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Taxation in Australia

Legal substance and R&D entity relationships
Damian Smyth

Asset protection and tax avoidance
Mathew Leighton-Daly, FTI

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Invitation to write

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Tax News – at a glance

by TaxCounsel Pty Ltd

May – what happened in tax?

The following points highlight important federal tax developments that occurred during May 2024. A selection of the developments is considered in more detail in the "Tax News – the details" column on page 598 (at the item number indicated).

PwC tax leaks issues: consultation

On 3 May 2024, Treasury released two consultation papers on several of the measures announced by the government in August 2023 in response to the PwC tax leaks matter. **See item 1.**

Philanthropy inquiry

The Productivity Commission's final report in relation to its inquiry into philanthropy (which was initiated by the Treasurer on 11 February 2023 with the release of the terms of reference for the inquiry) was handed to the government on 10 May 2024. **See item 2.**

TPB: breach reporting obligations

The Tax Practitioners Board has released draft guidance on the code breach reporting obligations that will be imposed on a registered tax or BAS agent where there is a significant breach of the Code of Professional Conduct by the agent or another registered agent on or after 1 July 2024 (TPB(I) D53/2024). **See item 3.**

ATO 2024 individual tax return priorities

With the approach of 2024 "tax time", the ATO has announced that it will be taking a close look at three common errors being made by individual taxpayers. **See item 4.**

Self-education expenses not deductible

The AAT has held that expenses incurred by a taxpayer (who had moved to Australia from a country where she was registered as a dentist) to enable her to practise as a dentist in Australia were not allowable as general deductions (*Ionita and FCT* [2024] AATA 808). **See item 5.**

Discretionary trust: vesting date extension

The Victorian Supreme Court has approved the variation of the terms of a discretionary trust to defer the vesting date of the trust (*Re Gengoult-Smith Family Trust* [2024] VSC 189). **See item 6.**

Terms of remittal to AAT

The Federal Court (Derrington J), in remitting a case back to the AAT for rehearing, did so on the basis that the taxpayer could adduce further evidence on limited issues (*FCT v Tan* [2024] FCA 406). **See item 7.**

Use of ATO compulsory examination transcript

The Queensland Court of Appeal (Bowskill CJ, Morrison JA and Fraser AJA) has unanimously held that, where a compulsory examination by an ATO officer was lawful, a copy of the transcript of the examination could be given to the Commonwealth Director of Public Prosecutions (*R v Van Eps; Ex parte Commonwealth Director of Public Prosecutions* [2024] QCA 46). **See Item 8.**

Work-related car expense deductions

The Commissioner has released a draft of a legislative instrument which will set the rate at which work-related car expense deductions may be claimed in an income year when using the cents per kilometre method (LI 2024/D5). The rate is to be 88 cents per kilometre for the income year commencing 1 July 2024 (and for subsequent income years, until such time as the instrument is repealed or varied).

Default assessments

In a recent decision, the Full Federal Court unanimously dismissed a taxpayer's appeal from a decision of the Federal Court which involved a challenge by the taxpayer to default assessments. This decision (*Buzadzic v FCT* [2024] FCAFC 50) is discussed in the Tax Tips column of this issue of the journal (at p 603).

President's Report

by Todd Want, CTA

Lack of tax measures in Federal Budget

President Todd Want reflects on the Federal Budget and its disappointing lack of tax measures.

Last month, Federal Treasurer, the Hon. Dr Jim Chalmers MP, delivered another cost-of-living Budget, focused — rightly so — on the future of Australia and living conditions for us all.

This Budget came amid sticky inflation and an uncertain trajectory for interest rates, continuing cost-of-living pressures and a challenging economic environment, in part due to flow-on effects from instability around the globe.

The Treasurer flagged the government's five key priorities in his Budget speech:

1. alleviating cost-of-living pressures;
2. increasing housing supply;
3. investing in Australian skills and industry;
4. strengthening Medicare and public health services; and
5. and broadening opportunities for Australians.

These priorities are intended to be underpinned by responsible economic management, which is expected to play a part in combatting inflation.

From my perspective, and many of my colleagues' in the tax profession, it seems that the tax system has been left behind in this future planning, with very few meaningful measures announced.

Holistic tax reform in this Budget was something that we perhaps hoped for but didn't truly expect. I think the more disappointing aspect is that the Budget failed to adequately acknowledge the tax system's major role in driving our economy, growth and prosperity as a nation. Tax is a vital component of our economic story and must factor heavily into discussions of our economic future.

The majority of the tax measures included in the Budget were directed to increasing compliance and integrity in the system, which is a goal we wholeheartedly support, but many were also temporary. For example, while extensions of ATO taskforces is positive, we have long advocated for increased, permanent funding for the ATO, in particular for developing guidance and practical support for taxpayers.

In a similar vein, the further extension of the instant asset write-off measure is welcome, although it is disappointing that it remains a temporary measure in the form of near-annual announcements since 2015. It should instead be a permanent feature of the system. Likewise, the extension of the energy bill relief measure is welcome and will go some way to support struggling individuals and small businesses. However, again, this is only a temporary solution. The Tax Institute continues to advocate for permanent solutions to long-term problems.

In a nutshell, this was a Budget where the tax system appeared to be an afterthought and there was a lack of meaningful movement on a host of tax issues. This Budget hasn't progressed the tax reform conversation and it missed an important opportunity to actively acknowledge the tax system's role in our overall economic future.

We remain hopeful that the next Federal Budget, likely to be a pre-election Budget, may bring more opportunity for true tax reform and lasting solutions.

CEO's Report

by Scott Treatt, CTA

Advocacy efforts post-Federal Budget

CEO Scott Treatt reflects on the Federal Budget and where the Institute goes from here.

As Todd has outlined in his report this month, the recent Federal Budget was lacklustre when it comes to tax measures.

As most of you will know, we made the decision to cancel our planned second webinar in light of the lack of substantive tax measures announced. This decision was made out of respect for our members' time. We did not feel that the measures announced were numerous or impactful enough to warrant a second webinar this year, and felt that your time would be better spent elsewhere.

All this brings us to the question: where do we go from here? I'd like to outline two points for the next steps that the Institute plans to take.

Member resources

Although new measures are light on this year, we will produce Federal Budget resources to unpack the announced measures, such as the instant asset write-off, as and when necessary. These resources are part of our commitment to you and join the pool of up to 88 resources that we provide to our members throughout the year.

Advocacy efforts

We continue to advocate for true and meaningful tax reform. This includes advocating for a holistic review of the tax system and its functioning, and continued advocacy for long-term or permanent solutions to issues within the tax system.

Our three core goals for the future of our tax system remain unchanged. In the next Federal Budget, or indeed within the regular cycle of legislation and policy updates, we would like to see:

1. a commitment to undertake holistic tax and superannuation reform to reduce complexity, improve equity and increase efficiency across the system, and a commitment to conduct post-implementation reviews of recently legislated measures;
2. the significant backlog of announced but unenacted measures that remain outstanding from previous Budgets, reviews and announcements addressed in order to provide certainty to taxpayers and their advisers; and
3. greater consistency and simplification of superannuation rates and thresholds to reduce complexity.

I encourage you to continue to engage with the Institute and our advocacy efforts to further add your voice to the work we do.

End of financial year – here to support you

As we begin the end-of-financial-year period, I'd like to remind you to look after yourself and your wellbeing during this busy period. Your clients may rely on you to help them through the complexities of this time but, as leaders and as people, it is important that we look after ourselves and our teams, as well as our clients.

The Institute is here to support you with resources and insights to make your EOFY more efficient and streamlined. Please keep an eye on our communications and continue to check back for resources that may assist you. We are here to help.

Senior Counsel – Tax & Legal's Report

by Julie Abdalla, FTI

Post-Budget critique

We reflect on and consider what the Federal Budget 2024–25 means for the future of holistic tax reform.

The Federal Budget 2024–25 (the Budget) was delivered by the Treasurer, the Hon. Dr Jim Chalmers MP, on Tuesday, 14 May 2024. The Budget was extremely light on tax measures, with the limited number of tax measures primarily attempting to alleviate the ongoing cost of living pressures for Australians and small businesses.

The lack of tax measures is likely a result of the economic and political circumstances surrounding the release of the Budget. More significant initiatives are perhaps more likely to be announced in the next Budget, during the election year. The economy has been hampered by high and then sticky inflation, and the government surely has this in mind in combination with an outlook of future budget deficits. Measures that result in increased government spending, or provide cash to taxpayers to alleviate cost-of-living pressures, are likely to add to inflationary pressures and worsen the future fiscal position. With this context, the lack of tax measures and overall uninspiring Budget was unsurprising.

What does this mean for tax reform?

The government's lack of appetite for meaningful and holistic tax reform remains a concern. In part, this may result from fears regarding future budget deficits. The Budget has forecast a surplus of $9.3b, following an unexpected surplus of $22.1b for 2022–23. However, looking ahead, deficits ranging from $24.3b to $42.8b are forecast for the forward estimates period. The upcoming predicted deficits are likely to heavily influence the government's approach to the tax and transfer system.

The bleak outlook may cause the current, and future, governments to prioritise funding cuts across all portfolios, while raising taxes from whatever sources possible, all without trying to get too many voters offside. It is a fine line to walk. When it comes to changes to the tax system, this is more likely to take the form of smaller, more targeted, measures rather than holistic reform. Piecemeal changes are not a long-term solution. They add to the complexity of the tax and superannuation systems, and increase compliance costs for taxpayers. They are a knee-jerk reaction to systemic problems.

As highlighted by current and past intergenerational reports, revenue pressures will continue to be exacerbated by Australia's ageing population and current tax mix. The majority of Australia's revenue comes from two sources:

- personal income tax – which accounts for almost half of all revenue collected; and
- corporate income tax – which has historically been unstable but can account for about one-third of all revenue collected.

The government intends to cap the tax-to-GDP ratio at 29%, while expenses risk increasing beyond this amount. This is an unsustainable approach. Australia's heavy reliance on personal and corporate income taxes will not suffice for the increased spending needed to support our future needs.

The forecast budget deficits are a clear example of why we need meaningful and holistic tax reform. Australia needs to seriously re-examine its underlying tax mix and approach to its tax and transfer system. There is a pressing need to address the underlying causes and stop resorting to temporary, band-aid solutions.

How can we put tax reform on the agenda?

The difficult question is how we can put holistic tax reform back on the government's agenda. With a clear absence of political will on the part of the government, this is no easy feat and will require a concerted effort from the tax profession and the broader community.

Despite the challenges ahead, there are steps we can take now. These include, but are not limited to:

- educating the community on the severe fiscal challenges and inequity that exists and will continue to escalate if there is no meaningful change;
- educating clients, and the community, on what meaningful tax reform looks like – it is not merely tinkering with rates but fundamentally addressing the system as a whole to make it more efficient, simpler, and more equitable for all Australians;
- pushing back on media and rhetoric that centres on winners and losers for each piecemeal change, and instead recalibrating the question of how a change will alleviate the known challenges we will face in the near future and foster sustainability in the system; and
- encouraging politicians to demonstrate political will and take courageous steps towards implementing real and meaningful change.

We can only achieve holistic tax reform if the community, and our elected leaders, understand the problem and appreciate that core changes need to be made to address them. It's important for the tax profession to be at the forefront of this charge for change and The Tax Institute remains committed to giving you a voice and leading this effort.

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Tax News – the details

by TaxCounsel Pty Ltd

May – what happened in tax?

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

Government initiatives

1. PwC tax leaks issues: consultation

On 3 May 2024, Treasury released two consultation papers on several of the measures announced by the government in August 2023 in response to the PwC tax leaks matter.

One consultation paper (*Response to PwC – regulation of accounting, auditing and consulting firms in Australia*) seeks feedback and views on the following issues:

- the adequacy of prescribed governance requirements for large partnerships;
- the adequacy of current professional standards, regulations and laws (including those relating to independence and the management of conflicts of interest);
- whether the transparency requirements for accounting, auditing and consulting firms are sufficient to:
  - give capital markets confidence that independent audit services are delivered in accordance with prescribed laws and standards; and
  - enable stakeholders to obtain the information they need to inform their engagement with the firm(s);
- the adequacy of regulatory enforcement capabilities and standard setting;
- the protection of whistleblowers; and
- competition/resilience in the audit sector.

The other consultation paper (*Response to PwC – tax regulator information gathering powers review*) examines:

- whether the ATO's information-gathering powers remain fit for purpose and operate to allow the ATO to properly assist the Australian Federal Police to investigate serious criminal offences perpetrated against the tax and superannuation systems; and
- the limitations on the TPB using formal information-gathering powers prior to commencing a formal investigation.

2. Philanthropy inquiry

The Productivity Commission's final report in relation to its inquiry into philanthropy (which was initiated by the Treasurer on 11 February 2023 with the release of the terms of reference for the inquiry) was handed to the government on 10 May 2024.

A draft report was released for comment on 30 November 2023. The draft report focused on three main areas which are designed to establish firm foundations for the future of philanthropy so that the benefits of giving can be realised across Australia. The three main areas of reform contemplated by the draft report were:

1. deductible gift recipient (DGR) system reform: refocusing which charities can receive tax-deductible donations to help donors direct support to where there is likely to be the greatest net benefits to the community as a whole;
2. regulation: bolstering the regulatory system by enhancing the ACNC's powers and creating regulatory architecture to improve coordination and information-sharing among regulators; and
3. information: improving public information on charities and giving to support donor choice and accountability.

From a tax perspective, the DGR proposed reforms are the most significant. Those reforms would, if recommended in the final report and implemented, have four possible outcomes for charities: (1) charities retaining DGR status; (2) charities not gaining DGR status; (3) charities gaining DGR status; and (4) charities with DGR status withdrawn (for example, school building funds).

The final inquiry report must be tabled in parliament within 25 sitting days of it being given to the government.

The Commissioner's perspective

3. TPB: breach reporting obligations

The Tax Practitioners Board (TPB) has released draft guidance on the code breach reporting obligations that will be imposed on a registered tax or BAS agent where there is a significant breach of the Code of Professional Conduct by the the agent or another registered agent on or after 1 July 2024 (TPB(I) D53/2024).

The draft guidance consists of a draft information sheet, a summary document, and a high-level decision tree. Together, the documents explain:

- the existing obligations to notify the TPB of a change in circumstances;
- the additional breach reporting obligations, supported by practical case studies;
- when the obligations apply;
- client confidentiality and legal professional privilege;
- what constitutes a significant breach;
- the timeframe for reporting a significant breach; and
- what happens if a significant breach is not reported.

The code breach reporting obligations will potentially raise significant issues in some circumstances, and practitioners will need to familiarise themselves with their operation.

The reporting obligations were considered in the February 2024 Tax Tips column (at p 375).

4. ATO 2024 individual tax return priorities

With the approach of 2024 "tax time", the ATO has announced that it will be taking a close look at three common errors being made by individual taxpayers. These are:

1. incorrectly claiming work-related expenses;
2. inflating claims for rental properties; and
3. failing to include all income when lodging.

In relation to work-related expenses, the ATO said that, in 2023, more than 8 million people claimed a work-related deduction, and around half of those claimed a deduction related to working from home.

Last year, the ATO revised the fixed rate method of calculating a working from home deduction to broaden what is included, increase the rate, and adjust the records that taxpayers need to keep.

To use this method, a taxpayer needs records that show the actual number of hours that they worked from home (such as a calendar, diary or spreadsheet) and the additional running costs that they incurred to claim a deduction (for example, a copy of their electricity or internet bill).

Deductions for working from home expenses can be calculated using the actual cost or the fixed rate method, and keeping good records gives a taxpayer the flexibility to use the method that works for them and claim the expenses that they are entitled to.

Rental properties continue to remain in the ATO's sights. ATO data shows that nine out of 10 rental property owners are getting their income tax returns wrong.

One area where landlords often make mistakes is in relation to repairs and maintenance deductions on rental properties. This year, the ATO will be particularly focused on claims that may have been inflated to offset increases in rental income to get a greater tax benefit. While performing general repairs and maintenance on a rental property can be claimed as an immediate deduction, expenses which are capital in nature (such as "initial repairs" on a newly purchased property and any improvements during the time a property is held) are not deductible as repairs or maintenance.

The ATO is also warning against taxpayers rushing to lodge their tax return on 1 July. If a taxpayer has received income from multiple sources, they need to wait until this is pre-filled in their tax return before lodging.

By lodging in early July, a taxpayer is doubling their chances of having their tax return flagged as incorrect by the ATO.

Recent case decisions

5. Self-education expenses not deductible

The AAT has held that expenses incurred by a taxpayer (who had moved to Australia from a country where she was registered as a dentist) to enable her to practise as a dentist in Australia were not allowable as general deductions (*Ionita and FCT*[1]).

More particularly, the taxpayer was qualified as a dentist in Romania and had moved to Australia to live in 2012. She commenced working in Australia as an employed dental technician in 2013.

The taxpayer wanted to become registered to practise as a dentist in Australia. To be able to do so, she was required to meet the requirements of the Dental Board of Australia, including undertaking an initial assessment and then completing written and practical examinations facilitated by the Australian Dental Council of Australia.

The taxpayer sought to claim as general deductions (under s 8-1(1) of the *Income Tax Assessment Act 1997* (Cth) (ITAA97)) the costs associated with her assessment and examinations to become registered as a dentist in Australia, as well as associated meals, accommodation and flight expenses.

The AAT said that, if the assessment and examination expenses undertaken by the taxpayer were for maintaining or improving her skills or knowledge necessary to perform her role as a dental technician, the expenses would be deductible. However, the AAT concluded that the assessment and examinations (and any associated study) were not required to maintain her skills and/ or knowledge as a dental technician. Further, the evidence did not suggest a sufficient correlation between the assessment and examinations and the improvement of the taxpayer's role as a dental technician.

The taxpayer contended that the additional study helped her to perform her duties as a dental technician and to be more efficient. However, the AAT agreed with the Commissioner's submission that it was not clear how the assessment, written examinations or practical examinations had the effect of maintaining or improving her skills as a dental technician.

The AAT said that the "essential character" of the expenses was to obtain registration as a dentist. Indeed, the expenses could be categorised as exclusively relating to eligibility to practise as a dentist in Australia. As the taxpayer was not yet employed as a dentist during the relevant income years but sought to become registered as a dentist to work as a dentist in the future, the expenses were incurred at a point too soon to be regarded as incurred in gaining or producing the taxpayer's assessable income.

The AAT acknowledged that, if the self-education undertaken by the taxpayer led to an increase in her income in her role as a dental technician, the expenses would be deductible. However, the AAT was not satisfied that the assessment and examinations (or any associated study for that matter) undertaken by the taxpayer led to the increases in her income in her role as a dental technician.

6. Discretionary trust: vesting date extension

The Victorian Supreme Court has approved the variation of the terms of a discretionary trust to defer the vesting date of the trust (*Re Gengoult-Smith Family Trust*[2]).

The trust, which was known as the Gengoult-Smith Family Trust (the trust), was established by deed dated 29 April 1974 (the deed) and had a vesting date of 29 April 2024. The trust owned approximately $80m worth of investments, mostly in real estate, which generated an annual net income of approximately $700,000. The trustee of the trust, Petela Nominees Pty Ltd (the trustee), distributed the trust's income to the beneficiaries each year at its discretion. The current beneficiaries of the trust included members of the Gengoult-Smith family, as well as related trusts, related corporations and charities.

The trust deed conferred on the trustee a power to vary the terms of the trust but the power did not extend to varying the vesting date.

Proceedings were brought in the Victorian Supreme Court under s 63A of the *Trustee Act 1958* (Vic) for the approval of an arrangement varying certain provisions of the trust deed so that, instead of vesting on 29 April 2024, the trust would vest on 29 April 2054 (this being the end of the 80-year perpetuity period permitted by the *Trustee Act 1958*). If the trust were to vest on 29 April 2024, the trustee would have held the trust assets for only a certain few individuals who formed part of a larger class of beneficiaries. There was also advice that, if the trust vested on 29 April 2024, the trust would incur a CGT liability of up to $10m.

In concluding that the court should make an order for the trust deed to be amended in accordance with the application before the court, Moore J said that the evidence before the court demonstrated that the trust had, for many years, provided a suitable vehicle for the Gengoult-Smith family to hold substantial investments and to distribute the income of the trust to family members. Although the trust was discretionary, the trustee had deposed that it was anticipated that future distributions from the trust would be made to family members, or entities controlled by family members. If the trust were to vest on 29 April 2024, the trustee would lose the ability to distribute income and capital at its discretion to the beneficiaries.

Further, his Honour said that, when appraising whether the proposed arrangement was proper and fair, not only was it significant that all of the legally capable beneficiaries of the trust had consented to it, but the decisive consideration was the fact that Alexandra, Hugh and Edward, being the persons who the settlor wanted to provide for by establishing the trust and whose interests were adversely affected by the proposed arrangement, had provided their consent to it. In those circumstances, Moore J was satisfied that the arrangement was aligned with the settlor's intentions to benefit Alexandra, Hugh and Edward, notwithstanding the deferral of their imminent entitlement. Hugh had deposed to the siblings' shared desire that the CGT liability that would arise from the vesting of the trust be deferred, and that the trust be used for the benefit of the grandchildren of Norman and Jillian.

Also, his Honour said that it had been repeatedly affirmed that a court should not hesitate to approve an arrangement for the extension of a trust's vesting date merely because one of the purposes of the arrangement is to avoid, reduce or defer taxation consequences.

The decision in this case highlights the need for practitioners to acquaint themselves with the vesting dates of the trusts that have been brought into existence for their clients. If the vesting date of a trust is such that the term of the trust is the maximum term permitted under the relevant trust legislation, nothing would need to be done. However, if the vesting date is before the maximum permitted term of the trust, it would be necessary to consider whether it would be advisable to extend the term. If it is considered that there should be an extension, the way that the extension should be effected will depend on whether the trust deed permits the proposed amendment being made. If it does not, an application to the Supreme Court would be necessary.

It needs to be kept in mind that an extension to the term of a trust would need to be made before the vesting date specified in the trust instrument. The variation in the case noted above was a bit close but effective; the trust was to vest on 29 April 2024 and the variation order was made by the Supreme Court on 17 April 2024.

Where an extension to the vesting date is being contemplated, it would be necessary to consider whether there could be any adverse revenue consequences. From a CGT perspective, the Commissioner takes the view that neither CGT event E1 (creating a trust over a CGT asset) or CGT event E2 (transferring a CGT asset to a trust) would happen if the terms of a trust (including an extension of the vesting day) are changed pursuant to a valid exercise of a power contained in the trust's constituent document, or varied with the approval of a relevant court order (TD 2012/21, particularly example 3A).

A final point to note is that, in some circumstances, it may be desired to advance the vesting date of a trust. How this may be able to be done will depend on whether the trust deed allows it or, if it does not, whether a court order is able to be obtained.

7. Terms of remittal to AAT

In remitting a case back to the AAT for rehearing, the Federal Court (Derrington J) did so on the basis that the taxpayer could adduce further evidence on limited issues (*FCT v Tan*[3]).

The assessments in issue were for the 2013 to 2016 income years and they had been made by the Commissioner using the assets betterment method and on the basis that there had been fraud or evasion. The taxpayer objected to the assessments and, following adverse objection decisions by the Commissioner, applied to the AAT for a review of those decisions. The AAT held that the taxpayer had established what his actual taxable income was for each of the income years.[4] The Commissioner appealed to the Federal Court from the AAT's decision.

By the commencement of the hearing before the Federal Court, the parties had reached an agreement that the Commissioner's appeal should be allowed and that certain orders should be made remitting the matter to the AAT for rehearing according to law. There was, however, an issue as to whether the matter ought to be remitted to the AAT with or without the hearing of further evidence from the taxpayer.

Derrington J described the case as complex and said that a substantial effort had been made by the taxpayer to establish what his taxable income was. A complication arose because the taxpayer had a perception, or at least exhibited a perception, that he was not a resident of Australia which made the manner in which he presented his case slightly more difficult, in particular, because residency was in issue. Had he succeeded on the residency issue and established that he was not an Australian resident, there would have been no question about the matters that were now in issue, namely, foreign sourced income.

The further evidence which the taxpayer was seeking to adduce was limited to addressing the issue of his alleged undeclared foreign income. Specifically, he was seeking to adduce bank statements in relation to his foreign bank accounts and to give evidence about the contents of those statements, including to explain the deposits and withdrawals contained in them.

Derrington J said that, when determining whether it was appropriate to allow the taxpayer to adduce this evidence, attention should be focused on the nature of the remittal. A remittal sends the matter back to the AAT to rehear the appeal from the Commissioner's assessment and, in doing so, to apply the law as it had been identified by the court. The intention of that process is to, as best as possible, ascertain what the taxpayer's true income is. While the taxpayer has had the benefit of the initial hearing and, perhaps, has been found wanting in terms of the evidence he adduced, in the circumstances of this rather complex case, allowing him to adduce evidence within a narrow scope would not amount to giving him a "second bite at the cherry". Rather, it would simply provide the AAT with all of the relevant evidence now available.

His Honour said that, ultimately, that was a preferable outcome because it meant that a more accurate assessment would be made by the AAT. That conclusion was reached taking into account the nature of the asset betterment method and the failure of the taxpayer to satisfy the onus. The consequence of the asset betterment method is that the "all or nothing" approach applies, which has the result that, on occasion, the taxpayer may be liable for more tax than might be the case if all of the necessary evidence had been adduced.

8. Use of ATO compulsory examination transcript

The Queensland Court of Appeal (Bowskill CJ, Morrison JA and Fraser AJA) has unanimously held that, where a compulsory examination by an ATO officer was lawful, a copy of the transcript of the examination could be given to the Commonwealth Director of Public Prosecutions (CDPP) (*R v Van Eps; Ex parte Commonwealth Director of Public Prosecutions*[5]).

The respondent was charged with one count of attempting to dishonestly obtain a financial advantage from a Commonwealth entity contrary to ss 11.1 and 134.2(1) of Sch 1 to the *Criminal Code Act 1995* (Cth). The offence was alleged to have involved lodging a false R&D tax offset claim.

Before being charged with any offence, the respondent was compulsorily examined by an ATO officer(s) pursuant to a power conferred on the Commissioner under s 353-10 of Sch 1 to the *Taxation Administration Act 1953* (Cth). A transcript of the examination was produced and subsequently provided to an entity within the Department of Industry, Science and Resources, known as AusIndustry, and also to the CDPP.

The respondent was charged on 4 April 2019 and an indictment was presented in the Queensland District Court on 18 September 2023. The respondent applied for orders for disclosure and to stay the prosecution against her in that court, in part on the basis that the distribution of the transcript of the compulsory examination was unlawful. That question had been the subject of conflicting intermediate appellate decisions. These decisions were the majority decision of the Queensland Court of Appeal in *R v Leach*[6] (*Leach*) which was to the effect that the disclosure to the CDPP was unlawful, and the unanimous decision of the New South Wales Court of Criminal Appeal in *R v Kinghorn*[7] which was to the effect that the disclosure was lawful. On this issue, the District Court held that it was bound by the decision of the Queensland Court of Appeal in *Leach*.

Pursuant to s 668A of the *Criminal Code 1899* (Qld), the CDPP referred to the Queensland Court of Appeal for its consideration and opinion the following points of law:

> "1. Where, before being charged with an offence, an accused was compulsorily examined by a taxation officer under s 353-10 of schedule 1 of the *Taxation Administration Act 1953* (Cth), can a taxation officer who is so authorised, lawfully disclose information obtained during the compulsory examination to:
>
> (a) the Commonwealth Director of Public Prosecutions (the **Prosecutor**);
>
> (b) the Department of Industry, Science and Resources (AusIndustry).
>
> 2. If such disclosure is lawful can the Prosecutor use the information to:
>
> (a) consider whether to commence a prosecution;
>
> (b) formulate charges;
>
> (c) prepare the prosecution case for committal and trial."

The points of law were referred to the Court of Appeal on the basis of assumptions that the taxation officer who conducted the compulsory examination was authorised to

do so, that the examination was conducted lawfully and for a proper purpose, and that the dissemination of the material by the ATO was otherwise lawful.

The Court of Appeal unanimously held that the answer to both questions was "yes".

The Court of Appeal said that it was important to record that it had considered only the points of law referred to it under s 668A. It was apparent from the materials before the court, and the submissions made by the respondent, that, in addition to the challenge to the lawfulness of the distribution of the transcript of the compulsory examination, the respondent also wished to challenge the lawfulness of the exercise of the power to compulsorily examine her in other respects. Those issues remained for determination in the context of the respondent's pending application in the District Court proceedings. The Court of Appeal's opinion in relation to the points of law referred to it under s 668A proceeded on the assumption that the power to compulsorily examine had been lawfully invoked but did not decide that issue.

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References

1 [2024] AATA 808.
2 [2024] VSC 189.
3 [2024] FCA 406.
4 *PQBZ and FCT* [2023] AATA 2984.
5 [2024] QCA 46.
6 [2018] QCA 131.
7 [2021] NSWCCA 313.

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Tax Tips

by TaxCounsel Pty Ltd

Filling in the blank

Where a taxpayer is seeking to challenge a default assessment made by the Commissioner, there are a number of important issues that potentially arise.

Background

There is a provision in the *Income Tax Assessment Act 1936* (Cth) (ITAA36) which confers on the Commissioner the power to issue what is usually called a "default assessment". This provision is s 167 and is set out below. The circumstances in which this power may be exercised are not confined to situations where a taxpayer has not lodged an income tax return but, understandably, extend to circumstances in which the Commissioner, for one reason or another, considers that there has not been a proper disclosure in a return that has been lodged.

Over the years, a substantial body of case law has developed as a result of taxpayer challenges to default assessments. A fundamental difficulty for a taxpayer in this kind of case is that the taxpayer has the dual onus under s 14ZZK of the *Taxation Administration Act 1953* (Cth) of showing not only that the Commissioner's assessment is excessive, but also of filling in the "blank" that the demonstration of excessiveness would create. Typically, this blank would be the amount of the taxpayer's taxable income for the income year. To fill in this blank, the taxpayer must show what the assessment should have been.

In relation to the corresponding burden of proof provision in the *Income Tax Assessment Act 1922* (Cth), Latham CJ in *Trautwein v FCT*[1] said:

> "The application of sec. 39 is not, in my opinion, excluded as soon as it is shown that an element in the assessment is a guess and that it is therefore very probably wrong. It is prima facie right – and remains right until the appellant shows that it is wrong. If it were necessary to decide the point I would, as at present advised, be prepared to hold that the taxpayer must, at least as a general rule, go further and show, not only negatively that the assessment is wrong, but also positively what correction should be made in order to make it right or more nearly right."

This filling in the blank onus that a taxpayer has is necessary because the facts relating to the correct taxable income are peculiarly within the taxpayer's knowledge.

The recent decision of the Full Federal Court (Bromwich, Abraham and McEvoy JJ) in *Buzadzic v FCT*[2] provides a useful analysis of the issues that can arise in a challenge by a taxpayer to a default assessment. The challenge in this case involved a number of steps: an objection by the taxpayer to default amended assessments; the review by the AAT of the Commissioner's objection decisions;[3] an appeal by the taxpayer to the Federal Court against the AAT's decision;[4] and a further appeal by the taxpayer to the Full Federal Court.

Just how the Commissioner arrives at the components of a default assessment will depend on the particular circumstances. One methodology that is used by the Commissioner in appropriate circumstances to make default assessments is what is called the "assets betterment basis".[5] But there are many situations where this methodology will not be appropriate. The *Buzadzic* case was such a situation.

This article considers the Full federal Court's decision in the *Buzadzic* case.

The legislation

The Commissioner's statutory authorisation for the making of a default assessment is s 167 ITAA36. That section provides as follows:

> **"167 Default assessment**
>
> If:
>
> (a) any person makes default in furnishing a return; or
>
> (b) the Commissioner is not satisfied with the return furnished by any person; or
>
> (c) the Commissioner has reason to believe that any person who has not furnished a return has derived taxable income;
>
> the Commissioner may make an assessment of the amount upon which in his or her judgment income tax ought to be levied, and that amount shall be the taxable income of that person for the purpose of section 166."

The Buzadzic case

The taxpayer (a Mr Buzadzic) operated a panel beating business and related businesses, including car towing and car rental businesses. He and his wife were associated with a group of at least 16 companies and three trusts. The taxpayer and his assistants directed all financial matters concerning the group of entities. He controlled all bank accounts in his name or in his wife's name. He directed deposits to be made into those accounts and the funds to be transferred from those accounts to other entities in the group.

The Commissioner formed the view that there had been fraud and/or evasion and made amended assessments (including penalties) for the taxpayer for the 2007 to 2013 income years in relation to five categories of transactions, being:

1. unexplained deposits in excess of $1,000 into his bank accounts or credit card accounts from group entities, third parties or unknown sources;

2. unexplained or unverified credit entries, being credit entries to his loan accounts in excess of $1,000;
3. interest paid on a term deposit in the 2008 and 2009 income years;
4. a capital gain on a share investment in the 2010 income year; and
5. outstanding loans owed to other entities in the group giving rise to a deemed dividend under Div 7A ITAA36.

The AAT

Before the AAT, the Commissioner conceded certain disputed deposits and credit entries, but maintained that the review applications should be dismissed because the taxpayer had failed to establish what his taxable income was for each income year. The AAT accepted the Commissioner's submission.

The AAT found that, with the exception of a small number of instances, the taxpayer had not explained the provenance of the unexplained deposits and unverified credit entries and, in particular, that the amounts involved were not undeclared income. He had, therefore, not discharged his onus to establish his taxable income. That is, the taxpayer was found to have failed to discharge the onus to fill in the "blank" for each income year that would be left by making good the assertion that the Commissioner's assessment was excessive to any degree.

The AAT said that it could expect to have explained to it the competing conclusions that should be reached based on the evidence led and to be directed to the specific material relied on by the parties. Necessarily, the Full Federal Court said, this observation was more acutely focused on the taxpayer as the party bearing the onus. By way of example, the taxpayer relied on evidence from Mr Hadded, a principal from a firm of accountants who had acted for the taxpayer and his wife between 2008 and 2011, and from July 2013, who deposed to a belief he held about the accuracy of accounting entries. The AAT found that he had not provided an explanation of the basis for the belief that he held, effectively leaving that belief without any proven foundation.

The AAT was unable to rely on the accounting records to reach the conclusions asserted by the taxpayer about the transactions that remained in dispute. In the absence of contemporaneous records and a forensic analysis of the ledger accounts relied on, the evidence was simply not sufficient to discharge the onus. The assertions of the taxpayer and his advisers relied on would not suffice, especially to explain otherwise unexplained deposits and credit entries. The taxpayer was unable, in the vast majority of instances, to produce supporting documentation for the reasons for deposits made many years ago, although he sought to explain some deposits. Those unsupported explanations were not accepted by the AAT, being found to be speculative and unreliable, with only one exception.

The AAT made numerous adverse references to the poor and unpersuasive quality of the evidence before it. The Full Federal Court said that the approach of the AAT was impeccable in the circumstances.

An appeal by the taxpayer from the decision of the AAT to the Federal Court was dismissed by Moshinsky J and a further appeal by the taxpayer to the Full Federal Court was also dismissed.

The Full Federal Court

In a unanimous decision dismissing the taxpayer's appeal, the Full Federal Court said that, to capture the flavour of the case that the taxpayer brought before the AAT, it was to be noted that the taxpayer ended up substantially abandoning reliance on his own forensic accounting evidence. This left the AAT with no explanation for the large volume of accounting records that had been tendered by the taxpayer, including in particular MYOB files. This took place despite the AAT having indicated that it would be assisted by an expert report to explain these records. The AAT said that it could not do this exercise for itself, noting that the taxpayer instead relied on external accountants and lawyers to attempt to do this, which was hardly the same and did not achieve the objective of assisting the AAT in any meaningful way.

The Full Federal Court said that impeaching the AAT's conclusions before Moshinsky J at first instance was a daunting exercise, requiring a disciplined and focused identification of error. It required much more than a mere disagreement with the outcome and an attempt to relitigate the case that had been heard before the AAT. Yet, in substance, that was what was attempted before Moshinsky J.

The Full Court noted that, after summarising the taxpayer's submissions before him in some detail, Moshinsky J characterised the thrust of the first two grounds of appeal as being a contention that the AAT applied too high a standard of proof. It became apparent on the appeal submissions that the point being raised could more precisely be understood to be the flip side of that argument, being an assertion that a lower quality of evidence adduced by the taxpayer should have been accepted as discharging the necessary civil onus of the balance of probabilities. This was advanced in argument as amounting, in substance, to the existence of some lower standard of proof, itself an untenable proposition.

The taxpayer's submission that a lower quality of evidence was necessary was based on the proposition that the point at which the onus was required to be discharged by him was after the time at which he was required to retain records to meet the substantiation requirements for expense deduction claims, if called on to do so by the Commissioner. The Full Court said that there were a number of answers to this argument. The court said:

> "25. Secondly, the record keeping and retention requirements imposed upon taxpayers accompanied the move to self-assessment of income tax many decades ago, such that receipts no longer had to be provided with income tax returns. Mr Buzadzic's argument, especially

orally, was to the effect that, where the Commissioner is making an assessment relating to tax for an earlier period, and the person is no longer required under the tax legislation to retain records for that period, '*the burden of proof on the balance of probabilities needs to be adjusted to take into account that that record does not exist*'. Mr Buzadzic's oral submissions seemed to argue that it was somehow not fair, or inconsistent with the retention periods in the relevant legislation, to require him to produce records for a period outside those retention periods in order to discharge the onus by establishing that certain impugned sums of money were not income. No proper basis was identified for why the requirement to retain such records for substantiation purposes would give rise to a relaxation of the quality of evidence necessary to discharge the onus of proving that an assessment is excessive, and what the correct assessed sum should be.

26. Of course, if a taxpayer were able to prove that records had been kept, but not retained after a retention period, so were not available to support the argument that a particular expense had been incurred, that might, in some cases, be a reason for the Tribunal to accept other evidence to the same effect in order to discharge the onus, as the Tribunal's reasons reproduced above tend to indicate. But that would be a matter for ordinary fact finding, bearing no resemblance to this case. That is simply a reflection of the fact that whether the onus is satisfied will depend on the circumstances of the case. Rather, Mr Buzadzic's argument seemed to be no more than that the passing of the point of time at which records were required to be retained meant that secondary accounting records should be accepted at face value. That proposition cannot be accepted, especially in light of the Tribunal's reasoning on this topic."

The Full Federal Court also said that Moshinsky J had correctly found that the AAT had provided clear and logical reasons for concluding that the taxpayer had not discharged the onus of proving what his taxable income was and had therefore not shown that the challenged assessments were excessive. Moshinsky J gave the following summary of key failings in the taxpayer's case before the AAT:

- there were clear deficiencies in the records provided to the AAT; the basis for accounting entries remained unexplained; the manner in which funds flowed between the entities was not explained except in the form of generalisations;
- the source and provenance of identified deposits and credit entries (and, in particular, the transactions that had given rise to the deposits or credit entries) remained unexplained;
- the AAT was not satisfied that the taxpayer had shown what the source or sources of money reflected in the disputed deposits and credits was or were; and
- the AAT did not accept the unsupported explanations for the deposits proffered by the taxpayer.

Observations

The decision of the Full Federal Court in this case has clearly established that there is no basis for inferring, from the statutory record-keeping and retention obligations, any lessening of the quality of evidence required to discharge the dual onus that a taxpayer has when challenging a default assessment, especially the second onus as to what the assessment should have been, even when the time for the compulsory retention of records has passed.

Where the Commissioner has disallowed an objection against a default assessment and it is proposed to challenge the Commissioner's objection decision, an application for a review by the AAT would usually be utilised because of the power that the AAT has to itself exercise a discretionary power that is conferred on the Commissioner; in the case of a default assessment, the discretionary power is the amount on which, *in the Commissioner's judgment*, income tax ought to be levied.

It should be noted that, in a recent decision, the Federal Court (Derrington J), in remitting a case that involved default assessments back to the AAT for rehearing, did so on the basis that the taxpayer could adduce further evidence on limited issues (*FCT v Tan*).[6] The decision in this case is noted in the Tax News column of this issue of the journal (at p 600).

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References

1 [1936] HCA 77.

2 [2024] FCAFC 50.

3 *Buzadzic and FCT* [2021] AATA 4820.

4 *Buzadzic v FCT* [2023] FCA 954.

5 For a recent example, see *FCT v Bazzo* [2024] FCA 452.

6 [2024] FCA 406.

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The Dux of CommLaw3 for Study Period 2, 2023 shares insights into her learnings from the subject.

Anna Trikoulis
Client Manager, Count North Sydney

Tell us about your tax career

I started 15 years ago at PwC in Private Clients, providing accounting and taxation services for small-to-medium businesses, high net worth family groups, and corporates. During my time at the Big 4, I also studied my Graduate Diploma of Chartered Accounting and Master of Taxation to deepen my technical knowledge in tax.

In my current role at Count North Sydney as a client manager, I manage the client relationships and oversee the accounting team that provides bookkeeping, payroll, GST and FBT compliance, outsourced CFO, and family office services. I also review the preparation of financial statements and income tax returns for companies, trusts, partnerships, superannuation funds, individuals and not-for-profit organisations. I support my clients when they require advice for complex taxation matters, including tax planning, structuring, residency, international tax, Div 7A and CGT.

As Count is a provider of integrated accounting and wealth services, I also work closely with my clients' financial advisers to assist them to achieve their financial and lifestyle goals for the future. I'm passionate about providing my clients with holistic business and taxation advice that aligns with their wealth creation strategy.

What has the CommLaw3 subject taught you?

The subject has expanded my knowledge of how property is regulated and dealt with in a commercial law context. I now appreciate more fully the distinction between tangible and intangible property. In particular, I have a deeper understanding of the intricacies of conveyancing of real property such as land, as well as how intellectual property such as trademarks and patents may be registered and protected against infringement.

I am better equipped to advise clients on the tax implications of transactions relating to property as I can perceive when there may be an issue when clients purchase or sell property. I also have a greater understanding of other issues such as the impact of competition and consumer law on businesses and consumers, the regulation of financing transactions, the impact of the Banking Royal Commission for financial advisers, as well as laws relating to electronic commerce and insurance.

Have you applied this new knowledge in your work?

Yes, I have applied my new knowledge from property law in my work. I advised a client group recently on the income tax, CGT, FBT and GST implications of a business sale. This involved reviewing the business property dealt with under the contract of sale, such as the goodwill, and understanding how it should be treated from an accounting and tax perspective. I was also required to consider the client's eligibility for the small business CGT concessions in relation to the business assets sold. As part of the next steps of winding down the company, I will also need to review the tax implications from a Div 7A perspective. My client appreciated how I was mindful of the different legal rights and obligations for each of the taxpayers concerned during the business sale. They were also happy with how I dealt with the issues promptly and simplified each complex element of the property transaction.

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

As the tax profession is always changing, and so that I can stay ahead of the curve, I am considering further study with The Tax Institute to gain my qualification as a Chartered Tax Adviser. This is a prestigious designation that will distinguish me from my peers as a tax adviser of the highest calibre who is committed to providing the best tax advice to clients. I am also looking to challenging myself in the future with post-graduate university studies in law.

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Legal substance and R&D entity relationships

by Damian Smyth, Chief Executive Officer, Swanson Reed

The ATO's release of new R&D tax incentive taxpayer alerts in December 2023 (TA 2023/4 and TA 2023/5) signifies upcoming scrutiny on R&D claims. These alerts focus on ensuring that entities claiming R&D tax offsets are legally entitled in accordance with the legislation. Applying TA 2023/4 and TA 2023/5, the ATO may more closely examine the legal and commercial aspects surrounding control, financial risk, and ownership of R&D results. This should compel R&D entities and advisers to move beyond superficial assessments and delve into the rights and obligations of the entity conducting the R&D. It necessitates a thorough evaluation of legal and commercial relationships within multi-entity and multi-jurisdiction groups to ensure compliance and legitimacy in claiming R&D tax offsets.

Executive summary

The ATO has traditionally used taxpayer alerts for the R&D tax incentive to signal concern regarding particular structures or issues, and to mark the commencement of heightened compliance activity.

New R&D tax incentive taxpayer alerts were released in December 2023 (TA 2023/4 and TA 2023/5).

These alerts primarily relate to whether entities registering R&D activities and claiming R&D tax offsets can be shown to be the entity for whom the registered R&D activities are conducted, as required in the legislation (s 355-210 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97)).

TA 2023/4 and TA 2023/5 indicate that the ATO will be more frequently scrutinising the legal substance and form of issues around control, financial risk and ownership of the results arising from R&D activities.

The alerts will compel R&D entities and advisers to look beyond whether, merely on face value, R&D activities are being conducted, or whether R&D expenditure is being incurred within a group of entities. Instead, the specific registering R&D entity (and not just the broader group) must be assessed to ensure that it is the entity that legally directs, bears the financial burden of, and will beneficially own the results of the R&D activity.

This requires careful consideration of the legal and commercial relationships between entities within multi-entity and multi-jurisdiction groups.

Background

Taxpayer alerts are specific publications that provide a summary of ATO concerns about new or emerging high-risk tax arrangements which will likely be a focus of future ATO compliance activity.

Taxpayer alerts are intended to be high-impact publications which the ATO uses to bring attention to affected taxpayers and arrangements.

Each taxpayer alert describes an arrangement, the ATO's concerns, and what the ATO is currently doing about such arrangements. Taxpayer alerts do not provide the ATO's view on arrangements but will often state if the ATO expects to issue advice or guidance on the matter following release of the taxpayer alert.

Taxpayers impacted by ATO taxpayer alerts should consider whether they may need to take action to reorganise their affairs, including making a potential disclosure to the ATO for prior years.

In February 2017, the ATO issued multiple taxpayer alerts for issues impacting the R&D tax incentive regarding concerns around R&D claims for software development, ordinary business activities, and other issues.[1] The previous 2017 alerts marked the commencement of a period of heightened compliance activity by both the ATO and AusIndustry, which act as joint regulators of the R&D tax incentive.

The ATO issued two new R&D tax incentive-specific taxpayer alerts on 14 December 2023:

- TA 2023/4, concerning R&D activities delivered by associated entities; and
- TA 2023/5, concerning R&D activities conducted overseas for foreign related entities.

It is expected that these taxpayer alerts may again mark the commencement of increased compliance activity by the ATO.

The December 2023 taxpayer alerts indicate a focus by the ATO on the legal substance and form of whether an R&D entity conducts an activity on its own behalf.

The legal requirement for R&D activities to be conducted on behalf of the registering R&D entity arises legally from s 355-210 ITAA97. This section specifies that R&D activities must be conducted for the R&D entity and not to a significant extent for some other entity.

An exception applies under s 355-220 ITAA97 where R&D activities are conducted for a foreign related entity.

Section 355-210 represents the equivalent provision of the "on own behalf" rule from the former R&D tax concession.

It operates as an integrity provision that generally limits R&D tax benefits to the entity which receives the majority of benefits arising from expenditure on R&D activities. The provision seeks to prevent the duplication of R&D claims by multiple entities where essentially the same R&D activities are involved.

The ATO's view is that the determination of who the R&D activities are being conducted for should be based on a number of factors, including the assessment of which entity:

- has an appropriate degree of control over the R&D activities;
- bears the financial burden or risk of conducting the R&D activities; and
- has effective ownership of the results from the R&D activities.

Whether an R&D activity is conducted for an entity is a matter of fact. It is determined by considering whether the activity is conducted, in substance, at the financial risk of the registering R&D entity and will provide this entity with the majority of knowledge benefits arising from the activity, such as access to intellectual property (IP).

This requires analysis of all factors and documentation to arrive at a determination of whether the registering R&D entity meets the requirements.

While TA 2023/4 and TA 2023/5 are applied to differing applications and areas of concern, the central issue within both alerts is the determination of whether R&D activities are conducted for the registering R&D entity.

TA 2023/4

TA 2023/4 is focused on R&D activities delivered by associated entities.[2]

The ATO notes that its primary concerns are arrangements that:

- incorrectly purport that the registering R&D entity has incurred or paid (or both) R&D expenditure under an agreement with an associate service provider; or
- incorrectly purport that the registering R&D entity has conducted R&D activities on its own behalf when the activities are, in substance, being conducted for an associate service provider.[3]

TA 2023/4 highlights a wide range of considerations when complying with Div 355 ITAA97 and may legally apply to combined concerns around:

- the scope of entities that are eligible R&D entities under s 355-35 ITAA97, which outlines that an eligible entity must usually be a company, and not a discretionary trust, unit trust, partnership or sole trader;
- the "on own behalf" rules derived from s 355-210 ITAA97, which specify that the R&D activity must be conducted for the R&D entity; and
- the associate entity R&D expenditure payment rules under s 355-205 ITAA97.

It is probable that TA 2023/4 is focused on issues considered in *XQDX and FCT*[4] and *Sunlite Australia Pty Ltd v FCT*[5] which found against the taxpayers and broadly involve the following facts and steps:

- a group has historically traded from and conducts R&D activity within an ineligible R&D entity, such as a discretionary trust;
- a special purpose R&D entity is incorporated, or a designation of the existing corporate trustee of the trading trust as an R&D entity is made;
- the ineligible R&D entity continues to employ R&D staff and incur the R&D expenditure which it invoices to a designated R&D entity under a service agreement;
- the ineligible R&D entity also trades with knowledge or IP arising from R&D activity, potentially paying a royalty to the designated R&D entity under a licence agreement; and
- the designated R&D entity registers R&D activity with AusIndustry and reports R&D tax offsets in its tax return.

The ATO appears to be particularly concerned with structures where an ineligible entity, such as a trust, is the entity for which the R&D activities are, in substance, conducted for, although a separate entity is purported to have incurred the R&D expenditure and conducted the activity through the implementation of arrangements. The ATO notes that such arrangements may also include contrived measures attempting to comply with the associate entity payment rules, such as via the use of complex set-offs.[6]

The ATO note in TA 2023/4 concerns arrangements between service providers and an R&D entity that:

- even if legally documented in writing, are inconsistent with the actual commercial substance of a group's operations;
- may satisfy the R&D entity's service payment obligations to the associate service provider by the issuing of shares in the registering R&D entity to the associate service provider (which the ATO considers as not constituting effective payment under TR 2008/5); or
- meet service fee payment obligations through payments in rapid succession using a circular flow of funds, such as a round robin type payment arrangement.

The ATO also notes in TA 2023/4 that, even if an arrangement is effective under the substantive provisions, if it can be objectively viewed that the arrangement was entered into for the purpose of obtaining a tax offset, the general anti-avoidance provisions in Pt IVA ITAA36 may apply to cancel a claimed R&D tax offset (noting that the Treasury Laws Amendment (A Tax Plan for the COVID-19 Economic Recovery) Bill 2020 now extends the concept of tax benefits in Pt IVA (s 177C ITAA36) to R&D tax offsets).

TA 2023/4 will require companies and advisers to assess the legal substance and form of their R&D entities, particularly where they may be operating within a multi-entity group. This may require consideration and documentation of:

- whether a structure has been established to allow a group previously operating through an ineligible entity, such as a trust, to access R&D tax offsets. If so, and if the ineligible entity will continue to largely trade and operate using the results of R&D activity, the risk of TA 2023/4 applying is high;
- which entity (and their controllers and employees) is responsible for conducting and directing the R&D activities, and which specific entity within the group are they making such R&D decisions for;
- financing arrangements and justification that the R&D entity will not be reimbursed for activity in the event of technical failure;
- which entity will ultimately and majorly commercially benefit from R&D activity in the event that technical success of the activity generates commercially exploitable results;
- ensuring that the R&D entity can show compliance with the associate entity payment rules in accordance with ATO guidelines and in a non-contrived way; and
- compliance with the additional integrity rules around market value and reductions to reflect mark-ups.

TA 2023/5

TA 2023/5 is focused on R&D activities conducted overseas for foreign related entities.

The ATO notes that its primary concerns are arrangements that:

- involve the use of an overseas finding related to claims for overseas activities; and
- incorrectly purport the registering R&D entity as having conducted R&D activities on its own behalf, when the activities are, in substance, being conducted for a foreign related entity.

TA 2023/5 highlights a wide range of considerations when complying with Div 355 ITAA97 and may legally apply to combined concerns around:

- the "on own behalf" rules derived from s 355-210 ITAA97, which specify that the R&D activity must be conducted for the R&D entity; and
- if the activities were conducted to a significant extent for the foreign related entity, whether the additional requirements in s 355-220 ITAA97 have been complied with, including the requirement that the R&D activity is conducted solely within Australia.

The title and content of TA 2023/5 suggest that the ATO's main concern relates to where overseas R&D activities are being claimed, and may indicate that, where an R&D entity conducts all R&D activities in Australia, TA 2023/5 may not be applicable. However, issues in TA 2023/5 may apply to arrangements of concern to restrict the eligibility of R&D activities conducted in Australia where it is determined that Australian R&D activities are conducted wholly, or to a significant extent, for a related foreign entity (s 355-210(2) ITAA97).

TA 2023/5 notes that arrangements of concern may display the following features:

- the agreements between the foreign related entity and the R&D entity:
  - are established under the instruction of the foreign related entity and its controllers;
  - result in the foreign related entity ultimately acquiring ownership rights in IP arising from the R&D activity;
  - impose restrictions on the R&D entity's rights around the developed IP;
  - grant to the foreign related entity primary rights to exploit and manage the developed IP; and
  - have a legal form that is inconsistent with the actual commercial substance of the arrangements between the entities;
- the foreign related entity:
  - owns pre-existing IP licensed to the R&D entity to undertake the R&D activity;
  - in substance and effect:
    - controls the strategic decisions regarding the R&D activities, including the instructions given to any contracted CRO of how the R&D activities are to be conducted;
    - assumes the financial and operational risks in relation to conducting the R&D activities, and sets the conditions for initial and subsequent funding of the R&D activities; and
    - will primarily commercially benefit in the event of a successful outcome; and
  - the foreign related entity may itself be contracted by the R&D entity to conduct some, or all, of the R&D activities; and
- the Australian R&D entity:
  - may have limited or no physical presence in Australia;
  - may have one or more foreign resident directors appointed by the foreign related entity;
  - may have an Australian-based resident director that acts in accordance with the directions and wishes of the foreign related entity or its controllers;
  - has few, if any, employees with the technical capability to conduct the R&D activities; and
  - lacks the economic capacity to either conduct the R&D activities or commercially exploit the developed IP in the absence of receiving a refundable R&D tax offset or further funding by the foreign related entity.

TA 2023/5 is perhaps most applicable to biological and medical technology entities, but it may apply to any industry, particularly in situations where:

- a foreign entity may have developed a technology over a number of years prior to the incorporation of an Australian R&D entity;

- a foreign entity incorporates a controlled Australian R&D entity to conduct specific R&D activities, such as a clinical trial investigating a technology previously developed by the foreign entity;
- direction and funding of the activity conducted by the Australian R&D entity is provided by the foreign entity;
- in the event that technical success of the R&D activity registered by the Australian R&D entity generates exploitable results, the foreign entity will primarily commercially benefit; and
- a finding for claiming overseas R&D activity applying s 28C(1)(a) of the *Industry Research and Development Act 1986* (Cth) may be involved.

To the author's knowledge, there has not yet been any cases decided by courts or the AAT involving these circumstances. However, the release of TA 2023/5 indicates that matters may be afoot.

The ATO notes in TA 2023/5 that, even if an arrangement is effective under the substantive provisions, if objectively viewed that the arrangement was entered into for the purpose of obtaining a tax offset, the general anti-avoidance provisions in Pt IVA ITAA36 may apply to cancel a claimed R&D tax offset.[7]

> "… the ATO will look beyond superficial compliance with the main rules on activities and expenditure …"

TA 2023/5 will require companies and advisers to assess the legal substance and form of their R&D entities, particularly in terms of how the Australian entity's R&D activity interacts with foreign related entities. This may require consideration and documentation of:

- what actual R&D activity is being undertaken by the Australian R&D entity, and whether it is undertaking a project of its own, or is merely contributing to a project undertaken by and for a foreign related entity; and
- the legal and commercial substance and form of structural arrangements to determine which entity the R&D activities are conducted for, and whether the "at risk" integrity rule may apply.[8]

Furthermore, where companies are conducting R&D activities on behalf of an associated foreign corporation, they must comply with the specific requirements under s 355-220 ITAA97. Key conditions of this provision include that:

- the R&D activity must be conducted solely within Australia;
- the relevant foreign entity must be located in a country that has a tax treaty with Australia; and
- service agreements must document the basis on which the Australian entity will provide R&D services to the foreign related entity.

Practical considerations and managing risk

So, what can be done if confronted with a structure or an issue exhibiting the risks noted in TA 2023/4 and TA 2023/5?

The unfortunate answer is that there is no easy solution to retrospectively address deficiencies within structures that are flawed with the issues outlined in these new R&D tax incentive taxpayer alerts.

The ramifications of the issues highlighted in the taxpayer alerts can be significant, particularly for TA 2023/4, and have the potential to render entire R&D claims invalid and lead to the imposition of penalties.

Companies and advisers identifying risks based on TA 2023/4 and TA 2023/5 should promptly assess whether continuing to register the R&D activities and claim tax offsets is suitable. A voluntary disclosure to the ATO for historical claims may also be advisable.[9]

To minimise the likelihood of TA 2023/4 and TA 2023/5 applying when commencing R&D activities, a number of measures can be taken to document key items when establishing an R&D entity or project.

In respect of TA 2023/4 (concerning R&D activities delivered by associated entities), these measures include:

- if a group's structure involves the use of a trading, ineligible R&D entity (such as a trust) that has historically conducted the group's R&D, having a new company designated as an R&D entity while the ineligible R&D entity continues to trade or incur R&D costs would lead to a high risk of TA 2023/4 applying. In such cases, advice should be sought on whether it is feasible to restructure into a single, corporate R&D entity which trades, and it should be ensured that the previous, ineligible R&D entity does not conduct activity that would lead to a conclusion that any future R&D activity may be majorly for that ineligible entity's benefit;
- consideration should be given as to how, when and to what degree the R&D entity will benefit commercially from the results of the R&D activity. This may include examining and documenting factors such as:
  - the context and function of the R&D entity within the group;
  - whether the R&D entity will directly sell the results of the R&D activity or derive licence income; and
  - if deriving a licence only, whether there will be another entity within the group that may commercially benefit from the results of the R&D activity to a greater degree than the registering R&D entity. If so, this may indicate a risk of TA 2023/4 applying;

- consideration should be given to the R&D entity's financing arrangements regarding how it will fund the R&D activity, for example:
  - increased complexity such as the use of set-offs or contingencies aggravates the risk of TA 2023/4 applying. Simplified structures such as financing via cash equity contributions or interest bearing full-recourse loans may be considered lower risk;
  - R&D expenditure must not be paid by the R&D entity issuing equity in settlement of its liabilities for incurred R&D expenditure based on TR 2008/5;
  - care should be taken to comply with the associate entity payment rules in a simple and non-contrived manner;
- having the R&D entity incur costs directly from external parties and directly employ R&D staff (rather than have them employed by another entity in the group) may reduce the risk of TA 2023/4 applying by reducing the scope of the costs delivered by associated entities; and
- documentation should be maintained to show how the staff and directors of the R&D entity, as opposed to that of another entity, have made decisions regarding the R&D activities, and that those decisions were for the benefit of the R&D entity, rather than for another entity within the group.

In respect of TA 2023/5 (concerning R&D activities conducted overseas for foreign related entities), these measures include:

- consideration should be given to the purpose of incorporating the Australian R&D entity and the actual R&D activity it will conduct. This may involve:
  - assessment of whether the Australian R&D entity is conducting experiments to develop its own new product or process; or
  - whether the Australian R&D entity's purpose is merely to conduct activities associated with progressing development of a project previously instigated by the foreign related entity. If so, there is a risk the activities are being conducted for the foreign related entity;
- consideration should be given to how the results of the R&D activities will be commercialised and whether the R&D entity or the foreign related entity will be the primary beneficiary of commercialisation rights. Documentation regarding IP rights and global business plans may be relevant; and
- if any Australian R&D activities are, in substance, conducted for the benefit of the foreign related entity, the Australian R&D entity's activities may still qualify under the additional requirements in s 355-220 ITAA97 (R&D activities conducted for a foreign entity):
  - this necessities compliance with several additional rules concerning the relationship with, and location of, the foreign related entity; and
  - service fee income derived by the Australian R&D entity from the foreign related entity under s 355-220 will likely result in the initial cash benefit derived for R&D expenditure being around $0.185 rather than $0.435. However, claiming under s 355-220 may reduce overall risk if the factors in TA 2023/5 are present.

Conclusion

It is anticipated that demonstrating control, financial risk and formal ownership of IP arising from R&D activity will be a large focus of upcoming ATO R&D reviews of multi-entity groups to ensure that R&D activities are conducted for the registering R&D entity.

It is also apparent that the ATO will look beyond superficial compliance with the main rules on activities and expenditure under the R&D tax incentive to look at the legal rights and obligations of an R&D entity. The ATO will also challenge the validity of structures which are documented "on paper" as complying with s 355-210 ITAA97 if, in substance, the risk and benefit of conducting the R&D activity are attributable to an entity other than the registering R&D entity.

TA 2023/4 and TA 2023/5 express concerns over issues related to multi-entity groups, and businesses operating simplified structures using a single, corporate R&D entity may have lower risk of the alerts applying. Accordingly, consideration regarding the requirements of structures and balancing complex issues such as asset protection and R&D eligibility should be weighed when setting up a new business that may include R&D claims.

As the complexity of the group and interactions with associate entities increase, so does the risk of TA 2023/4 and TA 2023/5 applying.

A review of issues under s 355-210 will often inevitably lead to a focus on legal principles and examining documentation showing IP ownership and financial risk. When documenting and implementing an effective structure, legal advice may be required for R&D claims within multi-entity groups.

When dealing with multi-entity groups, R&D entities and advisers must increasingly consider how an R&D entity fits within the group's legal and commercial framework to satisfy s 355-210.

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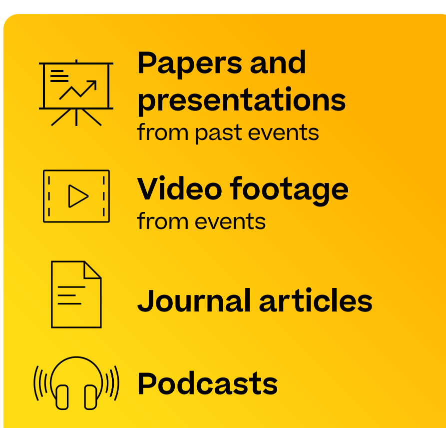

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Asset protection and tax avoidance

by Mathew Leighton-Daly, FTI, Lawyer and Academic, The University of Sydney

Australia's federal general anti-avoidance rules (GAAR) in Pt IVA of the *Income Tax Assessment Act 1936* (Cth) counter arrangements that, objectively viewed, are carried out with the dominant purpose of securing a tax advantage. Often overlapping with tax minimisation, asset protection is an inherently cross-disciplinary field concerned with managing insolvency risk in both commercial and family contexts. It is frequently intertwined with tax minimisation because, when an adviser gives advice regarding the preservation or transmission of individuals, families and/or corporations' property, it will often have tax consequences. This article considers whether, and/or when, asset protection-related advice might amount to tax avoidance by reference to Pt IVA. It introduces readers to asset protection as a distinct body of law and practice. Next it analyses the concepts of tax and legal advice and the GAAR, before, finally, looking at asset protection advice and tax avoidance in relation to three separate scenarios.

Introduction

The term "asset protection" refers to the field of commercial and family dealings aimed at minimising business and political risks. Asset protection advice may include legal advice, as well as accounting and/or financial advice. A co-consideration or consideration in asset protection-related advice may include preventing excessive taxation and, to that extent, it may also include tax advice. Australia's federal general anti-avoidance rules (GAAR) in Pt IVA of the *Income Tax Assessment Act 1936* (Cth) (ITAA36) have been described as applying to schemes that are blatant, artificial and contrived, although those words do not themselves appear in Pt IVA. This article explores the possible application of the GAAR to asset protection-related advice given by lawyers and tax practitioners, with a focus on the extent to which tax practitioners may give tax-related legal advice.

Analysis

Asset protection

Asset protection (sometimes referred to as "asset planning"[1]) is an inherently cross-disciplinary field concerned with aspects of corporate, commercial and family law, and includes legal as well as accounting and financial services advice (financial advice[2]). Chaikin describes the body of law known as "asset protection" as being:[3]

> "… concerned with the preservation and transmission of property of individuals, families or corporations. It has the broad purpose of minimising legal business and political risks by safeguarding assets from seizure, loss and diminution in value. It is concerned with the protection of assets from potential creditors, government expropriation, excessive taxation and catastrophic loss."

Although the law of asset protection can be described as including protection from "excessive taxation" – and to that extent might overlap with tax minimisation – it can nevertheless be distinguished from tax advice; asset protection is less focused on tax-related liabilities arising in the first place (and/or the minimisation of them) and more concerned with legitimately managing risk from – especially unsecured – creditors. Asset protection's focus is on managing insolvency risk in both commercial and family contexts. Commercial and family contexts here might be considered as synonymous with the term "ordinary business or family dealings" referred to in *Newton v FCT*.[4]

Tax advice

Tax advice is arguably (or arguably includes) legal advice. As Morgan states:[5]

> "… giving any real 'tax advice', will depend on understanding not only the tax law but the general law that influences the tax result. And, this flows into having enough skill and insight, to identify the relevant facts, and to integrate the facts and law, into a reliable result."

In *Cornall v Nagle*,[6] Phillips J concludes that it should be taken as established that legal advice will ordinarily be regarded as the "exclusive province of the professionally trained and duly qualified". Under state and territory laws, unqualified legal practice is prohibited. For example, s 10 of the *Legal Profession Uniform Law* (NSW) creates an offence for engaging in legal practice by unqualified entities, which is punishable by fine and/or imprisonment. At least after the introduction of the *Tax Agent Services Act 2009* (Cth) (TASA), non-lawyers who are registered tax agents may arguably give tax-related legal advice. This is because s 109 of the *Commonwealth of Australia Constitution Act* (the Constitution) resolves any inconsistency between state and federal law in favour of the Commonwealth, but only to the extent of any inconsistency. To "'that extent'", according to Morgan, the state legal profession statutes would be invalid under s 109 of the Constitution and tax practitioners may give tax-related legal advice.[7]

The federal statutory basis for tax practitioners who are not also lawyers to give tax-related legal advice is limited. Advice in relation to, and the associated preparation of, agreements and other commercial and family law documents[8] is probably legal advice, as is "'law heavy' tax advice"[9] and practice in state and territory taxes. Advice in relation to the application of tax avoidance provisions will often be "'law heavy' tax advice" too. As Pagone and

Woodger note, "the occasion to advise on the potential application of the anti-avoidance provisions may arise in the context of ordinary commercial or family dealings",[10] and has also been described by Dal Pont to be "outside the competence of most lawyers",[11] let alone non-lawyers.

Part IVA ITAA36

The principal role of the federal GAAR is to counter arrangements that, objectively viewed, are carried out with the dominant purpose of securing a tax advantage. According to Pagone:[12]

> "General anti-avoidance provisions occupy a very special role in tax laws because their role is to underpin the effectiveness of the primary operative provisions when those primary provisions fail to achieve their purpose."

Unfortunately, in practice, it can be difficult not only to distinguish between permissible tax minimisation and impermissible tax avoidance but also draft rules to adequately address the mischief of avoidance. Although the legality distinction provides demarcation between tax avoidance and tax evasion,[13] the GAAR in fact blurred the traditional distinction between tax minimisation and tax avoidance because:[14]

> "Part IVA involved a substantial departure from the principles that the tax laws should be applied literally and that tax payers are allowed to order their affairs 'so that the tax attaching under the appropriate Acts is less than it otherwise would be'."

Part IVA is crystalised by the making of a determination by the Commissioner under s 177F ITAA36. The two express preconditions in this section to the making of a determination are:

1. that a "tax benefit" either has been or would be obtained were it not for the application of Pt IVA itself; and
2. that the tax benefit was obtained in connection with a scheme to which Pt IVA applies.

In relation to a "scheme", in *FCT v Peabody*,[15] the High Court held that the Commissioner's erroneous identification of a scheme would result in a wrongful exercise of the discretion under s 177F only if "the tax benefit which the Commissioner purports to cancel is not a tax benefit within the meaning of Part IVA". An error by the Commissioner in the detail of the scheme will not invalidate a determination, although the incorrect identification of a taxpayer would.[16] The underlying logic behind these conclusions is that the operation of Pt IVA does not depend on the subjective opinion of the Commissioner, but rather on the objective facts which produce the tax benefits.[17]

Section 177D ITAA36 is the "lynchpin"[18] to the operation of Pt IVA. The GAAR cannot apply unless the conclusion contemplated by s 177D is reached once the matters identified in para (b) of the section have been considered. Section 177D provides that Pt IVA applies to a scheme where:[19]

> "(a) a taxpayer (in this section referred to as the relevant taxpayer) has obtained, or would but for section 177F obtain, a tax benefit in connection with the scheme; and
>
> (b) having regard to:
>
> (i) the manner in which the scheme was entered into or carried out;
>
> (ii) the form and substance of the scheme;
>
> (iii) the time at which the scheme was entered into and the length of the period during which the scheme was carried out;
>
> (iv) the result in relation to the operation of this Act that, but for this Part, would be achieved by the scheme;
>
> (v) any change in the financial position of the relevant taxpayer that has resulted, will result, or may reasonably be expected to result, from the scheme;
>
> (vi) any change in the financial position of any person who has, or has had, any connection (whether of a business, family or other nature) with the relevant taxpayer, being a change that has resulted, will result or may reasonably be expected to result, from the scheme;
>
> (vii) any other consequence for the relevant taxpayer, or for any person referred to in subparagraph (vi), of the scheme having been entered into or carried out; and
>
> (viii) the nature of any connection (whether of a business, family or other nature) between the relevant taxpayer and any person referred to in subparagraph (vi);
>
> it would be concluded that the person … who entered into … the scheme … did so for the purpose of enabling the relevant taxpayer … or other taxpayers … to obtain a tax benefit in connection with the scheme …"

The explanatory memorandum accompanying the Bill to introduce Pt IVA described the test in s 177D as being similar to that of the "blatant, artificial and contrived" test in *Newton's* case.[20] Although the government did not enact an exclusion in Pt IVA in the terms expressed by the Privy Council, in his second reading speech, the Treasurer said that the positive test created by 177D "seems best to capture the essence of the views expressed in *Newton's* case".[21]

Advice

Subjective intentions are not relevant for s 177D.[22] Indeed:[23]

> "In some cases, the actual parties to a scheme subjectively may not have any purpose, independent of that of a professional advisor, in relation to the scheme or part of the scheme, but that does not defeat the operation of section 177D."

As for attributing the purpose of a professional adviser to a taxpayer, in *Consolidated Press Holdings*, the High Court considered it both "possible and appropriate" (although

"possible" and "appropriate" are not synonymous). *Consolidated Press Holdings* is not a case where a professional adviser had a subjective motivation or purpose which was thought to be engrafted on a taxpayer who was otherwise able to show that neither could apply on the particular facts. As Pagone explains:[24]

> "… any relevant objective purpose flowed from the effects and consequences of the structure which was designed and created for the purpose of giving effect to those consequences. The attribution which had apparently been approved by the Full Federal Court was of '*the objective purposes associated with the implementation of [the] advice … to those who implemented it*', and the High Court did not criticise that analysis." (emphasis added).

In terms of the objective purposes associated with the implementation of advice, asset protection-related advice for the following analysis means advice relating to the management of insolvency risks in commercial and family law contexts. To consider the possible application of Pt IVA to advisers giving asset protection-related advice, three general situations are now considered ("scheme" and "tax benefit" are to be assumed for the sake of the scenarios).

Non-legally qualified advice

First, it was noted above that legal advice includes "'law heavy' tax advice", as well as the preparation of commercial and family documents and advice relating to the documents prepared. Non-lawyers who do such work not only run the risk of breaching professional sanctions, but also committing the criminal offence of unqualified legal practice.[25] Given that such practitioners are not qualified to opine on asset protection law, their clients are in jeopardy of advice being wrong. Their clients are also in jeopardy of having any asset protection purpose excluded from consideration of the dominant purpose because it is illegitimate.

Distinct asset protection advice

What about lawyers who give distinct asset protection legal advice (and non-lawyers who give distinct asset protection-related financial advice)? In this scenario, there would be a low risk of offending the GAAR because, objectively, the sole purpose was an asset protection-related purpose. However, the issue with distinct asset protection advice without the consideration of tax consequences is that it may amount to negligence and/or misconduct on the part of the adviser under relevant professional rules[26] if any tax minimisation was less than it ought reasonably to have been. In other words, from the client's perspective, they may be in a worse position in relation to their tax affairs if asset protection advice is given and acted on without the consideration of any tax consequences, even if a tax benefit were occasioned.

Asset protection and tax minimisation advice

What about advisers who are legally qualified, or non-legally-qualified who give advice that is financial in nature, which is motivated by the purposes of asset protection, as well as minimising tax? This is perhaps the more common scenario because, as noted immediately above, it may be negligent for an adviser not to give (or at least refer a client for) tax advice contemporaneously with the provision of asset protection advice.[27] This second scenario is at risk of offending Pt IVA on the basis that the objective *dominant* purpose (associated with the implementation of the advice to those who implemented it) may not be asset protection (although asset protection may objectively be a co-purpose). Overall commercial objectives will not negate the potential operation of Pt IVA either. *FCT v Hart*[28] was a similar case to *Consolidated Press Holdings* in that it also involved an overall commercial objective. As Pagone and Woodger observe, the critical element in these cases was not that tax benefits were the motive for undertaking a commercial activity but "that there were steps in transactions which (the steps) had no commercial explanation beyond the tax consequences they enabled to be obtained".[29] There would be no substitute in this scenario for a careful consideration of Pt IVA and the matters in s 177D(2) here.

Conclusion

This article has considered whether, and/or when, asset protection-related advice might amount to tax avoidance for Pt IVA purposes by reference to three separate scenarios. It introduced asset protection as a body of law and practice which relates to, and may overlap with, tax advice but is nevertheless distinct. It then analysed the concepts of tax and legal advice and the GAAR, before, finally, looking at asset protection advice and tax avoidance in relation to the three scenarios.

Asset protection-related legal advice – as distinct from financial advice – by non-lawyers probably amounts to unqualified legal practice. Moreover, as unqualified advice it may be excluded from consideration of objective purposes (because, even if it is not wrong, it is illegitimate). Distinct asset protection advice (that is, without consideration of any tax consequence) would be at a low risk of offending the GAAR because, objectively, the dominant asset protection-related purpose may be readily ascertained. However, in the event that any tax minimisation is less than it should reasonably be, the adviser may be negligent and/or face disciplinary action.

In relation to advice motivated by both tax and asset protection, such "schemes" will often be at risk of amounting to tax avoidance under Pt IVA and would require a careful consideration of the 177D(2) matters according to their individual circumstances.

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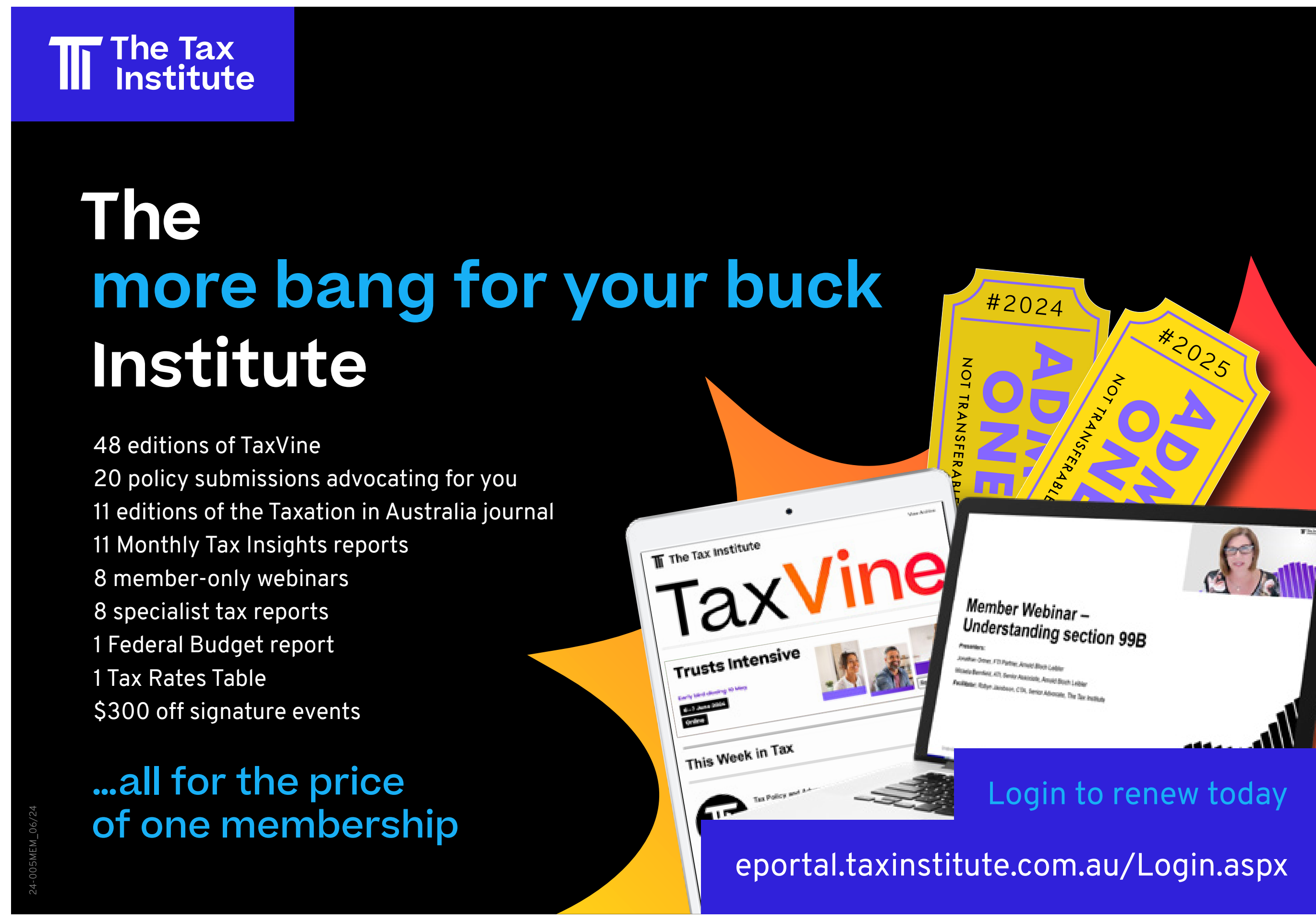

A Matter of Trusts

by Jan Harnischmacher, Sladen Legal

SMSFs investing in unit trusts

This article discusses how a new measure to target tax concessions available to individuals with a total superannuation balance of more than $3m may affect SMSF investments in unit trusts.

Introduction of Division 296 tax

On 3 October 2023, a new Bill to reduce the tax concessions available to individuals with a total superannuation balance (TSB) of more than $3m was tabled in the House of Representatives in Ch 1 of the Treasury Laws Amendment (Better Targeted Superannuation Concessions) Bill 2023 and the Superannuation (Better Targeted Superannuation Concessions) Imposition Bill 2023 (together referred to as "the Bill"). The Bill proposes to insert new Div 296 in the *Income Tax Assessment Act 1997* (Cth) from 1 July 2025. Division 296 tax will be levied at a rate of 15% on increases of a member's TSB (including retirement phase interests and accumulation phase interests) on the proportion to their TSB above $3m. Notably, the Division 296 tax is in addition to any tax payable by the superannuation fund on its income and capital gains.

Superannuation funds and unit trusts

A unit trust is a popular structure for superannuation funds to invest in property acquisitions and developments and other business ventures. There are a number of restrictions and requirements in the *Superannuation Industry (Supervision) Act 1993* (Cth) (ITAA97) for superannuation funds investing in unit trusts, particularly related trusts. Further, investments by superannuation funds in unit trusts can trigger non-arm's length income. While these issues must be considered before a superannuation fund invests in a unit trust, they will not be considered as part of this article. Rather, this article focuses on the impact of Division 296 tax on superannuation funds' investments in unit trusts.

Determining amount of Division 296 tax

Division 296 tax will only apply to the proportion of "earnings" above $3m. "Earnings" will be calculated with reference to the difference in a member's modified TSB at the start and end of a financial year, adjusting for withdrawals (such as superannuation benefit payments and family law splits) and contributions.

The movement of TSB will be a reflection of increases and decreases in the value of a superannuation fund's assets: the value of the superannuation fund's assets and, accordingly, the member's TSB will increase with income derived by the fund and appreciation of assets, and decrease from expenses and liabilities and depreciation of assets. Importantly, and controversially, the tax will be calculated on unrealised gains. This is discussed further below.

How will Division 296 tax be levied?

Division 296 tax assessments will be issued to the member personally. Individuals will be able to choose to pay this liability using funds outside superannuation or request that the funds be withdrawn from their superannuation accounts under a "release authority" arrangement akin to Division 293 tax. The individual will have 60 days to request a release of the amount from their fund and 84 days to pay the tax.

While "negative earnings" (ie a reduction in the value of the member's TSB and superannuation fund asset) can be carried forward to offset against positive future "earnings", there are no provisions to allow for tax refunds for capital losses that are reflected in negative earnings. Such losses may never be recovered if the member's balance permanently drops below $3m or the member dies.

Annual valuations

Regulation 8.02B of the *Superannuation Industry (Supervision) Regulations 1994* (Cth) (SISR) requires trustees of self-managed superannuation funds (SMSFs) to report the fund's assets at their market value in the fund's financial statements and accounts every year.

The member's TSB calculated on 30 June of each financial year determines the Division 296 tax liability. Accordingly, the value of superannuation assets on 30 June will need to be determined. The imposition of Division 296 tax is likely to increase the focus on asset valuations, which means that the costs of complying with the new tax will likely increase.

The requirement to value fund assets at market value can present problems when a fund invests in unlisted assets such as unit trusts. The value of the units in a unit trust is typically calculated on the value of the underlying assets of the unit trust. Therefore, in order to value the units (as required under the SISR), the value of the underlying assets must be determined.

This can be difficult if those underlying assets are hard to value (for example, commercial and farm properties, and business assets such as goodwill and intellectual property). It can also be difficult if the superannuation fund is a minority unitholder with no control or say in relation to the unit trust. In such a circumstance, the superannuation fund trustee may not be able to obtain a valuation of the underlying assets and/or the controllers of the unit trust may not provide such information. Even where valuations can be obtained, the costs of obtaining such

valuations, especially for business assets, can be costly and time-consuming.

Taxing unrealised gains

As noted above, Division 296 tax will be based on changes in the value of a member's TSB and the underlying assets of the superannuation fund, including unrealised gains.

Basing the Division 296 tax partly on unrealised gains will create significant issues for some members. If the members do not have disposable cash inside and/or outside of their superannuation, they may need to sell the assets in the superannuation funds or in their personal name to meet a Div 296 liability in respect of the appreciation in value of an asset in their superannuation funds.

This could be a significant issue for members whose SMSFs hold units in unit trusts. First, the SMSF may face difficulty selling, or redeeming, units in an unlisted unit trust due to the lack of trading activity and a scarcity of purchasers. Second, even if the units can be sold or redeemed, the SMSF may have to sell them for a lower value than they otherwise would have (eg as a forced seller). Third, as it may not be possible to sell the units, the unit trust may have to sell the unit trust's underlying assets. Again, this may result in those assets being sold for a lower value than they otherwise would have or before the full value of those assets are achieved.

Division 296 tax: SMSFs with investments in unit trusts

The following is an example of how the new measure could work for an SMSF that has invested in a unit trust.

Peter is the sole member of the Sladen Superannuation Fund. On 30 June 2026, Peter's TSB was $4.5m. The fund's main asset is units in a unit trust which holds real estate worth $4.4m. During the 2026–27 financial year, the real estate is rezoned and the value of the real estate is increased by $2m. To simplify this example, we have assumed that the fund did not derive any income and the other assets of the fund were cash. Therefore, Peter's TSB increased to $6.5m on 30 June 2027.

Step 1: The total amount of taxable superannuation "earnings" (TSE) for an income year is worked out by determining the percentage of the TSB at the end of the year that is above the "large superannuation balance threshold", which is defined to be $3m. The result is rounded to two decimal places (see proposed new s 296-35(3) ITAA97).

The percentage of the TSB exceeding the $3m threshold =

$$\frac{\text{(Your total superannuation balance at the end of the year – \$3m)}}{\text{(Your total superannuation balance at the end of the year)}} \times 100$$

Step 2: Division 296 tax is calculated by multiplying the proportion (calculated in step 1) of the TSE by the proposed tax rate of 15%.

Division 296 tax = [The percentage worked out in step 1 × (Current adjusted total superannuation balance – Previous total superannuation balance)] × 15%

= [53.85% × ($6,500,000 – $4,500,000)] × 15% = $161,550

Peter will therefore be issued with an income tax assessment of $161,550 based on the unrealised gain of the property in the unit trust. That is, unlike the normal taxing rules which only tax realised gains, there are no proceeds from which to pay this tax. If neither Peter nor the fund has sufficient cash to pay the Division 296 tax liability, Peter may have to sell the property, the units in the unit trust or assets out of the fund to pay this tax liability.

What if units or assets cannot be sold?

While there is a deferral regime for defined benefit arrangements, there is no ability to defer Division 296 tax for other superannuation interests such as accumulation accounts and account-based pension accounts. Therefore, the Division 296 tax liability issued to a member will be a tax debt, which can be enforced by the ATO like any other tax debt.

A reduced rate of general interest charge will apply to any outstanding liabilities relating to Div 296 which remain unpaid by the due date. The reduced rate will be the base interest rate plus 3% instead of 7%.

Paragraph 1.74 of the explanatory memorandum to the Bill makes the following comments in this regard:

> "The lower interest charge on unpaid Division 296 liabilities ensures that relevant taxpayers are subject to a rate of interest that is broadly like market rates. This means that the rate of interest does not penalise taxpayers in the very rare circumstance that they do not have liquidity within or outside of superannuation to meet the tax liability. While this provides significant additional payment flexibility for individuals, it maintains the real value of the tax liability over time to ensure it is not abused by taxpayers to reduce the tax they are required to pay."

While this is acknowledgement of the issue, without a deferral regime, the Division 296 tax will still be recoverable by the ATO, albeit with a "reduced" interest rate. That is, there is no relief for members who do not have sufficient liquidity inside or outside of superannuation to pay the tax.

Conclusion

The proposed Div 296 measure has been widely criticised for taxing unrealised gains. As can be seen in this article, this is likely to particularly affect SMSFs that have invested in illiquid assets such as unit trusts.

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Superannuation

by Daniel Butler, CTA, and
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Employee or contractor — changes to the Fair Work Act: part 6

This month's column discusses the Federal Government's recent changes to the definitions of "employer" and "employee" in the context of the *Fair Work Act 2009* (Cth).

Overview

The *Fair Work Legislation Amendment (Closing Loopholes No. 2) Act 2024* (Cth) (the Act) received royal assent on 26 February 2024. Among other things, the Act changes the definition of "employee" to specifically address the High Court's decisions in *Construction, Forestry, Maritime, Mining and Energy Union v Personnel Contracting Pty Ltd*[1] (*CFMMEU*) and *ZG Operations Australia Pty Ltd v Jamsek*[2] (*Jamsek*).

Broadly, these High Court decisions were considered by the government to have created a "loophole" as the judges largely focused on a contractual analysis of the rights and obligations established between the parties when determining whether an employee or an independent contractor relationship existed. The High Court essentially confined the expansive multi-factorial approach to an analysis of the contract where the terms of the working relationship had been committed to a comprehensive written agreement. Outside of limited exceptions, such as oral agreements or sham contracts, the actual terms of the contract were the primary focus of determining the proper characterisation of a working relationship.

The Act, however, seeks to change this framework by reinstating the expansive multi-factorial approach that does not give primacy to the employment contract. It seeks to achieve this by amending the definition of "employee" within the context of the *Fair Work Act 2009* (Cth) (FWA) by inserting new s 15AA in the FWA.

The multi-factorial approach is far more complex and less certain for those engaging as contractors as there are many factors that must be considered when determining whether a person is engaged and working as an employee or a contractor.

For more information on parts 1 to 5 of this series of articles, see under the "Related articles" heading below.

Employee/employer definitions

Section 15AA provides three criteria for determining whether an individual is an employee of a person within the ordinary meaning of that expression, or whether a person is an employer of an individual within the ordinary meaning of that expression. These factors are:

1. the real substance;
2. the practical reality; and
3. the true nature of the relationship between the individual and the person.

Importantly, these factors are ascertained through examining the totality of the relationship between the individual and the person, ie all parts of the working relationship between the parties over the duration of the working relationship rather than at the time the contract is entered into. This includes the terms of the contract and how the contract is performed in practice. This is a major shift to the existing test, which focuses primarily on the terms of the written contract.

A note in s 15AA states that this section was enacted in response to the High Court decisions in *Jamsek* and *CFMMEU*. As stated above, the government is legislating as it does not agree with the High Court's decisions.

These provisions are due to commence on 26 August 2024.

The High Court view rejected by the FWA

By way of background, we have extracted the following paragraphs from part 2 of this series of articles:

> "The majority High Court decision in *Jamsek* is consistent with the views of the majority decisions of the High Court in *Workpac v Rossato*[3] and *CFMMEU v Personnel Contracting*. There are now three recent High Court decisions where the rights and obligations of the parties under the contract take primacy over the multi-factorial test where a comprehensive written agreement exists. The High Court has also clarified that the multi-factorial test has a considerably limited application than previously considered …
>
> The multi-factorial test has been regarded as a key test in determining whether a person is engaged as an employee or a contractor over many years, as reflected in the following cases: *Stevens v Brodribb Sawmilling Co Pty Ltd*,[4] *Hollis v Vabu*,[5] *On Call Interpreters and Translators Agency Pty Ltd v FCT (No. 3)*,[6] and *Dental Corporation Pty Ltd v Moffet*.[7] The 'master–servant' control test was the key test relied on before the shift towards the multi-factorial test.
>
> However, the three High Court decisions discussed above, ie *Workpac v Rossato* (which was discussed in part 1), *CFMMEU v Personnel Contracting* and *Jamsek*,

> reflect a significant shift towards placing the primary focus on the contract in question and a decreased reliance on the multi-factorial test to determine whether a person is an employee or a contractor …"
>
> "The High Court confirmed that the factors that are applied in a multi-factorial test of the relationship can be considered to determine whether an employment or a contractor relationship exists. However, the multi-factorial analysis must have regard to the rights and duties established by any contract."

Limited to FWA

As you can see from the above extracts, the rejection of the High Court's views by recent government legislative changes will have a substantial impact on those engaging as "contractors", given the multiple factors that can change the outcome. In particular, the courts have generally examined each factor by giving a weighting and then deciding whether the factors weigh in favour of a worker being an employee or an independent contractor.

Note, however, that the new definitions of "employee" and "employer" pursuant to s 15AA are limited to the FWA. Therefore, the methodology set out by the High Court in *Jamsek* and *CFMMEU* is still relevant when analysing the employee/contractor distinction within the context of other legislative frameworks, such as:

- the *Taxation Administration Act 1953* (Cth) in relation to pay as you go withholding;
- the *Superannuation Guarantee (Administration) Act 1992* (Cth) (SGAA) for superannuation purposes (noting that s 12(3) SGAA provides for an expanded definition of "employee"); and
- for payroll tax and other purposes.

We understand that there are up to 16 different definitions of "employee" versus "contractor" that each need to be examined in relation to the specific legislation being considered (eg income and PAYG withholding tax, superannuation guarantee, payroll tax, WorkCover insurance, long-service leave, vicarious liability etc). Thus, it is not surprising that Australia has a reputation for being one of the most complex countries in the world to engage labour, given the complexities involved with seeking to determine who is an employee versus who is a contractor.

Opt out provisions

If a worker's earnings exceed the contractor high income threshold (this threshold is yet to be determined), a principal or employer may give the worker a written notice stating that the worker can give them an "opt out notice". This can be done when the principal or employer thinks that the worker may be in an employment relationship because of the new definitions of "employee" and "employer".

If a worker provides an opt out notice to the employer or principal, the new definition will not apply to their relationship. Thus, where the payment to the contractor exceeds the high income threshold, the principal or employer should consider the opt out system to minimise risk. However, an opt out notice can be revoked, albeit only once in respect of a particular relationship.

Other notable changes

Beyond the changes to the definition of "employee", the Act impacts a wide variety of employment areas and related issues. A brief summary of some of those changes is set out below.

Meaning of "casual employee"

Part 1 of the Act changes the definition of "casual employee". A casual employee will continue to be defined by an employment relationship characterised by an absence of a "firm advance commitment to continuing and indefinite work". However, similarly to the new "employee" definition in s 15AA, the characterisation of a relationship for casual employees will also be assessed with regard to similar factors (ie the real substance, practical reality and the true nature of the relationship).

This change in the FWA reflects the rejection of the High Court's decision in *Workpac v Rossato* (discussed in part 1 of this series of articles). Broadly, this decision reflected the first significant shift towards placing the primary focus on the contract in question when determining whether an employee was a casual employee. The Act has changed this to focus on the real substance, practical reality and the true nature of the relationship, and has given more rights to casuals to convert to permanent employee status.

Sham arrangement amendments

Part 9 of the Act provides a new exception to s 357 FWA concerning misrepresenting an employment contract as an independent contractor arrangement. Formerly, an employer was required to show that they did not know and were not reckless as to whether a contract was one for employment rather than services. However, s 357(2) now only requires that the belief of the employer was reasonable, which is determined with regard to, among other things, the size and nature of the employer's enterprise.

Conclusion

The above changes add to an already complex framework, with varying methodologies required to determine whether an employee or independent contractor relationship exists under the relevant legislation. Individuals and persons engaged in a working relationship should be mindful of a potential change to the classification of the relationship at the commencement date of s 15AA on 26 August 2024, as well as the impact of being subject to the provisions of the FWA.

Despite the shift to a multi-factorial test (rather than relying on the primacy of a contract), we recommend that a comprehensive written contract be documented for each employee and contractor.

As noted in part 5 of this series of articles, expert advice and written documentation that reflects the position should assist with minimising risk and penalties.

Related articles

For further guidance, refer to the earlier articles in this series:

1. D Butler and B Figot, "Employee or contractor – PAYG and SG: part 1", (2022) 57(1) *Taxation in Australia* 46 (available at www.taxinstitute.com.au/resources/journals/taxation-in-australia/2022/superannuation-employee-or-contractor-payg-and-sg-part-1);
2. W Fettes and D Butler, "Employee or contractor – clarifying the multi-factorial test: part 2", (2022) 57(2) *Taxation in Australia* 113 (available at www.taxinstitute.com.au/resources/journals/taxation-in-australia/2022/superannuation-employee-or-contractor-clarifying-the-multi-factorial-test-part-2);
3. C Hurley and D Butler, "Employee or contractor – payroll tax: part 3", (2022) 57(5) *Taxation in Australia* 286 (available at www.taxinstitute.com.au/resources/journals/taxation-in-australia/2022/superannuation-employee-or-contractor-payroll-tax-part-3);
4. B Figot and D Butler, "Employee or contractor – the application of SG to contractors: part 4", (2023) 57(10) *Taxation in Australia* 617 (available at www.taxinstitute.com.au/resources/journals/taxation-in-australia/2023/superannuatione-mployee-or-contractor-the-application-of-sg-to-contractors-part-4); and
5. D Butler and F Stead, "Employee or contractor – new ATO guidance: part 5", (2024) 58(8) *Taxation in Australia* 450 (www.taxinstitute.com.au/resources/journals/taxation-in-australia/2024/Superannuation-Employee-or-contractor-new-ATO-guidance-part-5).

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1 [2022] HCA 1.
2 [2022] HCA 2.
3 [2021] HCA 23.
4 [1986] HCA 1.
5 [2001] HCA 44.
6 [2011] FCA 366.
7 [2020] FCAFC 118.

Successful Succession

by Tim Donlan, ATI, Donlan Lawyers

Dissolution of partnership by death

Gifts in wills speak from the time the will was made. Where the subject of the gift changes afterwards, issues as to intention often arise.

Introduction

Whether a partnership is notionally or technically dissolved as opposed to being actually dissolved can have consequences for willmakers and beneficiaries where the gift of a partnership interest is made.

One of the most common forms of business structure is a partnership. As will be known to readers, a partnership is "a relationship that exists between two or more 'persons' carrying on a business in common with a view to profit".[1]

In Australia, apart from at general law, partnerships are largely regulated by the relevant partnership Acts that exist in each state and territory.[2]

Each of the partnership Acts provides for the dissolution of a partnership on the death or bankruptcy of a partner. For example, s 37 of the Victorian *Partnership Act 1958* provides:

> "**Dissolution by death or bankruptcy or charge[2]**
>
> (1) Subject to any agreement between the partners every partnership is dissolved as regards all the partners by the death or bankruptcy of any partner.
>
> (2) A partnership may at the option of the other partners be dissolved if any partner suffers his share of the partnership property to be charged under this Act for his separate debt."

The position under the relevant partnership laws is that a partnership is dissolved automatically if a partner dies or is declared bankrupt, but that such dissolution is subject to a contrary agreement of the partners.

The Kuenen decision

The Supreme Court of Western Australia was recently required to determine the effect of a gift in a will of a deceased partner in circumstances where there had been various changes of partners between the date when the will was made and the date of death of the partner.

In *Kuenen v Robert Leslie Hortin and Adrian Mark Bickford as Executor of the Estate of Late Leslie Mervyn Hortin*[3] (*Kuenen*), the partners had carried on a family farming business through a partnership structure for over 40 years. The farm operations were primarily livestock and dairying. The business was initially conducted by brothers Frank and John Hortin and their mother Mary. There was evidence that a company known as Hortin Grazing Co Pty Ltd had been registered in 1971. The minutes of the meeting of directors of that company referred to a loan from FV Hortin & Sons to cover the costs of incorporation of the company. The company owned land that it leased to the partnership of FV Hortin & Sons.

The business name FV Hortin & Sons was registered with ASIC in 1981. It remained registered at the date of trial of the matter. The name FV Hortin & Sons was registered as being owned by the partnership since 1984.

While John and Leslie Hortin and their mother Mary had conducted the business in partnership for many years, by 1984, the partners had changed by agreement to include John, Leslie and Mary, as well as John's son Robert and John's wife Dawn. They were each registered as the owners of the partnership name FV Hortin & Sons.

Over time, certain partners had died or exited the partnership. Prior to Leslie's death in 2021, all partners had been family members. Transfers of interests in the partnership (which were in differing proportions between the partners) took place for consideration and subject to the incoming partners entering into covenants to be bound by the terms of the partnership agreement. Where a partner had died (Mary in 1987, John in 2003, and Leslie in 2021), the administrator of their estate had temporarily become a partner in capacity as their legal personal representative (as well as, where applicable, being a partner in their own right) until the administration of the estate had been completed and a transfer of their interest to another party had occurred.

On Leslie's death, Robert and his solicitor, as executors of his will, became "partners" representing Leslie's interest in the partnership until the finalisation of his estate. When that occurred in October 2021, his wife Dawn also resigned from the partnership. The remaining partners of the partnership by agreement were Robert and his son Zak.

Issues in dispute in the court action

A dispute arose within the family as to the proper construction of the terms of Leslie's will.

Leslie had made his last will on 23 August 1994. The dispute was centred on cl 2.3 of the will which dealt with his interest in the partnership of FV Hortin & Sons.

Clause 2.3 of the will provided that Leslie left his interest in the partnership FV Hortin & Sons to the surviving partners of it. At the time of Leslie's death, the surviving partners were Robert and his son Zak.

The plaintiffs in the matter were other relatives of Leslie who were the residuary beneficiaries of his estate. They had never been involved in the partnership business.

The plaintiffs sought a declaration from the court as to their preferred construction of cl 2.3. If their construction was correct, the gift to the continuing partners of Leslie's interest in the partnership would fail and his interest would fall into the residue of the estate to be shared between them.

Not surprisingly, Robert and Zak took a different view as to the proper construction and effect of the gift of Leslie's interest in the partnership. They wanted the benefit of what they considered Leslie had intended at the time that he made the will, which Robert argued was consistent with the ongoing operation of the farm by the partners as they existed from time to time and the terms of their partnership agreements and covenants.

Legal principles

The court was required to consider and determine the interplay between the provisions of s 44 of the Western Australian *Partnership Act 1895* as it related to a dissolution on the death of a partner, as well as certain principles of construction relating to Leslie's will.

Hill J first considered the relevant principles applicable to the proper construction of wills. She observed:

> "30 The principles that govern the construction of a will are well settled and were not in dispute. These principles were comprehensively set out by the Court of Appeal in *Walsh v Sloan as executor of the estate of the late Keddie*[4] and can be summarised as follows.
>
> 31 The starting point is that the object of construing a will is to ascertain the testator's intention as expressed in the will itself. This requires consideration of what the written words mean in the particular case to determine the 'expressed intentions' of the testator.
>
> 32 In identifying the meaning of the words used by the testator, the court focusses on the objective intention of the testator at the time the will was made and not at the time of their death. This is reflected in the 'armchair principle', which allows the court to admit extrinsic evidence about the testator's property, family, acquaintances, and friends for the purpose of putting the court in a position where it can read the will as the testator would have read it. This principle is reflected in s 28A of the Act.
>
> 33 In so far as there is property, which is the subject of the will, the will takes effect as at the date of the testator's death. This is reflected in s 26(1)(a) of the Act. As a result, while the meaning of the words in the will do not change, because of events that have occurred after execution of the will, the words used may denote different property. That is, 'the words have a fixed connotation but their denotation may differ from time to time'.
>
> 34 In construing the words used, the court must recognise that what is being construed is a gift. The question to be asked is 'what is the thing (if any) that the testator, by the words used in the Will, expressed an intention to give?'.
>
> 35 The language in the will must be read in the sense that the testator appears to have attached to the expressions used. It should not be construed in a strictly technical or legalistic sense but be sensitive to the factual context, ordinary life and circumstances.
>
> 36 Where property that is the subject of disposition is void or fails to take effect, this property is to be included in any residuary disposition which is contained in the will." (footnotes omitted)

Doctrine of ademption

Under a legal doctrine known as "ademption", if the subject-matter of a gift in a will ceases to exist as part of the willmaker's personal property at the time of their death, the gift will fail. Ademption of a specific gift occurs where the property the subject of the gift is no longer property of the testator to dispose of as at the date of their death.[5] A common example of this would be where a willmaker leaves a specific gift of an asset, such as a motor vehicle, to a nominated beneficiary in a will and has sold it by the time of death.

Ademption can also occur where property has substantially changed at the time of the death of a willmaker from how it is described in their will. However, there are a number of exceptions that may apply to avoid ademption.

One exception is where continuing partners agree to continue a business under the same partnership name each time a new partnership is formed. Therefore, in *Kuenen*, one of the exceptions to ademption applied to save the gift to the existing partners Robert and Zak, being that the subject-matter of the gift had changed in form only but was substantially the same thing.

Hill J stated that the partnership was not to be considered as at the time of making the will, but rather the gift was "variable and ambulatory". For example:[6]

> "72 … Where a person in trade makes provision out of his share for his family, and afterwards renews the partnership, by which perhaps his interest is varied, yet it is not a revocation; if it was, it would occasion great confusion."

Construction of the will

With respect to the construction of the relevant clause in Leslie's will, Hill J stated:

> "63 In my view, Leslie's intention in cl 2.3 of the Will is clear. By using the expression 'the partnership known as FV Hortin & Sons', Leslie intended to give his interest in the family partnership that carried on the farming business to his surviving partners. This is the only asset to which the expression used in the Will by Leslie could apply."

Ultimately having found that the partnership had only been notionally dissolved by operation of the *Partnership Act 1895* (but not actually dissolved), that the doctrine of ademption did not apply, and that Leslie had intended his interest in the partnership to refer to any interest that he held in it at his death, the gift to the surviving partners was upheld.

The lesson for willmakers and their lawyers is to carefully consider the intention with respect to a gift of a partnership interest where the members of the partnership (and therefore the precise interest) may change over time. Careful will drafting is important, as is the need to review one's will from time to time to ensure that the intention is accurately reflected and concerns as to ademption on a dissolution are addressed.

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References

1 See, for example, s 1 of the *Partnership Act 1892* (NSW).

2 See s 44 of the *Partnership Act 1895* (WA); s 36 of the *Partnership Act 1891* (Qld); s 37 of the *Partnership Act 1958* (Vic); s 33 of the *Partnership Act 1891* (SA); s 33 of the *Partnership Act 1892* (NSW); s 37 of the *Partnership Act 1997* (NT); s 38 of the *Partnership Act 1963* (ACT).

3 [2024] WASC 152.

4 [2019] WASCA 107.

5 *Brown v Heffer* [1967] HCA 40 at [5].

6 Hill J citing *Backwell v Child* [1755] EngR 149.

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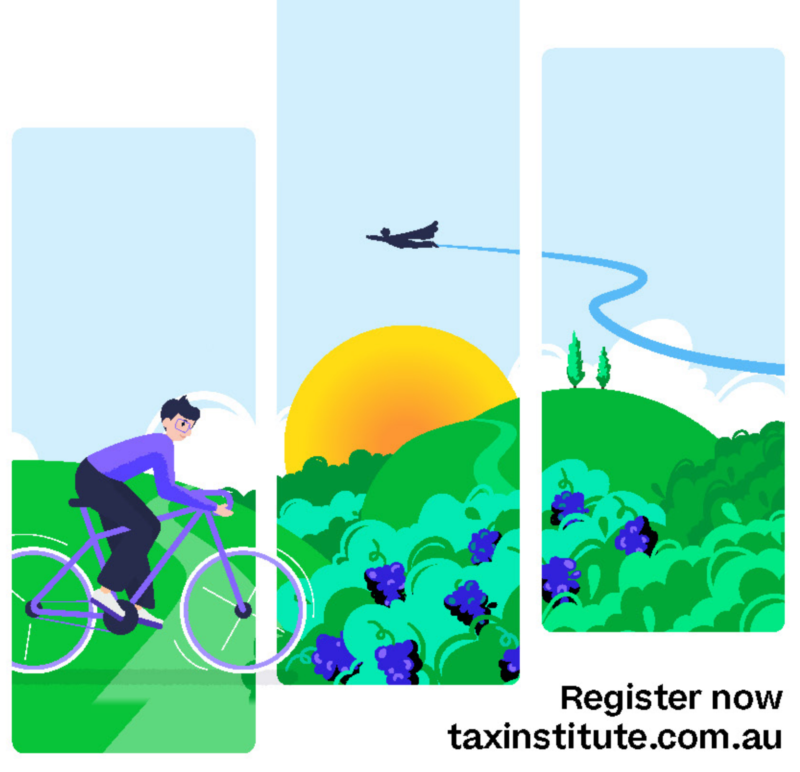

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18–19
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JULY
25–26
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NSW

State Taxes Convention

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AUGUST
1–2
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WA

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Wed–Fri

SA

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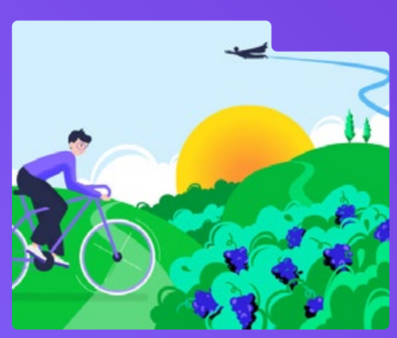

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Giving back to the profession

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