307....507, 508
Foreman v Kingstone [2004] 1 NZLR 841.... 391
Freeston's Charity, Re [1978] 1 WLR 741 391
Furs Ltd v Tomkies (1936) 54 CLR 583....390

G

Galea v Camilleri; The Estate of Patricia Camilleri [2023] NSWSC 206....211
Gashi v FCT [2013] FCAFC 30 .... 383, 386
George v Rockett [1990] HCA 26 377
Gerhard Horst Heinrich; DCT v [2024] QSC 51.... 541
Gibb v FCT [1966] HCA 74 202
Gisborne v Gisborne (1877) 2 App Cas 300 ....569, 570
Gleeson v Commr of State Revenue [2009] VSC 464 515
Glencore Coal Queensland Pty Ltd v State of Queensland (2022) 12 QR 295 323
Glencore Investment Pty Ltd v FCT [2019] FCA 1432 133
Glencore Investment Pty Ltd; FCT v [2020] FCAFC 187....133
Governor & c. of the Poor of Kingston-upon-Hull v Petch [1854] EngR 995....182
GP International Pipecoaters Pty Ltd v FCT [1990] HCA 25.... 327, 330, 335
GR Securities Pty Ltd v Baulkham Hills Private Hospital Pty Ltd (1986) 40 NSWLR 631....183
Granby Pty Ltd v FCT [1995] FCA 1217 ....131, 133
Grant v Grant; Grant v Grant (No. 2) [2020] NSWSC 1288....111
Greenhatch v FCT [2013] HCATrans 104....244
Greenhatch; FCT v [2012] FCAFC 84....244, 448
Greig v FCT [2020] FCAFC 25 314
Grimaldi v Chameleon Mining NL (No. 2) [2012] FCAFC 6....390, 391
Guardian AIT Pty Ltd ATF Australian Investment Trust v FCT [2021] FCA 1619 501
Guardian AIT Pty Ltd ATF Australian Investment Trust; FCT v [2023] FCAFC 3....35, 221, 508
Guazzini v Pateson [1918] NSWStRp 39 390

H

Ha v New South Wales [1997] HCA 34.... 321, 322
Hains (dec'd), Re; Barnsdall v FCT [1988] FCA 192 ....131, 133
Hancock v Rinehart (Trust Documents) [2018] NSWSC 1684 391
Harding v FCT [2019] FCAFC 29 10
Haritos v FCT [2015] FCAFC 92....384–386
Harmer v FCT [1989] FCA 432....202
Harper v Minister for Sea Fisheries (1989) 168 CLR 314....323
Harries v Church Commrs for England [1992] 1 WLR 1241.... 391
Harris & Dewell [2018] FamCAFC 94....153
Harris & Harris [2011] FamCAFC 245....153, 154
Harris; FCT v (1980) 10 ATR 869....445
Hay's Settlement Trusts, Re [1981] 3 All ER 786.... 569
Hayes v FCT [1956] HCA 21 445
Hedges and FCT [2020] AATA 5307....128
Hedges v FCT [2022] FCA 1389....128
Hedges v FCT [2023] FCAFC 105....126
Herdegen v FCT [1988] FCA 419 515
Hesford v Conti [2013] WASC 389....560
Heydon v Perpetual Executors Trustees & Agency Co (WA) Ltd [1930] HCA 26....343
Hill (Viscount) v Hill (Dowager Viscountess) [1897] 1 QB 483.... 507
Hill v Zuda Pty Ltd [2021] WASCA 59.... 143
Hill v Zuda Pty Ltd [2022] HCA 21....47, 143, 149, 497, 562, 563
Hochstrasser v Mayes [1960] AC 376....445
Holder v Holder [1968] Ch 353.... 391
Hordern v Hordern [1910] AC 465....390
Horn v GA & RG Horn Pty Ltd [2022] NSWSC 1519 339
Hornsby Shire Council v Commonwealth [2023] HCA 19 321
Hospital Products Ltd v United States Surgical Corporation [1984] HCA 64....390, 391
Howard v FCT [2012] FCAFC 149....157, 190, 194, 202

I

In the Marriage of Crapp and Crapp (No. 2) (1979) 5 Fam LR 47....508
In the Marriage of Kelly and Kelly (No. 2) (1981) 7 Fam LR 762....508
In the matter of an application by Police Association of SA [2008] SASC 299 563
Incollingo v Tax Practitioners Board [2023] FCA 878 126
Inland Revenue Commissioners v Duke of Westminster [1936] AC 1....172
Ioppolo & Hesford v Conti [2013] WASC 389....143
Ioppolo v Conti [2015] WASCA 45 560

J

J Rowe & Son Pty Ltd v FCT [1971] HCA 80 335
Jassar & Manesh Pty Ltd as trustee for the Jassar & Manesh Unit Trust and FCT [2023] AATA 3502....309
Jassar & Manesh Pty Ltd as trustee for the Jassar Manesh Consultants Unit Trust and FCT [2023] AATA 3499 309
JEL and DDF [2000] FamCA 1353....317
JMC Pty Ltd v FCT [2023] FCAFC 76 1
John Holland Group Pty Ltd v FCT [2015] FCAFC 82....65
Jones v Dunkel [1959] HCA 8.... 569
Jones v IR Commrs (1920) 1 KB 711 328
Jowill Nominees Pty Ltd v Cooper [2021] SASC 76 337
Jukka Pekka Kemi v Peter Hedley Wood [2013] NSWSC 180....343
Jumbunna Coal Mine NL v Victorian Coal Miners' Association (1908) 6 CLR 309....30
Just v FCT (1949) 8 ATD 419 328

K

Kafataris v DCT [2008] FCA 1454....202, 515
Karger v Paul [1984] VR 161 ....493, 568, 570, 572
Katz v Grossman [2005] NSWSC 934....143, 149
Kearney v FCT 84 ATC 4295....183
Kelly and Kelly (No. 2) [1981] FamCA 78 317
Kennon v Spry [2008] HCA 56....153, 154, 508
Khoury v Khouri [2006] NSWCA 184 183
Koitaki Para Rubber Estates Ltd v FCT [1941] HCA 13....255
Konebada Pty Ltd ATF the William Lewski Family Trust v FCT [2023] FCA 257....543–548
Koprivnjak v Koprivnjak [2023] NSWCA 2....504
Kornwasser v Spigelman [2022] VSC 759....508

L

Laidler v Perry (Inspector of Taxes) [1966] AC 16 444

Lance and FCT [2024] AATA 11 415
Le v FCT [2021] FCA 303 386
Londonderry's Settlement, Re [1965] Ch 918 .... 391, 573
Loughnan v Magistrate's Court of Victoria Sitting at Melbourne [1993] 1 VR 685 377
Loughnan v McConnell [2006] QSC 359 343
Lunney v FCT [1958] HCA 5 65
Lutheran Church of Australia South Australia District Incorporated v Farmers' Co-Operative Executors and Trustees Ltd (1970) 121 CLR 628 154
Lygon Nominees Pty Ltd v Commr of State Revenue [2005] VSC 247 508

M
Ma v FCT [1992] FCA 359 383
Mack v Lenton [1993] 32 NSWLR 259 17
Maggbury Pty Ltd v Hafele Aust Pty Ltd (2001) 210 CLR 181 86
Mahoney v FCT (1967) 41 ALJR 232 202
Makrylos v FCT [2023] FCA 971 178
Maks v Maks [1986] 6 NSWLR 34 .... 17, 207, 338
Malayan Shipping Co Ltd v FCT [1946] HCA 7 122
Mantovani v Vanta Pty Ltd (No. 2) [2021] VSC 771 .... 14, 207, 337, 338, 492, 493
Manzi v Smith [1975] HCA 36 343
Marion Elizabeth Collis v FCT [1996] FCA 1717 133
Marsella v Wareham (No. 2) [2019] VSC 65 .... 564, 565
Masters v Cameron [1954] HCA 72 .... 181, 183
McCormack v FCT [1979] HCA 18 386
McDonald v FCT [2001] FCA 305 183
McFadden v Public Trustee for Victoria [1981] 1 NSWLR 15 .... 49, 563
McGowan & Valentini Trusts, Re [2021] VSC 154 497
McIntosh v McIntosh [2014] QSC 99 .... 49, 143
McLean v FCT (No. 2) (1997) 78 FCR 140 444
McPartland v FCT [2023] FCA 1260 307
Mercanti v Mercanti [2016] WASCA 206 576
Minister for Immigration and Ethnic Affairs v Teoh (1995) 183 CLR 273 30
Minister of National Revenue v Merritt [1969] CTC 207 132
Moignard; FCT v [2015] FCA 143 386
Moorhouse v Dooland [1955] Ch 284 445
Mordecai v Mordecai (1988) 12 NSWLR 58 390
Moreton Resources Ltd v Innovation and Science Australia [2019] FCAFC 120 441
Morton & Morton [2012] FamCA 30 153
Moss v Contracoin Pty Ltd [2023] FCA 976 .... 180, 181
Moulsdale t/a Moulsdale Properties v Commrs for His Majesty's Revenue and Customs [2023] UKSC 12 548
Mulherin v FCT [2013] FCAFC 115 202
Munro v Munro [2015] QSC 61 .... 49, 143
Myer Emporium Ltd; FCT v [1987] HCA 18 .... 312, 314, 315, 539
Mylan Australia Holding Pty Ltd v FCT [2023] FCA 672 282

N
N & M Martin Holdings Pty Ltd v FCT [2020] FCA 1186 248
Narumon Pty Ltd, Re [2018] QSC 185 .... 48, 111, 563, 564
Newton; FCT v (1957) 96 CLR 577 30
Niesmann v Collingridge [1921] HCA 19 182
NQZG and FCT [2020] AATA 379 .... 330, 331, 335
Nyasa No. 19 Pty Ltd, In the Application of [2023] NSWSC 578 .... 17, 18, 493

O
O'Brien v Dawson [1942] HCA 8 182
Ogden & Ogden [2010] FMCAfam 865 153
Ogilvie v Adams [1981] VR 1041 343
Ogilvie v Littleboy (1897) 13 TLR 399 343
Oliver Hume Property Funds (Broad Gully Rd) Diamond Creek Pty Ltd v Commr of State Revenue (Review and Regulation) [2023] VCAT 634 210
Orifici as Executor of the Estate of Rosaria Giuseppe Orifici v Orifici [2007] WASC 74 343
Ormond Investment Co v Betts [1928] AC 143 172
Oswal v FCT [2013] FCA 745 515
Owies Family Trust, Re [2020] VSC 716 .... 495, 496
Owies v JJE Nominees Pty Ltd [2022] VSCA 142 .... 49, 208, 507, 568–572
Owners of the Ship "Shin Kobe Maru" v Empire Shipping Co Inc [1994] HCA 54 376
Ozone Manufacturing Pty Ltd and FCT [2013] AATA 420 440

P
Papas v Co [2018] NSWSC 1404 343
Paris King Investments Pty Ltd v Rayhill [2006] NSWSC 578 391
Partington v Attorney-General (1869) LR 4 HL 100 172
Pascoe v FCT (1956) 11 ATD 108 315
Pauling's Settlement Trusts, Re [1962] 1 WLR 86 391
Payne; FCT v [2001] HCA 3 65
Pepsi Co, Inc v FCT (unreported, Federal Court, Victorian Registry, 20 to 29 March 2023, VID74/2022) 30
Perez; FCT v [2023] FCA 1221 440
Permanent Building Society (in liq) v McGee (1993) 11 ACSR 260 391
Permanent Building Society (in liq) v Wheeler (1994) 11 WAR 187 391
Permanent Trustee Australia Ltd, Re (1997) 137 FLR 190 .... 390, 391
Permewan No. 2, Re [2022] QSC 114 337
Perri v Coolangatta Investments Pty Ltd [1982] HCA 29 182
Peter Greensill Family Co Pty Ltd (Trustee) v FCT [2021] FCAFC 99 .... 248, 497
Pfenning & Snow [2016] FamCA 29 317
Phipps v Boardman [1967] 2 AC 46 30
Pike v FCT [2019] FCA 2185 10
Porlock Pty Ltd, Re [2015] NSWSC 1243 16
Princess Ann of Hesse v Field [1963] NSWR 998 391
Purcell; DCT v (1921) 29 CLR 464 30

Q
QQRK and FCT [2023] AATA 3493 .... 308, 386, 387
Quy and FCT [2024] AATA 245 476

R
Rawson Finances Pty Ltd v FCT [2013] FCAFC 26 65
Rawson Finances Pty Ltd; FCT v [2023] FCA 617 65
Regal (Hastings) Ltd v Gulliver [1967] 2 AC 134 .... 390, 391
Registrar of Titles (WA) v Franzon [1975] HCA 41 548
Reseck v FCT (1975) 133 CLR 45 335
Reuter v FCT (1993) 111 ALR 716 335
Robinson v FCT [1927] HCA 8 510
Rosati v Rosati [1998] FLC ¶92-804 317
Ross; FCT v [2021] FCA 766 .... 386, 387
Rossiter v Miller [1877] UKLawRpCh 168 182
Royal Botanic Gardens and Domain Trust v South Sydney City Council [2002] HCA 5 507
Rozman; FCT v [2010] FCA 324 157
Russell and Dunphy v Dunphy [2023] NSWSC 282 340

S
Sage v FCT [2023] FCA 1247 301
SCCASP Holdings Pty Ltd as trustee for the H&R Super Fund v FCT [2013] FCAFC 45 202
Schmidt v Rosewood Trust Ltd [2003] 2 AC 709 391
Schmierer v Taouk [2004] NSWSC 345 343
Scott v FCT (No. 2) (1966) 10 AITR 290 202
Scott v FCT [1966] HCA 48 .... 335, 442, 444, 445
Scott v National Trust for Places of Historic Interest or Natural Beauty [1998] 2 All ER 705 507
Simplot Australia Pty Ltd v FCT [2023] FCA 1115 228
Sinclair, Scott & Co Ltd v Naughton [1929] HCA 34 182
Skeats' Settlement, In re; Skeats v Evans (1889) 42 Ch D 522 576
Smith v FCT [1987] HCA 48 445
Sole Luna Pty Ltd as Trustee for the PA Wade No. 2 Settlement Trust v FCT [2019] FCA 1195 202
Sparkling Beverages Pty Ltd (No. 2), Re [2023] VSC 419 183
Speight v Gaunt (1883) 9 App Cas 1 391
Spellson v George (1987) 11 NSWLR 300 391
Spellson v George (1992) 26 NSWLR 666 391
Spencer v Commonwealth (1907) 5 CLR 418 131
Squatting Investment Co Ltd v FCT [1953] HCA 13 445
Steiner v Strang [2016] NSWSC 395 343
Stock v NM Superannuation Pty Ltd [2015] FCA 612 141
Stone; FCT v [2005] HCA 21 445
Summergreene v Parker [1950] HCA 13 182
Sunlite Australia Pty Ltd v FCT [2023] FCAFC 43 .... 378, 439, 441, 548
Swansea Services Pty Ltd; FCT v [2009] FCA 402 .... 544, 548

T
Taffner v Taffner [2021] FamCAFC 68 317
Tambakeras v UniSuper Ltd [2022] NSWSC 1162 508
Tasman Group Services Pty Ltd; FCT v [2009] FCAFC 148 336
Tatham v Huxtable (1950) 81 CLR 639 154
Tawfik and FCT [2023] AATA 2541 169
Tax Practitioners Board v Van Stroe (No. 2) [2023] FCA 1533 371
TDS Biz Pty Ltd and FCT [2022] AATA 3543 437
TDS Biz Pty Ltd v FCT [2023] FCA 710 437
Tech Mahindra Ltd v FCT [2015] FCA 1082 86
Telstra Super Pty Ltd v Flegeltaub [2000] VSCA 180 569
The Bell Group Ltd (in liq) v Westpac Banking Corporation (No. 9) [2008] WASC 239 391
The Counsellor and FCT [2024] AATA 220 476
Toyama Pty Ltd v Landmark Building Developments Pty Ltd [2006] NSWSC 83 544
Traknew Holdings Pty Ltd, Re v FCT [1991] FCA 129 .... 156, 157, 190
Transvaal Lands Co v New Belgium (Transvaal) Lands and Development Co [1914] 2 Ch 488 390
Trautwein v FCT [1936] HCA 77 386
Trustee for the Estate of the late AW Furse No. 5 Will Trust v FCT (1991) 21 ATR 1123 131
Trustees of the Property of John Daniel Cummins v Cummins [2006] HCA 6 508
Twigg v Twigg [2022] NSWCA 68 494

U
Union Fidelity Trustee Co of Australia Ltd v FCT [1969] HCA 36 .... 189, 194, 244

V
Valuer-General Victoria v AWF Prop Co 2 Pty Ltd (2021) 65 VR 327 322
Vanderstock v Victoria [2023] HCA 30 .... 304, 320–323
Vanta Pty Ltd v Mantovani [2023] VSCA 53 .... 14, 17, 207, 208, 338, 507
Visy Packaging Holdings Pty Ltd v FCT [2012] FCA 1195 315
Voce v Deloraine [2012] NSWSC 1187 343
Von Hatzfeldt-Wildenburg v Alexander [1911] UKLawRpCh 90 182

W
W & J Investments Pty Ltd v FCT [1989] FCA 415 183
Wade; FCT v [1951] HCA 66 509–511
Walters v Perton (Costs) [2023] VSC 380 508
Walters v Perton [2023] VSC 37 497
Wareham v Marsella [2020] VSCA 92 .... 507, 570, 573
Warman International Ltd v Dwyer [1995] HCA 18 .... 390, 391
Webb v McCracken (1906) 3 CLR 1018 111
Western Australian Trustee Executor & Agency Co Ltd v Commr of State Taxation (WA) [1980] HCA 50 30
Westraders Pty Ltd; FCT v [1980] HCA 24 172
Whiting; FCT v [1943] HCA 45 244
Widdup v DCT [2023] FCAFC 145 177
Wilkinson v Clerical Administrative and Related Employees Superannuation Pty Ltd (1998) 79 FCR 469 507
Williams v Williams [2023] QSC 90 47
Willmington Investments Pty Ltd v Sarich [2023] WASC 191 .... 18, 343
Wood; FCT v [2023] FCA 574 11
Woodcock & Woodcock (No. 2) [2022] FedCFamC1F 173 .... 153, 508
Woodcock & Woodcock [2021] FedCFamC1F 88 505
Wooster v Morris [2013] VSC 594 .... 143, 560

X
XQDX and FCT [2021] AATA 4070 441

Y
Yap v Lee [2019] VSC 743 207
Yazbek v FCT [2013] FCA 39 202
Ying v Song [2010] NSWSC 1500 343
York Street Mezzanine Pty Ltd (in liq), Re [2007] FCA 922 343
Youyang Pty Ltd v Minter Ellison Morris Fletcher [2003] HCA 15 343

Z
Zeta Force Pty Ltd v FCT [1998] FCA 728 .... 202, 446
ZG Operations Australia Pty Ltd v Jamsek [2022] HCA 2 .... 450, 452

Authors

A
Abdalla, J
The changing face of tax practitioner obligations 427
Senior Tax Counsel's Report
- 2023: a recap 304
- Better targeting Div 296 536
- Design, consultation and time 60
- Interpretation of tax law 172
- Retrospective tax legislation 366

Abraham, T
A Matter of Trusts
- State trust surcharges invalid? 102

B
Barnes, J
The proposed intangibles anti-avoidance rule 26
Bembrick, P
Mid Market Focus
- CGT and the main residence exemption 76

Bishop, G
Vanderstock and the future of federal–state tax powers 320
Brandon, G
Mid Market Focus
- Continuity of ownership test: a different perspective 549

Brydges, N
The CGT main residence exemption: tips and traps 254
A Matter of Trusts
- Section 99B: is it safe to go back in the water? 156

Burgess, M
Tax and estate planning in 2024: what's "hot" right now? 337
Burnett, C
Intangible integrity intensity 82

Butler, D
SMSF succession planning, BDBNs, and more ... 559
Superannuation
- Draft NALE legislation released ... 50
- Employee or contractor – new ATO guidance: part 5 ... 450
- Family law superannuation splitting notices ... 349
- How the NALI and the CGT provisions interact ... 158
- New 15% tax on $3m+ member super balances ... 285
- Pending NALE changes place SMSFs at risk ... 392
- SMSF staff discount policy: do you have one? ... 516
- SMSFs and voluntary disclosure to the ATO ... 106
- Transfer duty on property investments ... 210

C

Chek, A
Vanderstock and the future of federal–state tax powers ... 320

Chitnis, G
Mid Market Focus
- CGT roll-overs and tax consolidation for SMEs ... 135

Chye, J
Mid Market Focus
- Unrealised tax liabilities in family law settlements ... 317

Cullen, R
Alternative Assets Insights
- Victorian tax reform: an update ... 453

D

Day, C
The rules behind the NALI and NALE acronyms ... 96

Donlan, T
Successful Succession
- Gifts made by an attorney ... 109

Dunne, C
Due diligence, tax structuring done … what next? ... 39

E

Esmerian, A
Alternative Assets Insights
- Victorian tax reform: an update ... 453

F

Fettes, W
Superannuation
- Family law superannuation splitting notices ... 349
- SMSF staff discount policy: do you have one? ... 516
- SMSFs and voluntary disclosure to the ATO ... 106

Figot, B
Superannuation
- Draft NALE legislation released ... 50
- How the NALI and the CGT provisions interact ... 158

Freshwater, L
Deceased estate taxation: Frankenstein's monster? ... 243

Fullarton, L
Tax accounting and livestock in Australia ... 509

G

Gandhi, N
Mid Market Focus
- Last chance to claim loss carry back tax offset ... 185

Gao, J
A Matter of Trusts
- Distribution resolutions and trust income ... 446

Gasiuk, K
A Matter of Trusts
- Discretionary trusts in tax consolidated groups ... 345

Goodwin, R
Changes to the thin capitalisation rules ... 274

H

Hanna, N
Default assessments: the "all or nothing approach" ... 383
Proper management of a trust: lessons from Owies ... 568

Harnischmacher, J
A Matter of Trusts
- Trust law principles and challenging BDBNs ... 47

Hendriks, M
Member Spotlight ... 485

Hennebry, E
The CGT main residence exemption: tips and traps ... 254
A Matter of Trusts
- Bare trusts, resulting trusts and dealings in land ... 513

J

Jacobson, R
In our sights at the start of a new financial year ... 32

K

Krishnan, S
Associate's Report
- Central management and control ... 122
- The OECD's Two-Pillar Solution ... 472

L

Lang, S
Vanderstock and the future of federal–state tax powers ... 320

M

Manapakkam, A
Successful Succession
- Death and the small business CGT concessions ... 288

Marshall, M
President's Report
- Local engagement, local connections ... 170
- New leadership to move us forward ... 222
- Tapped into the world of tax ... 4
- The Tax Summit: bigger, brighter and better than ever ... 120
- Time to prioritise working well ... 58
- A year of investment and connection ... 302

Mazzetti, C
CEO's Report
- The path toward our goals ... 171
- Reaching new heights at The Tax Summit ... 121
- You're at the heart of the Institute ... 59
- Your CPD for the rest of the year ... 5

Monotti, W
A Matter of Trusts
- Lost trust deeds: consequences for trustees ... 207

N

Ng, E
Changes to the thin capitalisation rules ... 274

Njokos, M
A Matter of Trusts
- Appointors sacking trustees to appoint themselves ... 575

P

Pace, S
Due diligence, tax structuring done … what next? ... 39

Peskett, T
Mid Market Focus
- Small business CGT: asset versus share sale ... 21

Pinto, D
Tax accounting and livestock in Australia ... 509

Psarrakos, G
Section 99B: implications for Australian beneficiaries ... 189

R

Raspin, I
Deceased estate taxation: Frankenstein's monster? ... 243

Ru, Y
Redefining the taxation of gifts ... 442

Russo, G
Trusts and distributions: avoiding disasters ... 487

S

Schaefer, S
SMSFs and death benefit payments ... 141

Shekhawat, A
Associate's Report
- Designing better integrity provisions ... 410
- Harmonising property taxes ... 6
- Setting the framework for superannuation stability ... 224

Skilton, E
A Matter of Trusts
- Appointors sacking trustees to appoint themselves ... 575

Smith, T
Mid Market Focus
- Early-stage innovation company scheme ... 238

Speed, P
Complications with trustee duties ... 388

Stead, F
Superannuation
- Employee or contractor – new ATO guidance: part 5 ... 450
- SMSF staff discount policy: do you have one? ... 516
- Transfer duty on property investments ... 210

Steed, J
Conditions of release ... 87

Stein, K
Self-coaching your way to bust your busyness ... 204

Streeter, M
Testamentary discretionary trusts: practical implications ... 147

Suraweera, A
Vanderstock and the future of federal–state tax powers ... 320

T

TaxCounsel Pty Ltd
Tax News – what happened in tax?
- June 2023 ... 8
- July 2023 ... 62
- August 2023 ... 124
- September 2023 ... 174
- October 2023 ... 225
- November 2023 ... 306
- December 2023 ... 368
- February 2024 ... 412
- March 2024 ... 474
- April 2024 ... 538

Tax Tips
- Arm's length issues ... 129
- CGT: dwelling acquired by deceased estate ... 418
- Code breaches: new notification obligations ... 375
- Connected entity issues ... 70
- Contract timing issues ... 180
- Enterprise issues ... 543
- Isolated transaction: deductible loss ... 312
- Lost trust deeds: "clear and convincing" proof? ... 14
- Main residence exemption: relationship roll-over ... 479
- Vacant land deductions ... 231

Thomas, E
Deferred consideration ... 325

Thompson, K
Member Spotlight ... 381

Tian, T
Vanderstock and the future of federal–state tax powers ... 320

Treatt, S
CEO's Report
- 2023: challenges, triumphs and future opportunities ... 303
- Acting on your feedback ... 471
- Have your say on our future plans ... 365
- Leading and listening as CEO of the Institute ... 223
- The role of advocacy at the Institute ... 535
- Shaping changes to our tax system ... 409

W

Want, T
President's Report
- Be active in shaping your legacy ... 408
- Continuing development for the Institute ... 470
- The Institute is what we make it ... 364
- Stay ahead of the upcoming Federal Budget ... 534

Wood, L
Ten things I hate about your R&D claim ... 434

Wu, T
The proposed intangibles anti-avoidance rule ... 26

Y

Yuan, H
Mid Market Focus
- Family trust elections: risks and pitfalls ... 422

Giving back to the profession

The Tax Institute would like to thank the following presenters from our April CPD sessions. All of our presenters are volunteers, and we recognise the time that they have taken to prepare for the paper and/or presentation, and greatly appreciate their contribution to educating tax professionals around Australia.

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Level 37, 100 Miller Street
North Sydney, NSW 2060

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

State Offices

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

Level 37, 100 Miller Street
North Sydney, NSW 2060

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

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

Level 3, 530 Collins Street
Melbourne, VIC 3000

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

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

310 Edwards Street
Brisbane, QLD 4000

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

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

152 St Georges Terrace
Perth, WA 6000

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

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

217 Flinders Street
Adelaide, SA 5061

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

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

E tas@taxinstitute.com.au

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