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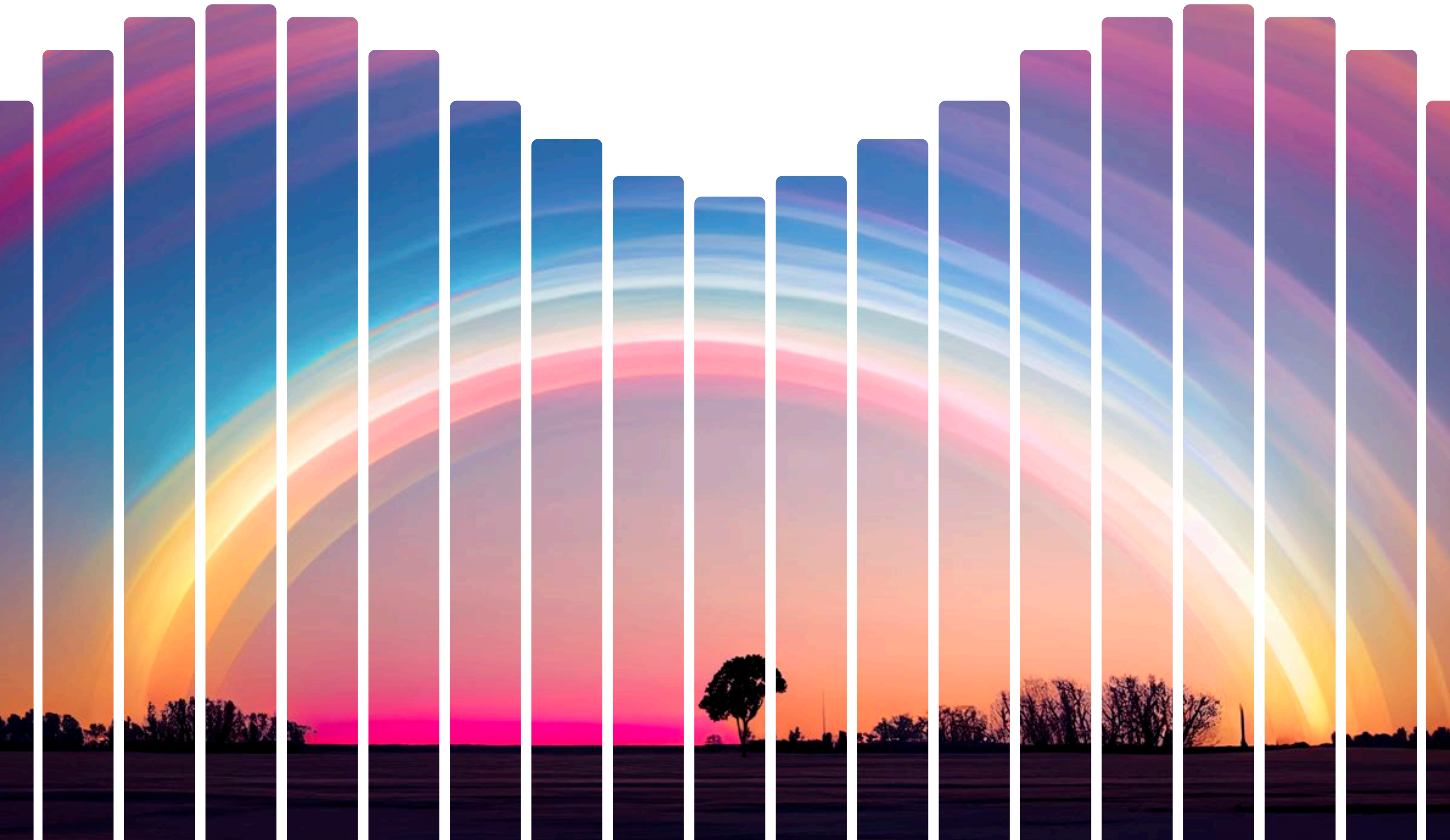
The Tax Institute

Taxation *in* Australia

The evolving landscape of tax practitioner obligations
Robyn Jacobson, CTA

Donations to charities: tax deduction reform
Fiona Martin, CTA



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We welcome original contributions that are of interest to tax professionals, lawyers, academics and students.

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Tax News – at a glance

by TaxCounsel Pty Ltd

July – what happened in tax?

The following points highlight important federal tax developments that occurred during July 2024. A selection of the developments is considered in more detail in the "Tax News – the details" column on page 50 (at the item number indicated).

New Inspector-General

In a media release on 21 June 2024, the Assistant Treasurer announced that Ms Ruth Owen CBE had been appointed as the Inspector-General of Taxation for a five-year period commencing on 15 July 2024. **See item 1.**

Car expenses: cents per kilometre rate

The Commissioner has released a legislative instrument that sets the rate at which work-related car expense deductions may be claimed in the 2024–25 income year when using the cents per kilometre method (LI 2024/19). **See item 2.**

Reasonable travel and overtime meal allowances

The Commissioner has released a determination that sets out the amounts that he considers are reasonable (reasonable amounts) for the substantiation exception in Subdiv 900-B of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) for the 2024–25 income year (TD 2024/3). **See item 3.**

Disqualified entities

The Tax Practitioners Board has finalised information sheets on the new obligations under the Code of Professional Conduct relating to disqualified entities that have applied since 1 January 2024. **See item 4.**

Challenge to asset betterment assessments fails

The Federal Court (Perry J) has dismissed an appeal by a taxpayer from a decision of the AAT in relation to default income tax assessments (including administrative penalties for failure to lodge documents) that were raised by the Commissioner on an asset betterment basis for the 2014, 2015 and 2016 income years (*Wang v FCT* [2024] FCA 585). **See item 5.**

Hardship relief denied

The AAT has recently dismissed a taxpayer's application for release under Div 340 of Sch 1 to the *Taxation Administration Act 1953* (Cth) from his tax liabilities on the grounds of serious hardship (*Doery and FCT* [2024] AATA 1493). **See item 6.**

Funds transferred from overseas assessable income

The AAT has affirmed a decision of the Commissioner to disallow a taxpayer's objection against assessments that had been made on the basis that four amounts received by the taxpayer from the United Arab Emirates in the 2018–19 and the 2019–20 income years were assessable income (*Youssef Said Abdelbari* [2024] AATA 1978). **See item 7.**

"Associates"

In a recent decision, the Federal Court (Logan J) considered some aspects of the definition of "associates" in s 318 of the *Income Tax Assessment Act 1936* (Cth) (ITAA36) which is relevant to a number of provisions of the ITAA36 (for example, Div 7A) and the ITAAA97 (*Ierna v FCT* [2024] FCA 592). **See item 8.**

CGT improvement threshold

The CGT improvement threshold for the 2024–25 income year is $182,665.

Arm's length

The Federal Court and the AAT have each considered the operation of the CGT arm's length market value substitution rule that applies for the purpose of determining the capital proceeds from a CGT event (*Moloney and FCT* [2024] AATA 1483; *Kilgour v FCT* [2024] FCA 687). These decisions are considered in the Tax Tips column of this issue of the journal (at page 55).

Dividend stripping

The Full Federal Court (Bromwich, Thawley and Hespe JJ) has recently considered the concept of a scheme that is by way of, or in the nature of, dividend stripping or a scheme that has substantially the effect of such a scheme in the context of s 207-155 ITAA97 which forms part of Subdiv 207-F ITAA97 (*FCT v Michael John Hayes Trading Pty Ltd as trustee of the MJH Trading Trust* [2024] FCAFC 80).

President's Report

by Todd Want, CTA

The Tax Summit: a sweeping technical program

President Todd Want on the in-depth and forward-looking technical program coming up at The Tax Summit.

Next month, The Tax Summit, the biggest event in our CPD calendar, kicks off at the ICC in Sydney.

Our theme this year is "Frame the future". It reflects the importance of tax practitioners being active and engaged in the process of defining and refining our tax system and the way we work with it.

Across three days, The Tax Summit technical program spans the latest issues impacting SMEs, corporates, ethics, property, trusts and many other domestic and international tax topics, with a particular focus on practical takeaways and real-world applications of various tax ideas. This practical focus is vitally important to me, and it is a big part of why CPD events at the Institute are so highly regarded and valuable to our attendees. I can be almost certain that you will walk away from The Tax Sumit with at least one (and probably plenty more) actionable insight that will make a true impact in your role or for your clients.

The program is designed to cater to all those working within the tax profession. There are nine specialised streams to choose from, as well as a line-up of excellent keynote speakers, which means you can make the event your own. I encourage you to do so, and to tailor your experience to get the very best value out of your attendance. For those attending with a whole team, a "divide and conquer" strategy may be best to ensure that you make the most of all parts of the program! Of course, you will also have access to all session recordings for six months post-Tax Summit, so if you simply can't decide between two concurrent sessions, the good news is, you don't have to.

We'll be delving into topical issues, such as "The TPB and professional obligations" (session 13.3), "Debt deduction creation rules" (session 14.3), and "ATO rulings in 2024 – Do they give the certainty you are looking for" (session 17.3, featuring Fiona Dillon, CTA, from the ATO as a star witness, so to speak).

True to the theme, the program also looks at what's next for tax practitioners and the tax system as a whole. We work in a constantly shifting environment of guidance and legislation, which necessitates clear-eyed and regular analysis of recent developments that may impact us and our clients. The program covers topics such as, "Crypto issues – They lost money but there is assessable income to report" (session 18.2), "Give me instructions that fit the facts – What will the issues be before the AAT" (session 6.2), and "Is super still a good investment fit for retirement" (session 18.1).

Our sincere thanks go out to my fellow organising committee members who worked tirelessly to put this program together, including Sandra Farhat, EY, Daniel Smedley, CTA, Sladen Legal, Loreena Gillon, CTA, Arithmos Chartered Accountants, Chris Wallis, CTA, Victorian Bar, Leo Efthivoulou, CTA, ENA Law, and Annemarie Wilmore, Johnson Winter Slattery.

The Tax Summit is an annual gathering of the best minds in tax, working together to shape tomorrow. I look forward to seeing you there.

CEO's Report

by Scott Treatt, CTA

A meeting of the minds at The Tax Summit

CEO Scott Treatt reflects on the importance of The Tax Summit for our tax community.

As you no doubt are aware, our annual flagship event, The Tax Summit, is just around the corner! This is always an exciting time at the Institute and our team of volunteers and staff are buzzing as we put the finishing touches on what is set to be a world-class event experience.

The Tax Summit's role for our community goes beyond a standard CPD event. All of our events are valuable in their own way – whether it be their robust and tailored technical programs or their opportunities for connecting to your network of peers and experts.

In his report, Todd has commented on the technical value of The Tax Summit's program this year, so I won't dwell on that side of things except to say that I'm incredibly proud of the depth and breadth of expertise being showcased, not just as the CEO of the Institute and a leader of those who arranged it, but as a tax professional myself. It's an incredible showcase of all that our profession does and touches.

Instead, I'd like to reflect on the experience of attending The Tax Summit, now in its fifth year and the fourth time we have held it in-person.

On paper, The Tax Summit is a CPD event, just on a grander scale. More sessions, more streams, more experts and more potential connections to be made.

For those who have attended The Tax Summit, you will know that, in reality, it's something different. There's a palpable electricity in the air when you gather such a large group of enthusiastic professionals together to discuss, debate and discover topics they're passionate about.

As the biggest event of its kind in the southern hemisphere, The Tax Summit really is a meeting of the minds for Australia's tax professionals. Nowhere else are you more likely to meet a new face, make a connection, open a door that propels your career forward. This is the true value of The Tax Summit, above and beyond the tax technical.

And, of course, it wouldn't be The Tax Summit without the gala dinner. We all love to dress up and let our hair down while connecting with colleagues old and new, and the gala dinner is a wonderful opportunity to do so. Tax people aren't just about boring suits and practical heels – now's our chance to prove it!

For those of you leading teams, I could not recommend bringing your team along more highly. This is the kind of valuable experience in networking, communication and navigating professional spaces that young team members can benefit from greatly. It's also an opportunity to build strong ties between team members and, of course, pick up new tax technical ideas and information that may assist your clients.

This year, we return to the ICC in Sydney. I am greatly looking forward to seeing you all there, connecting and reconnecting with practitioners from around the country.

If there's one event in the year you attend, The Tax Summit should be it – for more than just the excellent tax technical program on offer.

Senior Counsel – Tax & Legal's Report

by Julie Abdalla, FTI

Tax practitioner code of conduct

We examine the latest change in the ever-shifting obligations of tax and BAS agents, and the need for an ongoing constructive working relationship in the design of future law changes.

On 2 July 2024, the Tax Agent Services (Code of Professional Conduct) Determination 2024 (the Determination) was registered. The Determination amends the Code of Professional Conduct (the Code) in s 30-10 of the *Tax Agent Services Act 2009* (Cth) (TASA) under a new legislative power that enables the Minister to determine additional obligations to supplement the Code to ensure that tax agent services are provided to the community in accordance with the high professional and ethical standards expected of tax practitioners. This includes changes to the Code intended to ensure that the public has confidence in the profession and the broader tax and superannuation system. The Determination follows an earlier exposure draft released for consultation on 10 December 2023. The Tax Institute, in conjunction with other leading professional organisations (the Joint Bodies), made a joint submission concerning the exposure draft.

Noting the importance of the objectives of the Determination, the joint submission highlighted aspects of the exposure draft that may have an unintended or disproportionate impact on tax and BAS agents (tax practitioners). The Tax Institute supports reforms that enhance integrity but this should not come at the cost of unreasonable compliance burdens. While some key changes have been made to the Determination to address the feedback of the Joint Bodies, much of our serious concerns with the Determination remain.

Further guidance required

Despite some improvements to the Determination, the accompanying explanatory statement does not provide the necessary clarity and certainty, and tax practitioners still need further guidance from the Tax Practitioners Board (TPB) to help them understand the scope of their new obligations. This includes guidance on:

- how tax practitioners can take reasonable steps to ensure that staff who provide tax agent services on their behalf are appropriately trained;
- what systems or processes are needed to ensure that a sufficient quality management system is in place to satisfy tax practitioners that they are meeting their obligations under the Code; and
- what is necessary for a piece of information to satisfy the threshold of "any matter that could significantly influence" their client's decision to retain their services.

Like the breach reporting rules introduced by Sch 3 to the *Treasury Laws Amendment (2023 Measures No. 1) Act 2023* (Cth), the Determination imposes new obligations on tax practitioners who will be challenged by how to apply the rules in practice. Section 45 of the Determination requires tax practitioners to notify their current and prospective clients of "any" matter that could significantly influence a client's decision to engage the practitioner. The words "any matter" raise understandable interpretive concerns about what matters are pertinent to their clients' engagement decisions and to what extent, if any, personal and sensitive commercial matters can be pragmatically and sensibly treated as being out of scope by the TPB.

The Determination, as a form of delegated legislation, must be specific and clearly outline the responsibilities to ensure that practitioners can understand and comply with it. The delegated legislation must adhere to the parameters set out in s 30-12 TASA and should not exceed its authority. The Tax Institute is of the view that the Determination may overstep its boundaries in relation to s 45 by failing to take into account the implications of privacy laws, human rights and anti-discrimination laws. On this ground, the Determination should be retracted, reviewed, consulted on and re-introduced.

Given the Determination is law (subject to any parliamentary motion to disallow), tax practitioners need clear written guidance from the TPB on how the regulator will administer it, before the new obligations take effect. We had requested the government to defer the commencement date by at least six months. We welcome the Minister's response on 31 July 2024 to our previous request to defer the commencement date to 1 January 2025/1 July 2025 depending on the size of the firm (more information about this can be found in the cover article in this month's journal).

Final thoughts

The landscape impacting tax practitioner obligations continues to evolve as the government announces even more policy reforms to further strengthen the regulatory framework of the tax profession. It is important for the profession, in conjunction with the professional associations, to work closely with the government, the Treasury, the ATO and the TPB to ensure that the regulatory regime is future-proofed and balanced. The regime should not be subject to knee-jerk reactions that fall short of recognising that the vast majority of the profession does the right thing, the vast majority of the time.

Tax News – the details

by TaxCounsel Pty Ltd

July – what happened in tax?

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

Government initiatives

1. New Inspector-General

In a media release on 21 June 2024, the Assistant Treasurer announced that Ms Ruth Owen CBE had been appointed as the Inspector-General of Taxation for a five-year period commencing on 15 July 2024.

The Assistant Treasurer said that Ms Owen brings a wealth of experience in tax, public sector reform, complaints management and dispute resolution, having spent more than 30 years in various senior leadership positions across the public sector in Australia and the UK.

Ms Owen has previously been a Director General and Tax Commissioner of His Majesty's Revenue and Customs in the UK, Head of Profession in the UK Civil Service, and Deputy Secretary of the New South Wales Department of Education. She is currently Deputy Secretary of the NSW Premier's Department, leading the Strategic Implementation Group.

The Assistant Treasurer also said that Ms Owen's extensive experience will strengthen the important role the Office of the Inspector-General of Taxation and Taxation Ombudsman plays in providing independent oversight and investigation of the ATO and the Tax Practitioners Board's administrative practices.

The Commissioner's perspective

2. Car expenses: cents per kilometre rate

The Commissioner has released a legislative instrument that sets the rate at which work-related car expense deductions may be claimed in the 2024–25 income year when using the cents per kilometre method (LI 2024/19).

The Commissioner has determined the rate to be 88 cents per kilometre for the 2024–25 income year and subsequent income years, until such time as LI 2024/19 is repealed or varied. The previous rate was 85 cents per kilometre.

LI 2024/19 was developed to ensure that the rate for claiming work-related car expense deductions using the cents per kilometre method is updated to reflect recent average operating costs for cars. The update of the rate reflects the annual movement of the Private Motoring Subgroup of the consumer price index, rounded to the nearest whole cent within the year.

3. Reasonable travel and overtime meal allowances

The Commissioner has released a determination that sets out the amounts that he considers are reasonable (reasonable amounts) for the substantiation exception in Subdiv 900-B of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) for the 2024–25 income year (TD 2024/3).

TD 2024/3 relates to claims made by employees in the 2024–25 income year for:

- overtime meal expenses: for food and drink when working overtime;
- domestic travel expenses: for accommodation, food and drink, and incidentals when travelling away from home overnight for work (particular reasonable amounts are given for employee truck drivers, office holders covered by the Remuneration Tribunal, and federal members of parliament); and
- overseas travel expenses: for food and drink, and incidentals when travelling overseas for work.

The approach outlined in TD 2024/3 can only be used where the taxpayer receives an allowance to cover the particular expenses that they are claiming, for example, the taxpayer received an accommodation allowance and is claiming accommodation expenses.

The reasonable amounts only provide the maximum amount that can claimed by a taxpayer without being required to substantiate the expenditure. If a taxpayer relies on the reasonable amounts and the ATO checks the taxpayer's income tax return, the taxpayer will still be required to show:

- that the taxpayer spent the money when performing their work duties (for example, when travelling away from home overnight on a work trip);
- how the claim was worked out (for example, a diary was kept);
- that the money was spent by the taxpayer (for example, using a credit card statement or other banking records) and was not reimbursed (for example, a letter from the employer); and
- that the allowance was correctly declared as income.

4. Disqualified entities

The Tax Practitioners Board (TPB) has finalised information sheets on the new obligations under the Code of Professional Conduct relating to disqualified entities that have applied since 1 January 2024.

One of the information sheets (TPB(I) 41/2024) explains the obligations of registered tax practitioners under Code item 15 of the *Tax Agent Services Act 2009* (Cth) (TASA09) in respect of employing or otherwise using a disqualified entity to provide tax agent services on their behalf. Code item 15 states that registered tax practitioners must not knowingly employ or use the services of a disqualified entity to provide tax agent services on their behalf, unless approved by the TPB.

The other information sheet (TPB(I) 42/2024) explains the obligations of registered tax practitioners under Code item 16 in respect of their arrangements with a disqualified entity. Code item 16 states that registered tax practitioners must not enter an arrangement with an entity that they know, or ought reasonably to know, is a disqualified entity.

The expression "disqualified entity" is defined (in s 45-5(2) TASA09) as an entity that is neither a registered tax agent or BAS agent, nor a qualified tax-relevant provider, and that, within the last five years (inter alia):

- has been convicted of a serious tax offence, a serious offence or an offence involving fraud or dishonesty;
- has been penalised for being a promoter of a tax exploitation scheme;
- has had action taken against it under s 30-15(2) TASA09 (sanctions for failure to comply with the Code of Professional Conduct);
- has had its registration terminated under Subdiv 40-A TASA09 (for example, for ceasing to meet a practitioner registration requirement);
- has had an application for registration or renewal of registration rejected (other than on the basis of qualifications and experience); or
- has been found by the TPB after an investigation, or by a court, to have contravened the TASA09.

Recent case decisions

5. Challenge to asset betterment assessments fails

The Federal Court (Perry J) has dismissed an appeal by a taxpayer from a decision of the AAT in relation to default income tax assessments (including administrative penalties for failure to lodge documents) that were raised by the Commissioner on an asset betterment basis for the 2014, 2015 and 2016 income years (the relevant income years) (*Wang v FCT*[1]).

The taxpayer was a Chinese immigrant who became an Australian citizen in June 2009. It was common ground that the taxpayer was an Australian tax resident for the relevant income years. The taxpayer did not lodge any income tax returns for the relevant income years because he claimed that it was unnecessary for him to do so in circumstances where he had not derived any income. The tax payable under the default assessments was $6,283,493 and the penalties totalled $5,194,995.

An audit was conducted by the Commissioner of the taxpayer's financial affairs for the relevant income years which concluded in January 2020. The ATO position paper indicated that the taxpayer held more than 25 Australian bank accounts in his name and/or as a joint holder with his former girlfriend, Ms Lin. He was also a signatory of multiple accounts in other names, including of various companies.

For the purposes of applying the asset betterment method, the Commissioner used the income year ending 30 June 2013 as the starting base income year. The Commissioner did not consider that the various documents produced by the taxpayer explained his version of events.

It was not in issue that the taxpayer had purchased and sold properties in South Australia and Queensland before and during the relevant income years, and had obtained investment loans from Australian banks for those purchases. The AAT found that the loan application forms revealed, among other things, that the taxpayer claimed he would earn rental income from the properties being purchased.

It was also not in issue that the taxpayer was involved in a proposed business venture through the company Whitsunday Chinatown Investment Pty Ltd of which he was a director and shareholder. The AAT found that, as at 12 May 2014, the company had paid-up share capital of $4m. In 2014, the company purchased council land at Airlie Beach, Queensland, for the sum of $785,789, with a view to developing an area to be known as Airlie Beach Chinatown. The major attraction of the development was to be a high-rise casino resort complex, with an approximate development value of $300m. However, the project did not proceed due to objections from residents. The AAT found that the precise amount invested by the taxpayer in the proposed business venture and the company was "unclear", although the Commissioner was "understandably" of the view that the applicant was heavily involved.

The taxpayer was also a director and shareholder of approximately 15 other Australian private companies, which had been deregistered save for two companies. The AAT found that "it wasn't clear what those companies were involved in, nor for that matter did [the taxpayer] explain the past activities of all the other deregistered companies as well as his involvement".

The AAT also found, according to information provided by Australian casinos of which the taxpayer was a member, that his gambling activities produced a "total player loss" in the order of approximately $2.3m in the relevant income years.

The AAT concluded that the taxpayer had provided no meaningful explanation to support his assertion that, during the relevant income years, he was self-funded using his own accumulated wealth in China and loans from third parties in China. The taxpayer did not provide sufficiently reliable evidence to corroborate his claims.

Further, the AAT held that the taxpayer had failed to discharge his onus of proof by his attempts to pick and choose his way through the asset betterment methodology and to seek to prove that particular items were incorrect or should not have been included.

In dismissing the taxpayer's appeal to the Federal Court, Perry J said that the taxpayer's argument rose no higher than bare assertion and was directly contrary to the well-established principles that require a taxpayer to positively prove their actual taxable income when seeking to establish that a default assessment based on the asset betterment method of calculation is excessive.

One contention of the taxpayer on the appeal was that, although he had the burden of proving that the assessment was excessive or otherwise incorrect and what the assessment should have been, if he could prove that there were errors in the default assessment and could prove the dollar value of those errors, it would follow that the default assessment should be reduced to that extent and the authorities to the contrary were wrongly decided. Perry J rejected the taxpayer's contention.

Further, the taxpayer's submission that, where there were errors, the default assessments may be arbitrary and capricious was based on a misapprehension as to the nature of the statutory onus. It also misapprehended the nature of a default assessment achieved by using the asset betterment method and conflated the different kinds of assessment undertaken under ss 166 and 167 of the *Income Tax Assessment Act 1936* (Cth) (ITAA36). Whereas the former involved a calculation based on evidence as to taxable income, as the Full Court also held in *Gashi v FCT*:[2]

> "55. The asset betterment method, and the resulting assessment, is necessarily a guess to some extent and 'almost certainly inaccurate in fact' … It is therefore 'no part of the duty of the commissioner to establish affirmatively what judgement he formed [under s 167 of the 1936 Act], much less the grounds of it, and even less still the truth of the facts affording the grounds' …"

6. Hardship relief denied

The AAT has recently dismissed a taxpayer's application for release under Div 340 of Sch 1 to the *Taxation Administration Act 1953* (Cth) from his tax liabilities on the grounds of serious hardship (*Doery and FCT*[3]).

The applicant was a 55-year-old man who was a sole trader in the construction industry. He was currently unemployed and in receipt of Centrelink benefits on account of mental health issues. He had not worked for many years. He was not actively having treatment at this time. He currently lived in shared accommodation and had no other income apart from welfare benefits. He had no assets. The evidence revealed that his expenses were such that he had $15 per week in surplus.

The applicant did not contest the amount of the tax liabilities claimed by the Commissioner. He testified that his tax returns were completed by an accountant. He was unhappy with his first accountant and then sourced another. He testified that he was informed that he would have a tax debt, but also admitted that he knew that he had an obligation to pay taxes on the sale of properties that he bought and developed. The applicant also admitted that he lodged his tax returns late, testifying that time had got away from him. He was overwhelmed with health and financial issues. He indicated an appreciation between eligible debts and ineligible debts, maintaining that he understood that the GST could not be released under the hardship provisions but requested that the balance of the tax debt attract such relief.

The AAT said that it was clear from the authorities that, when assessing whether "serious hardship" has been established, consideration must be given to whether the taxpayer, if required to pay the tax liabilities, would experience financial difficulties which are serious but not necessarily at the level of causing destitution.

Having regard to the evidence, the AAT found that the applicant would suffer serious hardship if he were required to meet his tax liabilities within the meaning of the relevant statutory provisions. The evidence suggested that his income was limited and he had no assets. The tax liabilities were significant. However, the AAT said that the assessment did not stop there. What was required was an assessment of whether the discretionary power to release the applicant from his tax liabilities should be enlivened.

In declining to answer this discretion in the applicant's favour, the AAT said that the applicant was the author of his own financial misfortune. He engaged in imprudent expenditure, with no regard to his tax obligations. While his motivations appeared to have been well intentioned, that is, he had to "spend money to make money", he engaged in a pattern of spending which failed to prioritise his accumulated tax liabilities. His failure to promptly file his returns and contact the Commissioner to engage in some form of payment arrangement were all factors that had contributed to the liability. The AAT said that it had not ignored the mental health issues raised by the applicant. However, the medical evidence did not suggest that the applicant was incapable of making decisions or managing money and, even if it did, his activities of daily living would indicate otherwise.

The applicant maintained that much of the funds were spent during the COVID-19 pandemic on basic living expenses. The AAT said that it could not accept this given that he was in receipt of Centrelink benefits for the vast majority of that period. The absence of bank statements and a detailed picture of his spending did not assist the applicant. Also, it could not be ignored that the applicant was given ample opportunity to provide these documents. Further, there was no evidence that the applicant incurred extraordinary expenses as a result of his mental health situation or otherwise. His claimed expenses (that had been disclosed and verified) were largely on par with other citizens who also had to endure the unforeseen consequences of the pandemic.

For these reasons, the AAT concluded that there was no basis on which it would be appropriate to exercise the discretionary power to release the applicant from his tax liabilities.

7. Funds transferred from overseas assessable income

The AAT has affirmed a decision of the Commissioner to disallow a taxpayer's objection against assessments that had been made on the basis that four amounts received by the taxpayer from the United Arab Emirates (UAE) in the 2018–19 and the 2019–20 income years (the relevant income years) were assessable income (*Youssef Said Abdelbari*[4]).

On 22 September 2017, the taxpayer emigrated to Australia and became a resident for income tax purposes. Prior to 22 September 2017, the taxpayer lived and worked in the UAE. While there, the taxpayer was a partner in Delma Laboratory for Soil & Construction Materials Inspection LLC (Delma Laboratory), in which he held a 49% share. On 5 August 2017, the Abu Dhabi Business Center had issued a commercial license for Delma Laboratory. The taxpayer was listed as a named partner.

On 20 August 2017, in anticipation of his move to Australia, the taxpayer appointed his son, Yousif, as his special power of attorney in respect of his share in Delma Laboratory. On 9 May 2018, Yousif, in his capacity as the taxpayer's special power of attorney, transferred the taxpayer's 49% share in Delma Laboratory to himself for no consideration.

During the relevant income years, the taxpayer received four amounts totalling $A232,506 via international transfers. The payer of three of the four transfers was Delma Laboratory (made on 16 January 2019, 6 March 2019 and 23 July 2019) and the description of these transfers was "payment of salary". The fourth transfer was made on 5 February 2020 by Yousef and had the description "family support". This information about the transfers was contained in a report produced by the Australian Transaction Reports and Analysis Centre (AUSTRAC). There were numerous other transfers reported in the AUSTRAC report, both prior to and after the relevant income years. For example, after the relevant income years, there were further transfers made by Yousif to the taxpayer on 6 July 2020, 27 August 2020 and 17 November 2020 for the amounts of $A78,016, $A75,398 and $A37,070, respectively, each described as being "family needs".

The taxpayer's position was that all four transfers made to him in the relevant income years, regardless of their description, constituted loans from Yousif. Following the completion of an audit, the Commissioner issued an amended assessment for each of the relevant income years on the basis that the transfers were assessable foreign source income subject to income tax.

In disallowing the taxpayer's objections, the Commissioner took the view that he was not satisfied that the arrangement between the taxpayer and Yousif were genuine loans and that the first three transfers (which were from Delma Laboratory) were in connection with the taxpayer's income-producing activities and were therefore assessable as ordinary income. The Commissioner took the view that the fourth transfer was to be treated similarly but also stated that:

> "30. … 'Yousif is a third party to your partnership at Delma Laboratory, has the authority to conduct the business of Delma Laboratory and make decisions affecting the operation of the business on your behalf'."

The AAT held that the overall lack of independent evidence produced by the taxpayer meant that he had failed to discharge his onus of proof with regard to the existence of a loan from Yousif to him representing the four transfers. The AAT said that the taxpayer had failed to persuade it of the existence of a loan between him and his son. The taxpayer's evidence was not reliable and, therefore, could not be accepted. Moreover, the documentary evidence produced by the taxpayer had various deficiencies and did not, in any event, advance his case in proving the existence of a loan. The documentary evidence was all done after the event "for the case".

The AAT also said that, if it were necessary to decide the character of the payments, the four transfers to the taxpayer were income according to ordinary concepts because they were periodic payments in the nature of maintenance payments, as discussed in *FCT v Dixon*.[5] Applying the decision in *Dixon*, it would not matter whether the payments were related to the taxpayer's income-producing activities with Delma Laboratory or indeed whether or not they were made by Delma Laboratory, such as deferred employment income. This was because the taxpayer depended on the regular transfers for himself and his dependants, and the payments were paid to him to support him and his family in their transition from Abu Dhabi to Sydney. Therefore, the transfers had the character of income according to ordinary concepts.

8. "Associates"

In a recent decision, the Federal Court (Logan J) considered some aspects of the definition of "associates" in s 318 ITAA36 which is relevant to a number of provisions of the ITAA36 (for example, Div 7A) and the ITAA97 (*Ierna v FCT*[6]).

The definition of "associates" is relevant not only for the purposes of the ITAA36, but also for the purposes of provisions of the ITAA97, the *Fringe Benefits Tax Assessment Act 1986* (Cth) and the *A New Tax System (Goods and Services Tax) Act 1999* (Cth).

So far as is relevant for present purposes, the definition of "associate" includes, as an associate of a natural person (the primary entity), of a company (also the primary entity) or of a trustee (also the primary entity), a trustee of a trust where the primary entity benefits under the trust (s 318(1)(d) and (2)(c) ITAA36). The associates of a trustee include any entity that benefits under the trust (s 318(3)(a) ITAA36).

Logan J, after pointing out that s 318 ITAA36 specifies how entities, be they individual or corporate, become "associates" of a "primary entity", said that the point was made for the taxpayers that a trust has no separate legal personality. His Honour went on:

> "183. … This is fundamental. A 'trust' may be described as obligations, enforceable in a court of equity, assumed by a person having legal personality in respect of property or income (or both). The absence of legal personality of a trust is so even though, for the purposes of income taxation, the net income of a trust estate is treated as if a trust did have legal personality separate from the person who was subject to the relevant trust obligation. From this,

> it was said to follow that, although a trustee, individual or corporate, of a trust may, under s 318, be such an 'associate', the same would not be true for a trust itself."

Logan J said that the Commissioner's riposte was that, in construing s 318, a rule of necessity operated such that the role of "associate" was attached to the trustee of the trust in its capacity as such. This was said to arise by implication such that, materially, the "profit" of a trust was to be regarded as the profit of its trustee. His Honour then said:

> "185. A difficulty with any such implication is that the text of s 318 draws a distinction between a trustee of a trust and the trust: see s 318(2)(c). Moreover, and further to develop a point earlier made as to the taxation of trusts, the ITAA 1936, by s 96, expressly provides that, 'Except as provided in this Act, a trustee shall not be liable as trustee to pay income tax upon the income of the trust estate.' The presence of that expressly stated general position, and the exception to it, suggests that it is unlikely that an exception was intended to arise by implication. As it happens, there are other reasons, flowing from the circumstances of this case, why s 45B [ITAA36] had no application. So, the case can be decided by assuming that the Commissioner's construction is correct. I do, however, record my preference, for the reasons just given, for the construction promoted by the applicants."

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References

1 [2024] FCA 585.
2 [2013] FCAFC 30.
3 [2024] AATA 1493.
4 [2024] AATA 1978.
5 [1952] HCA 65.
6 [2024] FCA 592.

Tax Tips

by TaxCounsel Pty Ltd

Arm's length issues

The CGT capital proceeds arm's length market value substitution rule has been recently considered by the Federal Court and the AAT.

Background

For the purposes of CGT, the *Income Tax Assessment Act 1997* (Cth) (ITAA97) contains provisions that are aimed at preventing a tax advantage from being obtained as a result of the parties to a contract, or other agreement, attributing a value to an asset (including an asset that is created) that exceeds or is less than the market value of the asset.[1]

The basic situation that attracts the operation of these CGT provisions is where the entities involved in the transaction did not deal with each other at arm's length in connection with the transaction.

In recent decisions, the Federal Court and the AAT have each considered the operation of the CGT arm's length market value substitution rule that applies for the purposes of determining the capital proceeds from a CGT event where the parties to a disposal and an acquisition of an asset did not deal with each other at arm's length. The Federal Court decision is *Kilgour v FCT*[2] which was handed down on 26 June 2024, and the AAT decision is *Moloney and FCT*[3] which was handed down on 7 June 2024.

This article considers the views expressed in these decisions. It should be kept in mind that, as indicated, the AAT decision was the first to be handed down.

The relevant CGT provision

The CGT provision that is particularly relevant for this article is s 116-30(2) ITAA97 which provides as follows:

> "**116-30 Market value substitution rule: modification 1**
>
> …
>
> There are capital proceeds
>
> (2) The capital proceeds from a CGT event are replaced with the market value of the CGT asset that is the subject of the event if:
>
> (a) some or all of those proceeds cannot be valued; or
>
> (b) those capital proceeds are more or less than the market value of the asset and:
>
> (i) you and the entity that acquired the asset from you did *not* deal with each other at arm's length in connection with the event; or
>
> (ii) the CGT event is CGT event C2 (about cancellation, surrender and similar endings).
>
> (The market value is worked out as at the time of the event.)
>
> …"

For the purposes of subpara (2)(b)(i), "arm's length" is defined in the ITAA97 Dictionary, which relevantly provides (s 995-1(1)):

> "***arm's length***: in determining whether parties deal at ***arm's length***, consider any connection between them and any other relevant circumstance."

It should be noted that, where a CGT asset is acquired from another entity, there is a corresponding cost base and reduced cost base modification in relation to the first element of the cost base and reduced cost base of the CGT asset (s 112-20 ITAA97).

Federal Court decision

The *Kilgour* case concerned a CGT controversy that arose out of the sale of all of the shares in Punters Paradise Pty Ltd (Punters) to the Australian incorporated News Corp Australia Investments Pty Ltd (News Corp Investments) pursuant to a written share sale agreement dated 4 October 2016. News Corp Investments was part of an Australian group the ultimate holding company of which was News Corporation (News Corp) which was incorporated in the US and had its principal office in New York.

As at 4 October 2016, Punters had 120,000 issued ordinary shares which were held by three companies (the vendor shareholders), each in its capacity as the trustee of a trust in the percentages 60%, 20% and 20%. Pursuant to the share sale agreement, the vendor shareholders received the sum of $31,057,722 in respect of the disposal of the whole of the shares in Punters.

The underlying taxable facts concerning the business conducted by Punters prior to the share sale agreement, the negotiations which preceded that agreement, and the making of that agreement were not, in themselves, controversial. However, flowing from the market value substitution rule in s 116-30(2) ITAA97 (see above), what was very much controversial was whether, in the sale of the shares, the vendor shareholders in Punters dealt with News Corp Investments at arm's length. If they did not, there was a consequential controversy as to the market value of the shares immediately prior to their disposal.

Logan J held that Punters and News Corp Investments dealt with each other at arm's length in connection with the share sale agreement. His Honour said:

> "15. … The evidence offered by the Applicants exposed the internal decision-making processes in relation to the purchase of the shares in Punters not just of News Corp Australia but also within the News Corp group

hierarchy up to News Corp's Head Office in New York. That evidence reveals that, ultimately, the decision to purchase the shares was made in New York, following significant internal analysis within the News Corp group of companies of the worth of the shares, as reflected in Punters business. The share acquisition was a corporate group-level, strategic decision made at a corporate group headquarters, not subordinate, Australian operational level. In this Head Office decision, there was neither collusion with any of Messrs Kilgour, Pettett or Isterling (or their respective wives) or Punters' appointed agent, nor a mere rubber-stamping of an analysis offered by a not disinterested, local operational level subordinate within News Corp Australia."

This meant that the market value substitution rule was inapplicable and, hence, the consequential market value issue and the related small business concession issue were, strictly, unnecessary for Logan J to decide. This notwithstanding, because each issue was fully argued and against the contingency that his conclusion as to arm's length dealing may be in error, his Honour nonetheless addressed these issues.

The following points were made by Logan J:[4]

- modification 1 is in the nature of an exception to a prima facie position. In relation to that exception, regard to the text of s 116-30 ITAA97 also discloses that the fact that the capital proceeds are more or less than the market value of the asset is not to be equated with a conclusion that the entity disposing of the asset and the entity that acquired the asset did not deal with each other at arm's length in connection with the event. Outcome is not to be equated with such a cause. Instead, that the capital proceeds are more or less than the market value of the asset may or may not be indicative of a non-arm's length dealing;
- capital proceeds which do not represent the market value of an asset can be an indicator that the parties to a disposal of that asset did not deal with each other at arm's length;
- textually and contextually, therefore, given the definition of "arm's length", an examination of whether the parties to a disposal have dealt with each other at arm's length should commence with an examination of what, if any, connection existed between the parties "in connection with" the dealing. It is the dealing which supplies the prism through which one views whether, and, if so, to what extent, there was any connection between the parties. Flowing from the phrase "in connection with", the statutory criterion is not whether the parties to the disposal were at arm's length but whether, in relation to the disposal concerned, they dealt with each other at arm's length; and
- a feature of the definition of "arm's length" is that it does not so much define the term as offer subjects for inquiry as to whether the term as ordinarily understood is applicable on particular facts. That the one definite subject for inquiry is the existence of any connection between the parties shows that parliament is not using "arm's length" in any sense that is different to the term's meaning as a matter of ordinary English. That meaning is, "conducted or agreed by independent parties not able to coerce or control each other; characterized by distance, independence, or impartiality" (*Oxford English Dictionary*). That ordinary meaning also indicates what subjects might, in terms of the definition of "arm's length", be a relevant circumstance in relation to a dealing, apart from a "connection".

Logan J said that the meaning so derived was consistent with authorities which have considered the meaning to give to arm's length dealing in analogous contexts. Those authorities were helpfully collected by McKerracher J in *Healey v FCT*[5] as follows:

"1. Whether the parties dealt at arm's length is a question of fact …;

2. There is a distinction between dealing at arm's length and an arm's length relationship … Whether the parties did not deal at arm's length is not to be decided by answering whether the parties were not in an arm's length relationship. The fact that the parties are themselves not at arm's length does not mean that they have not, in respect of a particular dealing, dealt with each other at arm's length …;

3. Whether the parties dealt at arm's length involves an analysis of the manner in which the parties to a transaction conducted themselves in forming that transaction …;

4. At issue is whether the parties have acted separately and independently in forming their bargain … There should be an assessment of whether the parties dealt with each other as arm's length parties would be expected to behave so that the outcome is a matter of real bargaining …;

5. It is relevant to consider the nature of any relationship between the parties …;

6. If the parties are not at arm's length the inference may be drawn that they did not deal with each other at arm's length …"

Logan J said that it was common ground that Punters and News Corp Investments were at arm's length from one another. This was relevant but, as the authorities referred to in *Healey* confirmed, by no means determinative. The relevant question is whether the parties *dealt* with each other at arm's length?

The taxpayers submitted that it should be concluded that the parties to the share sale agreement, although at arm's length, had nonetheless not dealt with each other at arm's length in relation to the disposal of the shares in Punters. Logan J rejected the submission.

Logan J said that the taxpayers' submission was just a version of one considered and rejected by Davies J in *Barnsdall v FCT*.[6] Materially, Davies J had to determine (in the context of a satisfaction-based criterion) whether an error of law had attended the meaning given by the

Commissioner to the then s 26AAA(4)(b) ITAA36, which included the analogous language, "having regard to any connection between the taxpayer and the person to whom the property is so sold or any other relevant circumstances, the taxpayer and the other person were not dealing with each other at arm's length".

Evidence was tendered that the grant of options such as occurred in that case was not an unusual transaction in respect of shares and it was submitted that it was not shown that the prices fixed by the options were not fair. In rejecting the submission that it followed that the dealing was at arm's length, Davies J stated in *Barnsdall*:

> "23. However, the effect of this evidence was to show no more than that the price fixed by the option agreements between Mr Hains and Corporate Investments Pty Ltd may well have been a fair price. Proof that a transaction was fair is not sufficient to show, in the context, that the dealing was at arm's length. The term 'at arm's length' in s 26AAA(4)(b) is not to be construed as meaning 'for a fair price'. Indeed, this provision did not turn its attention primarily to price, though the price paid may be a relevant factor. The provision did not purport to fix a fair price for the transaction but rather, when a finding had been made that the dealing was not an arm's length, fixed and arbitrary consideration, the value of the property at the time of its sale."

Logan J said that, in the same way, and in relation to "modification 1", the proof that a disposal was "fair", or at market value, is not sufficient to show that the dealing was at arm's length. So, too, is proof that, in the same way, a disposal was not "fair", or not at market value, is not sufficient to show that the dealing in connection with the disposal was not at arm's length.

What, in hindsight, and sometimes even in prospect, are advantageous or disadvantageous disposals of assets can occur between parties who have dealt with each other at arm's length. This is just a feature of business and private life in relation to the disposal of assets. A "price taker" is not necessarily a purchaser who has dealt with the vendor other than at arm's length in connection with the disposal of an asset. They may just want the asset for some reason, have the requisite means, and be content to pay the price requested.

Although Logan J concluded that the vendor shareholders in Punters and News Corp Investments dealt with each other at arm's length in connection with the disposal of all of the shares in Punters, his Honour went on to express conclusions in relation to the market value issue. In this regard, Logan J said:

> "131. The term used in the provisions of the ITAA 1997 with which these appeals are concerned is 'market value'. It may be accepted that the market concerned is a hypothetical one. But there is nothing in the text of the provisions concerned which dictates either expressly or by necessary implication that one must exclude from this hypothetical market a particular willing purchaser present in that market who sees value particular to that purchaser in acquiring the asset concerned. Nor is there support for the exclusion of such a purchaser to be found in *Spencer*.[7] A purchaser 'cognizant of all circumstances which may affect its value, either advantageously or prejudicially' might well be cognisant of an advantage peculiar to that purchaser and be willing to pay for that advantage.
>
> 132. That the value must be market value doubtless does, by necessary implication, exclude from consideration any value in the asset which is peculiar to the vendor and which is necessarily lost on its disposal. Market value is thus not a value peculiar or special to the vendor alone. Care must therefore be taken when considering those acquisition of land cases where compensation is based on a value to the owner.
>
> 133. The hypothetical market also assumes a vendor and one or more purchasers. At least when acting in the same capacity, the hypothetical vendor in the market cannot also be the hypothetical purchaser."

AAT decision

The dealing at arm's length issues that the AAT considered in *Moloney and FCT* arose in the context of applying the maximum net asset value test that is relevant for the purposes of the CGT small business reliefs.

The AAT held that the parties to the sale and purchase of a business as part of a restructuring did not deal with each other at arm's length but that the market value of the business was (as contended by the taxpayers) \$3.5m and not (as contended by the Commissioner) \$10.64m, with the result that the maximum net value test was satisfied.

Between 1996 and 2015, the JG Moloney Family Trust (the Moloney Trust), trading as Mt Noorat Freighters, carried on a bulk haulage freight business predominately in western Victoria, specialising in stock feed, grain and other agricultural products (the Mt Noorat Freighters business).

The trustee of the Moloney Trust was JG Moloney & Co (Noorat) Pty Ltd (JGM). The directors of JGM were two of the taxpayers, Raymond Moloney and his brother, Anthony Moloney. The Moloney Trust was a discretionary family trust. The beneficiaries of the trust included the four taxpayers, being the two directors of JGM and each of their spouses.

Commencing in 2014, on the advice of Crowe Horwath, accountants, steps were taken to restructure the business holding. These steps, as set out by the AAT, were:

- on 12 June 2014, Mt Noorat Freighters Pty Ltd was registered with Anthony Moloney and Raymond Moloney as directors;
- on 12 March 2015, Anthony Moloney and Raymond Moloney commenced to hold their shares in JGM as beneficial owners;
- on 20 March 2015, Mt Noorat Freighters Pty Ltd changed its name to Mt Noorat Freighters Holdings Pty Ltd; and

- on 25 March 2015, JGM, in its capacity as trustee of the Moloney Trust, entered into a contract for sale of business pursuant to which the Mt Noorat Freighters business was sold to JGM in its own right for $3.5m.

A special condition of the contract for sale provided that the price of the business was $3.5m (exclusive of GST) plus the assumption of liabilities for all debts of the business, including but not limited to all creditors, all staff entitlements, all hire purchases and leasing liabilities, and all bank debt.

On 25 March 2015, JGM, in its capacity as trustee of the Moloney Trust, entered into an agreement for sale of its shares to Mt Noorat Freighters Holdings Pty Ltd for $3.5m (the CGT event).

On 31 March 2015, JGM entered into a deed of appointment pursuant to which JGM was replaced as trustee of the Moloney Trust by Raymond Moloney and Anthony Moloney.

On 19 June 2015, the trustees of the Moloney Trust passed a distribution resolution under which the net income of the trust for the 2015 income year was distributed equally between the four taxpayer beneficiaries.

For the purposes of determining the net income of the Moloney Trust for distribution to the beneficiaries for the 2015 income year, the trustees treated the capital gain that arose from the sale of the shares as being reduced to nil after taking into account the 50% CGT discount and the CGT small business concessions, in reliance on a November 2014 valuation, which was carried out by a valuation specialist, Mr Lachie McColl, within Crowe Horwath. Mr McColl valued the Mt Noorat Freighters business as being $3.5m as at 30 June 2014. For the 2015 income year, the Moloney Trust lodged an income tax return on this basis.

On 29 April 2021, the Commissioner issued an audit conclusion letter notifying the taxpayers that their assessments were to be amended on the basis that the Moloney Trust was not entitled to the CGT small business concessions and deemed the shares sold by JGM to Mt Noorat Freighters Pty Ltd to have been disposed of for a market value of $10.64m.

The market value of $10.64m was based on the midpoint of a range of valuations of the Mt Noorat Freighters business (excluding debt) just before 25 March 2015, which was determined by KordaMentha in an updated valuation report dated 28 April 2021, after consideration of material provided by the taxpayers.

The Commissioner relied on the market value substitution rule to substitute the KordaMentha value in place of the sale price of the shares in the contract with Mt Noorat Freighters Holdings Pty Ltd, including on the basis that the parties to that contract did not deal with each other at arm's length.

Based on the above, the Commissioner amended the assessments of the taxpayers to include an additional $872,185 in each of the taxpayer's assessable income as their share of the trust distribution from the Moloney Trust. Thus, each taxpayer's share of the trust distribution was increased from $321,989 to $1,194,174.

The issues

The two main issues that arose for decision by the AAT were:

1. whether the market value substitution rule in s 116-30 ITAA97 applied to permit the Commissioner to substitute the KordaMentha value of the shares (or any other value) in place of the actual capital proceeds as agreed/specified in the share sale agreement. The taxpayers contended that the rule did not apply because of the absence of a prerequisite, namely, the requirement that the parties to the share sale agreement did not deal with each other at arm's length; and
2. whether the CGT small business concessions applied and, in particular, whether the maximum net asset value test in Div 152 ITAA97 was satisfied just before the relevant CGT event, being the execution of the share sale agreement on 25 March 2015.

The AAT accepted that related parties, that is, parties who are themselves not at arm's length, may deal with each other at arm's length in relation to a particular transaction. However, the AAT did not accept that there was such a dealing in the present case. What was produced and relied on was an indicative valuation, albeit as at 30 June 2014, prepared by Mr McColl. It was stressed that Mr McColl dealt directly with the taxpayers for the purposes of the valuation, and neither Mr DeLorenzo (an accountant from Crowe Horwath), nor any member of the tax advisory team within Crowe Horwath, was involved in the valuation process.

The AAT said that, even if it were accepted that Mr McColl's valuation could be regarded as independent, there was still no real bargaining between the parties to the share sale agreement. They just left it to the accountants. On receipt of Mr McColl's valuation, as the taxpayers submitted, "the tax advisory team then advised that the sale of shares could proceed".

The AAT said:

> "48. There was none of the normal indicia of bargaining which might be expected of parties dealing with each other at arm's length. The valuation was not challenged or queried on behalf of either the seller or the purchaser. That is unsurprising because each party to the agreement was substantially controlled and directed by the same persons. As the [Commissioner] submits, there was simply no bargaining.
>
> 49. In all the circumstances, I am satisfied that the parties to the share sale agreement did not deal with each other at arm's length in respect of the transaction."

The AAT then went on to consider in some detail what the correct valuation figure was, having regard to the evidence that had been adduced. It said:

> "120. In my view, the Maintainable EBITDA is within PKF's range of $1.6 to $1.7 million, say $1,650,000. In my view, the appropriate capitalisation multiple is at the high end of PKF's range of 3.75 to 4.25. This values the business at the valuation date at approximately $7,012,500

($1,650,000 × 4.25). The agreed long term/financial liabilities are $3,660,000. This leads to a valuation of $3,352,500. Adding the combined CGT assets of the connected entities ($803,901) leads to $4,156,401.

121. The Applicants have established that the net value of the CGT assets of the Moloney Trust (including the net CGT assets of the connected entities) did not exceed $6,000,000 just before 25 March 2015. Consequently, the objection decisions should be set aside and the Applicants' objections to the amended assessments allowed."

Observations

The decisions in the cases discussed above highlight the importance of establishing, in a given case, whether the parties to a transaction are dealing with each other at arm's length. In some scenarios, the position will usually be clear (for example, where a CGT asset is sold at a public auction) but, in other scenarios, the position will not be clear and the parties will need to ensure that there is competent valuation evidence.

It is well established that, in relation to the market value of an asset, there may be an acceptable range of figures that a competent valuer using due skill and care would reach.[8]

The large discrepancy in the valuations that were obtained in the *Moloney* case illustrates the problems that can arise. From a CGT perspective, the possibility of roll-over relief applying in the particular circumstances would need to be considered.

TaxCounsel Pty Ltd

References

1 There are, of course, other provisions of the ITAA97 and provisions of the *Income Tax Assessment Act 1936* (Cth) (ITAA36) that impose an arm's length value test.

2 [2024] FCA 687.

3 [2024] AATA 1483.

4 [2024] FCA 687 at [34]–[38].

5 [2012] FCA 269 at [95].

6 [1988] FCA 192.

7 *Spencer v The Commonwealth* [1907] HCA 28.

8 See generally, *Flemington Properties Pty Ltd v Raine & Horne Commercial Pty Ltd* [1997] FCA 788.

Higher Education

Gaining specialised superannuation skills

The Dux of Advanced Superannuation in Study Period 2, 2023 shares her journey into superannuation law, driven by a fascination with SMSFs and a commitment to deepening her expertise in this intricate field.

Victoria Mercer
Associate
BusinessDEPOT, Queensland

Victoria's journey into the intricate world of tax law and superannuation began with a Bachelor of Laws from Griffith University and a Graduate Diploma of Legal Practice from Queensland University of Technology. Since embarking on her legal career in 2017, she has focused on wealth transfer and estate planning, gradually delving deeper into the complexities of taxation matters.

Victoria's motivation

"From the outset of my legal journey," Victoria explains, "I found myself drawn to the complexities of SMSFs, recognising their pivotal role as key entities for motivated families seeking to accumulate and transfer wealth. This fascination has not only shaped my professional trajectory but has also driven me to continually deepen my expertise in superannuation matters."

Victoria selected the Advanced Superannuation subject as an elective in her Graduate Diploma of Applied Tax Law. Speaking about her motivation, she stated, "This subject aligns with my professional aspirations to delve deeper into the intricate domain of superannuation law, specifically in relation to SMSFs, from a tax and accounting perspective."

Gaining specialised skills

Through her studies, Victoria gained invaluable skills and knowledge in superannuation law, strategy and compliance, particularly in the context of SMSFs. Victoria emphasises that she applies this newfound knowledge daily in her role, ensuring compliance with relevant laws and strategically incorporating superannuation considerations into comprehensive estate plans.

The educational journey

Victoria said that her experience studying at The Tax Institute Higher Education has been excellent. "The program has provided me with a good foundation for understanding taxation laws, various structures and entities," she remarked. The quality of education, coupled with encouragement to delve into advanced topics, has motivated her to pursue further programs with The Tax Institute in the future.

Balancing act: managing work, study and life

Successfully managing the demands of study, work and other commitments has not been easy for Victoria. "Studying during weekends and nights has allowed me to balance professional responsibilities with my academic pursuits," she shared. Victoria credits her supportive employer, understanding family and friends for helping her to navigate the workload.

Future plans: continuing the journey

Looking ahead, Victoria plans to continue her tax education by considering the Chartered Tax Adviser Program, focusing on small business CGT concessions. Her advice to other tax professionals considering studying is to not fear the commitment to extra studies. "Find a balance between work, study and personal life that works for you," she advises, emphasising the importance of seeking support and networking with peers and mentors in the field.

Interested in a formal qualification in tax? Learn more here.

The evolving landscape of tax practitioner obligations

by Robyn Jacobson, CTA,
Senior Advocate, The Tax Institute

Members of the profession recognise that the recent significant changes to the regulatory framework governing registered tax agents and BAS agents are essential for maintaining trust and confidence in society. However, a balanced approach is necessary to ensure that the new rules are fairly implemented without causing major disruption to the vast majority of tax practitioners who overwhelmingly conduct themselves with integrity and honesty. The rapid implementation of layers of changes with short commencement dates, without adequate consultation or consideration of practical implications, hinders tax professionals' ability to fulfil their duties effectively, leading some to contemplate leaving the profession altogether. In this article, we explore the recent changes to the obligations imposed on tax practitioners, with a special focus on the breach reporting rules and the recently registered Ministerial Determination, and analyse their impact on the tax profession and the tax system.

Overview of recent changes to tax practitioner obligations

In March 2019, the government announced a review into the effectiveness of the Tax Practitioners Board (TPB), and the operation of the *Tax Agent Services Act 2009* (Cth) (TASA) and the *Tax Agent Services Regulations 2009* (Cth) (TASR). The final report of the 2019 *Review of the Tax Practitioners Board* (the James review) made 28 recommendations that proposed significant changes to the regulatory framework for tax practitioners. The purpose of these changes is to ensure that tax agent services are provided by registered tax agents and BAS agents (tax practitioners) to the public in line with professional and ethical standards.

The James review assessed whether the legislative framework of the TPB effectively achieves its objectives which include:

- maintaining, protecting and enhancing the integrity of tax practitioners;
- promoting the TPB as an independent, efficient and effective regulator; and
- safeguarding consumers of tax agent services.

The government's response to the James review supported 20 of these recommendations and has so far implemented nine recommendations over two tranches of legislative changes.

First tranche of legislative changes

The first tranche of key changes to the TASA was effected by Sch 3 to the *Treasury Laws Amendment (2023 Measures No. 1) Act 2023* (Cth) (TLAA1) which, among other changes:

- updates the objects clause[1] of the TASA – from 1 January 2024 (Part 1);
- creates a new ministerial power (Code item 17) that enables the Minister to supplement the existing Code of Professional Conduct (the Code) in s 30-10 of the TASA with additional obligations[2] – from 1 January 2024 (Part 1);
- introduces new Code items 15 and 16 dealing with the employment or use of disqualified entities[3] – from 1 January 2024 (Part 1);
- replaces the three-year registration period with an annual registration period[4] – from 1 July 2024 (Part 2);
- establishes a TPB special account[5] to increase the TPB's financial independence from the ATO – from 1 July 2024 (Part 3);
- ensures that individuals appointed to the TPB as Board members meet the definition of "community representative"[6] – from 1 October 2024 (Part 4); and
- introduces the new breach reporting rules[7] – from 1 July 2024 (Part 5).

Second tranche of legislative changes

Amid the ongoing scrutiny of the tax profession and giving effect to the government's announcement on 6 August 2023 regarding perceived tax adviser misconduct, the recently enacted *Treasury Laws Amendment (Tax Accountability and Fairness) Act 2023*:

- expands the promoter penalty regime in Div 290 of Sch 1 to the *Taxation Administration Act 1953* (TAA) which penalises tax practitioners for promoting a scheme[8] – from 1 July 2024;
- extends whistleblower protections to eligible whistleblowers who make disclosures to the TPB,[9] as well as disclosures to certain other entities which may support or assist the whistleblower – from 1 July 2024;
- implements further recommendations arising from the James review to increase the information published on the TPB Register,[10] replace the 12-month time limit for certain information to remain on the register with a five-year period,[11] and extend the timeframe that the TPB has to conduct an investigation from six months to 24 months[12] – from 1 July 2024; and

- allows tax officers and TPB officials to share protected information[13] with the Treasury about misconduct arising out of breaches or suspected breaches of confidence by intermediaries engaging with the Commonwealth, and with prescribed professional disciplinary bodies – from 1 June 2024.

The Australian Greens' amendments

The breach reporting rules were not part of the first tranche of exposure draft legislation released by the Treasury on which consultation was undertaken, or the Treasury Laws Amendment (2023 Measures No. 1) Bill 2023 (TLAB1) as introduced into the parliament in February 2023.

Amendments to introduce the breach reporting rules were tabled on 8 November 2023 by Greens senator, Senator Barbara Pocock, and were formally inserted into Pt 5 of Sch 3 to the TLAB1 on 15 November 2023. The amendments were agreed to by the Senate and the Bill was passed by the Senate and the House of Representatives on 15 and 16 November 2023, respectively. These measures were not subject to the usual process of public consultation and were tabled before the parliament without an accompanying explanatory memorandum. The TLAB1 received royal assent on 27 November 2023 as Act No. 101 of 2023.

The new breach reporting rules and the ministerial power to supplement the Code are discussed in detail below.

Breach reporting obligations

From 1 July 2024, tax practitioners must comply with the new breach reporting rules which require them to notify the TPB in writing if they have reasonable grounds to believe that they (self-reporting[14]) have, or another agent (reporting another agent[15]) has, breached the Code and that breach is a "significant breach". In the case of another agent, the tax practitioner must also notify the agent's relevant professional association. Notification to the TPB and the association must be made within 30 days of the day on which they became, or ought to have become, aware of the breach.[16] The rules apply to breaches arising on or after 1 July 2024.

A breach is a "significant breach" if it:[17]

- constitutes an indictable offence, or an offence involving dishonesty, under an Australian law;
- results, or is likely to result, in material loss or damage to another entity (including the Commonwealth);
- is otherwise significant, including taking into account any one or more of the following:
  - the number or frequency of similar breaches by the agent;
  - the impact of the breach on the agent's ability to provide tax agent services;
  - the extent to which the breach indicates that the agent's arrangements to ensure compliance with the Code are inadequate; or
- is a breach of a kind prescribed by the regulations.

Key terms such as "reasonable grounds to believe", "indictable offence", "offence involving dishonesty", "material loss or damage", "otherwise significant" and "ought to have become" are not defined in the legislation, so tax practitioners will need to heavily rely on the TPB's guidance (once finalised) to understand their reporting obligations. The profession was blind-sided by the amendments and not afforded an opportunity to consult on the amendments tabled by the Greens, or to consider any unintended consequences or express concerns on the practical implications of the breach reporting rules before they became law. The Tax Institute, in conjunction with other leading professional associations (the Joint Bodies), issued a media release on 15 November 2023, taking the stance:

> "… that consultation should be undertaken for all significant changes to the law. Poor tax law design and lack of consultation can often lead to poor or unintended outcomes for everyone involved, which is why the usual process of parliamentary consultation is in place and should have been followed in this case."

The TPB released TPB(I) D53/2024: Breach reporting under the TASA (the draft guidance) for public consultation on 30 April 2024. The Joint Bodies made a joint submission outlining the profession's primary concerns with the legislative amendments and the draft guidance provided by the TPB. Broadly, the Joint Bodies expressed concerns about the lack of formal consultation on this measure, resulting in vaguely expressed law that is unclear and places a heavy compliance burden on tax practitioners. This lack of clarity makes it challenging to effectively apply and enforce the law in practice, creating difficulties for the TPB in implementing and administering the rules as the regulator.

The key recommendations proposed by the Joint Bodies to improve the draft guidance include:

- enhancing interpretive guidance and relevant case studies to be of greater practical assistance to tax practitioners;
- clarifying that the intent of the tax practitioner is irrelevant when determining whether a breach is a "significant breach";
- providing a more concise framework for evidentiary requirements for tax practitioners to follow as varying degrees of evidentiary requirements may result in confusion and practical challenges for tax practitioners;
- the creation of a dedicated resource on the TPB website to offer guidance and direct tax practitioners to legal services where they seek legal advice on areas outside their expertise, such as criminal law, to ascertain whether an offence is an indictable offence – obtaining a legal counsel's opinion and filing a breach report within the 30-day reporting timeframe is likely to be challenging for tax practitioners;
- clarifying which entity has the reporting obligation or is the subject of a breach report where a registered agent operates through a company or a partnership that is also a registered agent;

- offering guidance on:
  - the repercussions of frivolous, vexatious or malicious complaints and failing to comply with reporting obligations;
  - lack of whistleblower protection for unrelated[18] tax practitioners;
  - disagreements with the TPB's position on reporting and appeal rights; and
  - actions to be taken by recognised professional associations on notification of a breach;
- establishing an ethics officer or hotline for tax practitioners to seek guidance on ethical dilemmas and their obligations under the TASA, preferably on an anonymous basis;
- providing additional examples and case studies on the meaning of "significant breach" and "otherwise significant"; and
- addressing practical circumstances related to the breach reporting rules, such as:
  - supervision and control of employees;
  - staff training delivered by tax practitioners;
  - disclosures of breaches by tax practitioners in tax discussion groups; and
  - tax practitioners conferring with or providing advice to other tax practitioners.

At the time of writing, the TPB is yet to finalise its guidance on the breach reporting rules.

Ministerial Determination

The new ministerial power to determine additional Code obligations was recommended[19] by the James review which considered that the Minister should be given a legislative instrument (LI) power to be able to supplement the Code and address emerging or existing behaviours and practices. The government agreed that there are clear benefits in having processes in place to ensure that the Code remains contemporary, and undertook to ensure that any proposed changes to the Code would be considered first by the TPB's Tax Practitioner Governance and Standards Forum.

Consequently, the Joint Bodies made a joint submission to the Treasury on the exposure draft of the Treasury Laws Amendment (Measures for Consultation) Bill 2022: Tax Practitioners Board Review (the draft TPB Review Bill). The draft TPB Review Bill proposed to amend the TASA to implement the recommendations of the James review. In the joint submission, the Joint Bodies raised concerns regarding recommendation 5.1 that granting the Minister the authority to unilaterally modify the Code obligations could potentially bypass thorough parliamentary scrutiny.

However, without addressing the Joint Bodies' concerns, recommendation 5.1 was given effect by Pt 1 of Sch 3 to the TLAA1 which inserted Code item 17.[20] Code item 17 requires tax practitioners to comply with any obligations determined by the Minister under s 30-12 TASA, which empowers the Minister to determine additional Code obligations by making an LI. Any additional obligations determined by the Minister should not be inconsistent with existing Code obligations and should elaborate or supplement them.[21] The power under s 30-12 cannot be used by the Minister to reduce any existing obligations under the Code and, to the extent that a determination made by the Minister conflicts with the Code, the conflicting provisions have no effect.[22]

On 10 December 2023, the Treasury released for public consultation the Tax Agent Services (Code of Professional Conduct) Determination 2023 (the draft Instrument). The draft Instrument supplemented the existing Code obligations, arguably even duplicating some of them, by introducing eight new Code obligations.

The Joint Bodies made a joint submission on 23 January 2024 to the Treasury regarding the draft Instrument. While the Joint Bodies recognise the significance of a robust Code in upholding public confidence in the tax and superannuation systems, adjustments to the draft Instrument were recommended to avoid unintended outcomes.

On 1 July 2024, the Assistant Treasurer and Minister for Financial Services, the Hon. Stephen Jones MP (the Minister), made the Tax Agent Services (Code of Professional Conduct) Determination 2024 (the Determination). It was registered on 2 July 2024 and was due to commence on 1 August 2024.

The Determination requires tax practitioners to:

- uphold and promote the ethical standards of the tax profession (s 10);
- not make false or misleading statements to the TPB or the Commissioner (s 15);
- take any reasonable steps to identify and avoid any material conflicts of interest in relation to any activities undertaken for an Australian government agency and disclose the details of any such material conflicts of interest as soon they become aware of the conflict (s 20);
- maintain confidentiality in dealings with Australian government agencies (s 25);
- keep proper client records regarding the tax agent services provided to clients, including former clients, for five years after the service was provided (s 30);
- ensure that those providing tax agent services on behalf of tax practitioners maintain the relevant knowledge and skills and are appropriately supervised (s 35);
- establish and maintain a system of quality management designed to ensure compliance with the Code and document and enforce the policies and procedures of the quality management system (s 40); and

- keep all current and prospective clients informed of "any" matter that could significantly influence a client's decision to engage, or continue to engage, the tax practitioner to provide a tax agent service (s 45).

The Determination contains new obligations that were not part of the draft Instrument, along with notable additional consequences. For example, s 45 of the Determination applies to matters arising on or after 1 July 2022, more than two years ago. Broadly, tax practitioners must notify their current and prospective clients of all relevant matters within 30 days of becoming aware of the matter. However, a transitional rule in s 151 proposes to modify this 30-day notification period to 90 days from the date on which the Determination commences for matters arising on or after 1 July 2022 and on or before the commencement of the Determination.

Additionally, a new obligation in s 15(2)(c) requires tax practitioners to report their clients to the ATO or the TPB if an error is identified in a statement prepared by the tax practitioner and the client does not correct the statement that is false, incorrect or misleading in a material particular within a reasonable time. This obligation is tantamount to a client "dob-in" rule and was not in the draft Instrument.

Code item 6[23] prevents tax practitioners from disclosing information relating to a client's affairs to a third party without their permission – unless the tax practitioner has *a legal duty to do so*. The Determination imposes a legal duty to disclose client information in circumstances covered by s 15, so it does not override, or seem to be inconsistent with, the existing Code. However, it challenges, even undermines, the important agency relationship of trust that exists between a practitioner and their client.

The tax law is complex and mistakes are made – most of the time, they are honest mistakes. The tax law acknowledges this by allowing taxpayers and tax practitioners to make voluntary disclosures, amend statements and returns to correct errors, request remission of the general interest charge and penalties, and seek the exercise of the Commissioner's discretion. The new Code obligation in s 15(2)(c) raises the intolerance bar to an unacceptably high level.

The requirement in s 45 to disclose "any" matter is an overreach. The scope of this wording is so impossibly broad that the TPB would need to read down the wording in the law to avoid disclosures of personal matters infringing on tax practitioners' privacy rights. Tax practitioners should not be required to disclose matters beyond the scope of whether they are a fit and proper person to provide tax agent services to their clients, such as the state of their mental health. Keeping clients informed should not impose an unreasonable compliance burden on tax practitioners – or worse, constitute an invasion of privacy for working tax professionals. It will be interesting to see whether the TPB can read down the wording in the law when it issues its guidance to ensure that matters of a personal nature, consistent with maintaining human rights and upholding anti-discriminatory behaviour, are not required to be disclosed to clients.

The Tax Institute welcomes the TPB's recent indication that it will take a "pragmatic and practical" approach in implementing the new rules in the Determination. However, the TPB needs to finely balance the implementation and enforcement of the new law with phased education and awareness to support tax practitioners. Assurances from the TPB must be supported by formal written guidance to provide certainty to tax practitioners.

More to the point, relying on the regulator to read down the wording so it can be practically and sensibly implemented is extremely unsatisfactory. It is deeply concerning that the letter of the law can be drafted with so wide a scope that the regulator is required to limit that scope through pragmatic guidance which does not carry the weight of law.

The Determination's commencement date of 1 August 2024 was unrealistic and unachievable for many tax practitioners who are already operating under heavy workloads.

> "Relying on the regulator to read down the wording so it can be practically and sensibly implemented is unsatisfactory."

The Joint Bodies submitted an open letter on 15 July 2024 to the Minister requesting a deferral of the start date of the Determination, as well as its withdrawal to allow further consultation and a reconsideration of its impact so there are no unintended consequences for tax practitioners or the TPB. We will also be working with the TPB as it develops its guidance.

On 31 July 2024, the Joint Bodies received a response from the Minister advising of an amendment to the start date of the new obligations.

In his response to the Joint Bodies, the Assistant Treasurer wrote:

> "Following advice from Treasury and the TPB, I am of the view that the concerns that you have raised can be effectively addressed through the finalisation of guidance without further changes to the Determination. However, given the importance of the TPB's guidance material, I will insert a transitional rule into the Determination that will *provide firms with 100 employees or less until 1 July 2025 and larger firms with 101 employees or more until 1 January 2025* to bring themselves in compliance with these new obligations,

so long as they continue to take genuine steps toward compliance during this period.

This aligns with the Government's existing approach and the public statements that the TPB has already made regarding implementation of these important obligations. It also provides certainty that the TPB can and will work collaboratively with you to understand and implement the obligations. *Should it become clear to the government during the process to finalise guidance that it is critical that changes be made to the Determination I will engage constructively with you and other stakeholders.*" (emphasis added)

This is an outcome that we hope eases the minds of our members and the wider profession. You can read the full letter here. The Minister followed up on 1 August 2024, with a media release confirming this position.

We are pleased by the Assistant Treasurer's understanding of the critical nature of TPB guidance in ensuring that these rules function well for the tax system and all those who work with it. The new dates provided allow for important consultation and guidance and a more sensible implementation period for practitioners.

We also appreciate that the Assistant Treasurer has indicated a willingness to make critical changes to the Determination, should that be considered appropriate after further consultation regarding the implementation of the new obligations.

While we welcome the deferral of the start date, we have continuing concerns with the following aspects of the Determination in particular:

- the new reporting obligation in s 15(2)(c) which requires tax practitioners to report clients to the Commissioner if they do not correct false or misleading statements within a reasonable time; and
- the extremely broad scope of s 45 which requires tax practitioners to notify current and prospective clients of "any" matter that may significantly influence a client's decision to engage the practitioner.

We are committed to working with Treasury and the TPB to further represent our members and advocate for appropriate outcomes regarding this matter.

What's next?

The latest response from the government saw the release of a consultation paper on 17 July 2024 that:

- seeks stakeholder feedback on proposed reforms that will seek to strengthen and modernise the TPB's registration requirements for tax practitioners; and
- explores the following areas of improvement for registration pathways:
  - strengthening company and partnership registration eligibility requirements;
  - reviewing the professional association "recognition" and registration pathways; and
  - broadening the TPB's ability to accept alternative forms of "relevant experience".

Final thoughts

The breach reporting rules and the new ministerial power to supplement the Code have heightened concerns across the tax profession. The lack of clarity and consultation on these measures, as well as pending TPB guidance, has created enormous challenges for tax practitioners. We will continue to engage with the government, the profession and the TPB to ensure that any changes to the TASA and related guidance are made and developed in a transparent and consultative manner. We will also work to advocate on behalf of the profession and provide our members with the guidance, resources and support they need to navigate the evolving landscape of tax practitioners' obligations. Our goal is to ensure that the tax profession can continue to serve the needs of businesses and individuals while upholding the highest standards of integrity and conduct. We are committed to advocating for a tax system that is fair, simple and efficient for our members and their clients.

Author's note: This article was based on publicly available information at the time it was written.

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3 S 30-10(15) and (16) TASA.

4 S 20-1 TASA.

5 Subdiv 60-G TASA.

6 S 60-25(4) TASA.

7 Ss 30-35(1)(ba), (2)(ba) and (3)(ba) and 30-40 TASA.

8 S 20-45(da) TASA.

9 S 14ZZT(1A) and (3A) TAA.

10 S 60-135(1) to (3) TASA.

11 The government did not agree to James review recommendation 8.1(c) to remove the time limit for displaying specific information on the TPB Register, but the 12-month limit has been replaced with a five-year limit by the Tax Agent Services Amendment (Register Information) Regulations 2024 with effect from 5 July 2024.

12 S 60-125(3)(a) TASA.

13 S 355-65(8), Sch 1 TAA.

14 S 30-35 TASA.

15 S 30-40 TASA.

16 Ss 30-35(3) and 30-40(3) TASA.

17 S 90-1(1) TASA.

18 The meaning of "eligible whistleblower" in s 14ZZU TAA includes an "associate" within the meaning in s 318 of the *Income Tax Assessment Act 1936* (Cth). Two unrelated tax practitioners will not be associates of each other. An agent who is not an "associate" of the other agent is not

an eligible whistleblower and therefore is not entitled to whistleblower protection.

19 Recommendation 5.1.

20 S 30-10(17) TASA.

21 S 30-12 TASA.

22 Para 3.81 of the supplementary explanatory memorandum to the TLAA1.

23 S 30-10(6) TASA.

Donations to charities: tax deduction reform

by Fiona Martin, CTA, Emeritus Professor, UNSW Business School

In July 2024, the Productivity Commission released its final report on the future of charitable giving. As there are around 60,000 charities in Australia and approximately 25,000 of these are eligible for tax donations, this report is both timely and important. In addition, Australians donate over $13b to charities every year. The report identifies several areas of concern with the current system. These are huge roadblocks for organisations that are uniquely placed to do public good. It makes recommendations that include determining donation status using a principles approach that balances government support with the unique skills and networking abilities that charities offer. It also recommends that some organisations are no longer eligible for tax deductible donations even though they should remain as charities. The overall recommendations would increase the number of eligible charities in Australia to around 40,000.

Introduction

The Productivity Commission has recently released its final report into charitable giving,[1] so this article is a timely update on the current situation relating to the tax deductibility of donations to charities.

In 2021, Australian charities received $13.4b in donations.[2] The Productivity Commission report argues that charitable giving, in all forms including donations, can provide funding for activities that the community values and that these areas might be underfunded or not funded at all due to constraints on governments.[3] Furthermore, donors and charities can contribute their skills, relationships or experience working with networks or communities that governments may not have. These skills and networks may allow donors and charities to achieve better and more valued outcomes at lower cost compared with direct government provision or grant funding. The report also argues that some types of giving, like volunteering, create indirect benefits for society by contributing to social networks, building social capital within communities, and diffusing knowledge and innovation.

According to the Australian Charities and Not-for-profits Commission (ACNC), there are 60,572 charities registered with the Commission. As a result, these charities enjoy exemption from income tax.[4] The Australian Bureau of Statistics states that Australia's population was 25,978,935 people as of 30 June 2022, which equates to approximately one charity for every 433 Australians.[5] Only around 25,000 or approximately 40% of these charities have tax donations status.[6] In other words, donations to these charities are tax deductible to the individual or corporate donor. This is termed "deductible gift recipient" (DGR) in the *Income Tax Assessment Act 1997* (Cth) (ITAA97).[7]

The most recent ACNC report advises that, in 2022, more than 70% of charities reported receiving donations and bequests. Nearly 66% of extra small charities reported receiving this type of revenue. This was an increase of around 11% from the previous year.[8] In the same year, charities reported receiving $13.9b in donations.[9] It is the role of the Commissioner of Taxation to endorse an entity as a DGR in most cases.[10]

Table 1 shows how the income tax deduction works for a $100 donation by an individual to a DGR.

The taxpayer must claim the donation in their income tax return to obtain the deduction. Such a donation can only reduce an individual's taxable income to nil, it cannot go into a loss situation.[11]

Not all charities are created equal

For an entity to become a DGR it must fall within one of the DGR categories set out in the income tax legislation. There are 53 categories. The eight most common categories of DGR endorsement are:

1. public benevolent institutions;
2. health promotion charities;
3. harm prevention charities;
4. animal welfare charities;
5. arts or cultural organisations;
6. environmental organisations;
7. community sheds; and
8. overseas aid funds.[12]

In addition, entities that do not fit into one of the 53 DGR endorsement categories can gain access to DGR status through specific listing and what is termed "auspicing"

Table 1. Tax savings with $100 donation

Taxable income	Tax rate	Tax saving	Cost to taxpayer
$0–$18,200	Nil	Nil	$100
$18,201–$45,000	16%	$16	$84
$45,001–$135,000	30%	$30	$70
$135,001–$190,000	37%	$37	$63
$190,001 upwards	45%	$45	$55

(support, sponsorship or guidance) arrangements. However, gaining specific listing can be difficult to access, costly and lack transparency.[13] With specific listing of organisations, it is noted that significant political influence and connections are often part of the process of being included in the tax legislation. Without the political connections and influence that some or all of these entities have, it is unlikely that they would have gained DGR status.[14]

Most of the DGRs are charities registered with the ACNC as charities, but there are around 2,000 that are DGRs because they are a different type of entity, such as a school building fund for a government school.[15]

The rules around DGR eligibility are complex and difficult to administer. The most common form of DGR is the "public benevolent institution" (PBI). This term arose through its use in tax legislation dating as far back as 1927. In that year, the federal income tax legislation was amended to alter the range of eligible donees to include "public charitable institutions" in Australia, public universities in Australia or affiliated colleges, and public funds to establish and maintain funds for public memorials relating to World War I.[16] The *Estate Duty Assessment Act 1928* (Cth) defined "public charitable institution" to mean a public hospital, a public benevolent institution, and a public fund established and maintained for the purpose of providing money for such institutions or for the relief of persons in necessitous circumstances.[17]

The legislature also deleted the word "charitable" from the *Estate Duty Assessment Act 1914–1922* (Cth) and included "public benevolent institution".[18] The federal legislature therefore introduced the PBI, a more limited category of entity that was more akin to the ordinary meaning of charitable rather than its broader legal meaning.[19] In other words, some sort of benevolent relief or relief of poverty is required. The phrase is not defined anywhere, so that case law has had to be relied on in order to understand its meaning. To be considered a PBI, an organisation must be "public", "benevolent" and an "institution". Furthermore, it must be "organised, conducted or promoted for the relief of poverty, sickness, destitution, helplessness, suffering, misfortune, disability or distress".[20]

In 2023, the head of the ACNC issued what is termed a Commissioner's "interpretation statement" on what it means to be a PBI.[21] This statement provides additional commentary in relation to this term which arises from recent case law. The revised statement has removed the "clear mechanisms" test, which required that an organisation could only be considered a PBI if it had a clear mechanism for delivering benevolent relief. This test has been replaced by a "sufficiency of connection" requirement which requires that there be a sufficient connection between the organisation's activities and the benevolent relief of its intended beneficiaries.

In the *Equality Australia Ltd* case,[22] the Administrative Appeals Tribunal held that there was not a sufficiency of connection between the entity's activities and the benevolent relief of its intended beneficiaries. Equality Australia engaged in advocacy, education and campaigning for legal and social change to relieve the distress caused by structural discrimination to Australia's LGBTIQ+ community. The tribunal found that the organisation was not organised, conducted or promoted for the benevolent relief of the LGBTIQ+ community. However, the ACNC has said that there are circumstances in which a PBI can engage in advocacy.

The interpretation statement refers to the *Global Citizen Ltd* case,[23] in which it was found that activities directed towards securing financial commitments for specific projects that organisations were undertaking to relieve poverty around the world would be accepted as "for the benevolent relief of poverty". It confirmed that it will also be possible for a registered PBI to engage in advocacy that is ancillary to the delivery of the benevolent relief. It should be noted that the *Equality Australia* case decision is on appeal to the Full Federal Court.

"Many researchers and commentators in the charities sector have criticised the current situation that only grants DGR status to some charities."

Many researchers and commentators in the charities sector have criticised the current situation that only grants DGR status to some charities. Myles McGregor-Lowndes of the Australian Centre for Philanthropy and Nonprofit Studies has stated that the tax concessions to encourage and enable non-profit organisations are mainly based on nearly century-old notions of benevolence and relief of poverty or the whim of a politician.[24] Krystian Seibert, former Associate Commissioner with the Productivity Commission, commented that questions about DGR status have been raised consistently throughout the Productivity Commission's ongoing inquiry into philanthropy.[25] Others have stated that the DGR system has evolved in an ad hoc manner.[26]

DGR eligibility has become a contentious topic for charities, and it has significant implications for a not-for-profit's bottom line.

Productivity Commission Report 2024

In 2023, the federal government tasked the Productivity Commission with investigating ways of increasing charitable giving in Australia. The final report states as its purposes to first understand trends in philanthropic giving in Australia, the underlying drivers of these trends, and to identify opportunities and obstacles to increasing such giving. And second, to make recommendations to government to address barriers to giving and harness opportunities to grow it further.[27]

The final report was released to the public in July 2024. In it, the Commission recommended reform of the DGR system to create fairer and more consistent outcomes for donors, charities and the broader community. It recommended that a new approach should be principles-based, with classes of charitable activities included within the system based on whether:

- there is a rationale for taxpayer support because the activity is expected to generate net community-wide benefits and is likely to be undersupplied by the market;
- there are net benefits from providing government support for the activity through subsidising philanthropy using a tax deduction for giving (versus grants); and
- the risk of converting donations to private benefits is unlikely.

The Commission proposals would, it suggests, result in three major reforms. These are:

1. the majority of charitable activities would be eligible for DGR status, but some classes would be excluded where they do not align with the principles proposed by the Commission;
2. these excluded classes are all activities for the purpose of advancing religion, and activities related to aged care, early childhood education and care, and primary, secondary, religious and informal education. However, there should be an exception where the activities are undertaken by a PBI or for education activities that are clearly equitable. This would maintain the status quo for most charities; and
3. these reforms would increase the number of charities with DGR status from about 25,000 to between 30,000 and 40,000 charities.

Conclusion

The current system of determining DGR status is, it is argued, complex and based on outdated or confusing concepts, such as benevolence and poverty. This in turn provides obstacles to charity administrators in determining whether or not their organisation is eligible for this important status. The Productivity Commission's report is a clarion call for change, and it is hoped that the federal government is listening.

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A Matter of Trusts

by Kseniia Gasiuk, Sladen Legal

Vesting date amendments

This article explores the judicial considerations and complexities involved in amending trust vesting dates without explicit variation powers.

Introduction

Amendments to the vesting date of a trust are significant legal actions with far-reaching implications for both trustees and beneficiaries. From the Commissioner's perspective, the vesting date, which marks the point at which interests in the trust's assets become fixed, signifies that these interests have become vested both in interest and in possession. Modifying this to the beneficiaries would therefore solidify their entitlements to the trust property.[1] Whether the date can be varied by the trustee requires careful consideration of the terms of the trust or, where the terms of the trust do not allow the trustee to vary, whether the variation can be achieved through other methods. It also requires careful consideration for potential tax consequences.

This article explores the judicial considerations of trusts which lack explicit variation powers, with a particular focus on *Re Gengoult-Smith Family Trust* (*Gengoult-Smith*).[2] This case provides an exemplar of the legal complexities and challenges involved in extending a trust's vesting date, illustrating the court's application of s 63A of the *Trustee Act 1958* (Vic) to ensure that the trust's purpose and the beneficiaries' interests are preserved.

Variation power

The ability to change the vesting date is usually outlined in the trust document or governed under the administration and management authority granted in the different state and territory trustee Acts.

Trustees should first check the trust document to see if it allows for changes to the vesting date. Deciding if the trustee has the power to change the vesting date requires a careful look at the terms of the trust deed. While a trustee may possess a general power to amend the deed, there could be specific exclusions to that power, for example, this power might be confined to advancing the vesting date of the trusts, without allowing any extension of that date.

In the absence of explicit provisions, in limited circumstances, trustees may rely on the rule in *Saunders v Vautier*.[3] As stated in *Re Dion Investments Pty Ltd*,[4] while the principles of equity might allow for the extension of the rule in *Saunders v Vautier* to encompass the variation of a trust deed by adult beneficiaries who possess full legal capacity:

> "46. … Their capacity to produce that result also enables them to require, as an alternative, that the property be held by the trustee upon varied trusts; but, if they do so require, the situation may in truth be one of resettlement upon new trusts rather than variation of the pre-existing trusts (and the trustee may not be compellable to accept and perform those new trusts …)."

Alternatively, a trustee may need to seek court assistance to understand whether the vesting date can be amended. While the court's powers in this respect vary across jurisdictions, in Victoria, the court is not able to modify or change the fundamental terms of a trust; rather,[5] the court has specific powers to consent to the variation of the trust.[6]

In Victoria, s 63A of the *Trustee Act 1958* (Vic) permits the court to approve any arrangement to vary or revoke a trust on behalf of certain classes of persons incapable of providing consent, including minors and unborn beneficiaries.

The judgment in *Gengoult-Smith* provides a recent example of s 63A's application. In this case, the court concluded that extending the vesting date was in the interests of the minor and unborn beneficiaries as it allowed the trust to continue serving all beneficiaries. Without the extension, the benefits to these beneficiaries would cease.

Background

In *Gengoult-Smith*, Moore J of the Supreme Court of Victoria approved the application by Hugh and Edward Gengoult-Smith to vary the terms of the Gengoult-Smith Family Trust. The plaintiffs sought to extend the trust's vesting date from 29 April 2024 to 29 April 2054 (from 50 to 80 years). The stated reason for extending the vesting date was to avoid a significant CGT liability and to continue benefiting a broader class of beneficiaries,[7] including minors and potential unborn beneficiaries. The trust owned investments worth approximately $80m, primarily in real estate, and generated an annual net income of around $700,000.[8] Petela Nominees Pty Ltd was the trustee responsible for distributing the trust's income to its beneficiaries each year at its discretion.[7]

Clause 3 of the trust stipulated that, on the vesting date of 29 April 2024, the trust's assets were to be distributed equally among the surviving children of Norman and Jillian Gengoult-Smith, with a contingent remainder to the descendants of any deceased child. Consequently, assuming they survived until 29 April 2024, the trust vested in Hugh, Alexandra and Edward, each receiving an equal share.[9]

The court considered the consent of all adult beneficiaries to amend the vesting date and the interests of current and potential minor beneficiaries. After careful consideration, it was decided that extending the date would be beneficial as this would allow the trust to benefit family members, including minors and unborn beneficiaries and charitable organisations, for a longer period. The changes involved adjusting the distribution date, extending the time for the trust to exist to 80 years, and ensuring that the trustee's authority to make discretionary decisions remained unchanged.

Moore J held that the proposed changes aligned with the settlor's intentions and would prevent the trust's premature vesting, which would limit the potential benefits to only a few beneficiaries, all of whom consented to the change.[10] The Attorney-General for Victoria, representing charitable beneficiaries, did not oppose the application,[11] and all adult beneficiaries consented to the variations.[12] Consequently, the court found the arrangement to be proper and fair, leading to the approval of the proposed trust deed variations.[13]

Application for variation

In *Gengoult-Smith*, the trust deed's variation power did not allow changes to the clause specifying the vesting date. Specifically, the variation power in cl 5(d) of the Gengoult-Smith Family Trust stated:

> "15 … [The Trustee] may at any time and from time to time by Deed vary any of the provisions contained in clauses 5 to 10 hereof, provided that no such variation shall increase the rate of commission prescribed by clause 7 hereof or diminish the liability of the Trustee prescribed by clause 10 hereof or otherwise operate to the personal advantage of the Trustee."

It was submitted that, if the trust were to vest on the original date, it would incur a CGT liability of up to $10m and limit the distribution of assets to a smaller group of beneficiaries.[14]

Given the lack of explicit power to vary the trust to extend the vesting date, Hugh and Edward Gengoult-Smith, who were beneficiaries of the trust, applied for court approval to extend the vesting date under s 63A. The application proposed three key variations to the trust:[15]

1. replacing the vesting date of 29 April 2024 with 29 April 2054;
2. changing the word "fifty" to "eighty" in cl 3 of the trust deed, thus extending the trust's duration; and
3. inserting a new cl 3A to specify an 80-year perpetuity period, aligning with the new vesting date.

These changes were deemed necessary to maintain the trustee's discretionary powers over the trust's income and capital until 2054.

The court's consideration: a two-stage approach

When considering the application to vary the provisions of the Gengoult-Smith Family Trust under s 63A, Moore J applied a two-stage approach (which was also considered by Lyons JA in *Re The Pickering Family Trusts*[16] and elaborated on in *Perpetual Trustees Victoria Ltd v Barns*[17]), establishing a consistent approach to court considerations under a s 63A review.[18]

Stage one: benefit to the relevant persons

The first stage requires the court to determine whether the proposed arrangement would be for the benefit of the relevant persons – in this case, the minor and potential unborn beneficiaries of the trust. Moore J examined how the variations would operate in practice and whether a tangible benefit could be established.

In line with Lyons JA's analysis, three principles guided this.[19]

First principle: assessment of practical execution

The court must evaluate how the arrangement or proposal is likely to be executed in practice.

Second principle: demonstration of benefit

The benefit must be demonstrated, encompassing not just financial gains but also social, familial, moral or educational advantages. These benefits should be evaluated within the context of the specific trust. For discretionary trust objects, any proposed benefit must be considered, given their current rights. However, if the arrangement's benefits are merely theoretical or illusory due to inherent risks, it is not considered a "benefit" for the first stage purpose. Lyons JA expressed caution about the appropriateness of determining whether the risk is one an adult would take, particularly concerning infants or unborn children.

Third principle: limitations on familial benefits

Lyons JA noted the limitations in relying on familial benefits aimed at promoting family harmony and avoiding conflicts and jealousies. Applying these principles, in *Gengoult-Smith*, the court noted that, if the trust were to vest on 29 April 2024, the minor and unborn beneficiaries would lose their potential to benefit from the trust.

Conversely, extending the vesting date to 2054 would allow these beneficiaries to continue as discretionary objects of the trust and maintain their rights and expectations.

The extension would also provide an opportunity for more individuals to be born who could qualify as beneficiaries, aligning with the broader familial intentions of the settlor.

The court recognised that the beneficiaries' interests as discretionary objects meant that they did not have fixed entitlements to income or capital. Thus, the potential dilution of benefits due to a larger beneficiary class was outweighed by the advantage of prolonging the trust's duration.

Stage two: proper and fair arrangement

The second stage requires the court to assess whether the proposed arrangement is proper and fair. This involves a businesslike consideration of the arrangement as a whole, including the total advantages to various parties, their bargaining strength, and the trust's purpose.[20]

Moore J considered the purpose of the trust and the settlor's intention, which was to benefit the children of Norman and Jillian Gengoult-Smith. The proposed variations were supported by all sui juris beneficiaries, including those most directly affected by the change, namely, Hugh, Alexandra and Edward.[21] Their consent was essential as they stood to receive immediate benefits on the original vesting date. The deferral of their imminent entitlement in favour of a broader, longer-term benefit for the family and charitable entities was deemed to align with the settlor's intentions.

Furthermore, the court acknowledged that extending the vesting date would avoid a substantial CGT liability, preserving the trust's assets for future beneficiaries. Moore J affirmed the principle by McMillan J in *Re Perenna Nominees*[22] that:

> "45 … 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 court determined that the proposed variations to the Gengoult-Smith Family Trust deed were both beneficial to the minor and potential unborn beneficiaries, and proper and fair within the context of the trust's overall purpose and the settlor's intentions. Thus, the application under s 63A of the *Trustee Act 1958* was approved.

Conclusion

The court's comprehensive analysis in *Gengoult-Smith* underscores the complexity inherent in the court's power pursuant to s 63A of the *Trustee Act 1958*, and the challenges modifying trust provisions, when the trust deed does not explicitly confer the power to make such amendments.

The court's use of the two-stage approach under s 63A highlights the need to demonstrate tangible benefits for minor and potential unborn beneficiaries, and that those outweigh any benefits maintaining the status quo. It also highlights the requirement that any proposed variation be fair and appropriate. *Gengoult-Smith* demonstrates the meticulous process involved in a court applying its power to consent to vary the terms of a trust, ensuring that the interests of all relevant parties are protected and that it is consistent with the intentions of the settlor and purpose of the trust.

The *Gengoult-Smith* case illustrates that, by carefully applying legal principles and considering the broader implications of amendments, trustees can navigate these complexities to achieve outcomes that uphold the trust's integrity and benefit its intended beneficiaries, even when the trustee does not have power to do so.

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References

1 Para 12 of TR 2018/6.

2 [2024] VSC 189.

3 [1841] EngR 765. Note that this rule provides that, if beneficiaries are of full age and they consent unanimously, they can direct the trustees to terminate the trust and distribute the assets, regardless of the terms of the trust deed. Judges often reference this rule when beneficiaries wish to end a trust early but must ensure that all conditions are met. If there are minors or unborn beneficiaries, the rule cannot be applied as these parties cannot give their consent.

4 [2014] NSWCA 367.

5 *Re Dion Investments Pty Ltd* [2014] NSWCA 367.

6 See: s 81 of the *Trustee Act 1925* (ACT); s 81 of the *Trustee Act 1925* (NSW); s 94 of the *Trusts Act 1973* (Qld); s 59C of the *Trustee Act 1936* (SA); s 47 of the *Trustee Act 1898* (Tas); s 63 of the *Trustee Act 1958* (Vic); s 89 of the *Trustees Act 1962* (WA); and s 50A of the *Trustee Act 1893* (NT).

7 [2024] VSC 189 at [2].

8 [2024] VSC 189 at [1].

9 [2024] VSC 189 at [14].

10 [2024] VSC 189 at [44].

11 [2024] VSC 189 at [3].

12 [2024] VSC 189 at [5].

13 [2024] VSC 189 at [45]–[46].

14 [2024] VSC 189 at [2].

15 [2024] VSC 189 at [16]–[17].

16 [2024] VSC 5.

17 [2012] VSCA 77 at [36].

18 [2024] VSC 189 at [24].

19 [2024] VSC 189 at [25].

20 [2024] VSC 189 at [26].

21 [2024] VSC 189 at [44].

22 [2022] VSC 193 at [101].

Alternative Assets Insights

by James Nickless, Bianca Wood and Chris Stewart, PwC

New thin capitalisation regime

Taxpayers will need to assess the impact of the new thin capitalisation rules on their debt deductions and any resulting tax accounting adjustments.

Overview

Key components of the reforms to Australia's thin capitalisation regime apply to taxpayers with effect for income years commencing on or after 1 July 2023.

With 30 June fast approaching, June-balancing taxpayers will be the first group of taxpayers that needs to consider the impact of the new thin capitalisation rules and, where necessary, understand the tax accounting reflexes where there may be debt deductions disallowed.

We highlight some of the issues that June-balancing taxpayers should consider when working through the new thin capitalisation rules in preparation for their first-year end.

In detail

The new thin capitalisation regime for "general class investors" will broadly apply to income years commencing on or after 1 July 2023 (except for the new debt deduction creation rules, which will apply one year later).

Preparing for the first year end

For June-balancing taxpayers that are subject to the new thin capitalisation regime, reviewing your capital structure and financing arrangements before year end and determining indicative debt deductions and net debt deductions for the year ended 30 June 2024 is a great place to start. Additional steps are set out below.

Scope of the new thin capitalisation rules

All taxpayers should confirm, or reconfirm, that they are subject to the thin capitalisation rules. Some taxpayers may have paid little attention to the thin capitalisation rules in the past as they were safely within the safe harbour debt amount (effectively assuming that they were subject to the (former) thin capitalisation rules). These taxpayers should use this opportunity to validate whether they are in fact subject to the new thin capitalisation regime.

Similarly, taxpayers that were not subject to thin capitalisation due to the availability of certain exemptions should also consider which exemption they relied on and whether the basis for relying on this exemption still applies.

As an example, many June-balancing taxpayers are Australian headquartered businesses with offshore operations that previously were exempt from the thin capitalisation regime by relying on the 90% Australian asset exemption. While this exemption is still available in respect of the thin capitalisation rules, the debt deduction creation rules (which apply from income years commencing on or after 1 July 2024) can potentially affect debt deductions arising from both existing and new arrangements.

Further, assessing who a taxpayer's associate entities are is an important step in not only confirming whether the thin capitalisation rules apply, but also how these new rules apply. For example, this may be relevant to whether a deemed choice to apply the third-party debt test may be taken to be made for a taxpayer as a result of someone else's choice to use this test. The process of validating the relevant factual circumstances and undertaking analysis on this point can be a time-consuming process and should commence pre-year end.

Other rules that may limit deductions for interest

Before modelling the potential impact of the new thin capitalisation regime, it is important to consider the various other relevant Australian tax rules (see Table 1).

After considering the rules in Table 1, any (net) debt deductions that remain can then be tested under the new thin capitalisation rules. Practically, a debt deduction can only be denied once under the tax rules, so any taxpayers balancing budgeting and resource constraints should consider the order of priorities of the rules.

Modelling

Modelling the impact of the new thin capitalisation rules to the remaining net debt deductions can then be undertaken. Where modelling was undertaken based on previous draft versions of the rules, ensure that the latest assumptions and changes are applied, including the amendments expanding the scope of debt deductions that are subject to the thin capitalisation rules.

Tax accounting

Where debt deductions are denied under the thin capitalisation rules, this will impact the effective tax rate (ETR). However, this does not mean all debt deductions denied under the new thin capitalisation regime will have a permanent impact on the taxpayer's ETR as there may be opportunities to have a timing benefit where the fixed ratio test is applied.

Table 1. Other rules which might limit debt deductions

Transfer pricing for cross-border related party borrowing	For taxpayers with cross-border related party loans, the first step is to determine whether the quantum and pricing of the related party borrowing is arm's length. This step is important as any deduction denied under the transfer pricing rules is permanent.
Hybrid mismatch rules	Similarly, for taxpayers with related party loans and deductions denied under the hybrid mismatch rules, any denial under Div 832 is also permanent.
The debt deduction creation rules (apply to existing and new arrangements for income years on or after 1 July 2024)	While not applicable for this year end, for future years, this rule applies in priority to the thin capitalisation interest limitation rules. The interaction of the thin capitalisation rules and the debt deduction creation rules means that, for most taxpayers, these rules should be considered together, rather than waiting until next year to consider the impact of the debt deduction creation rules. Any debt deduction denied under these rules is also permanent.
Withholding tax obligations	Deductions will be denied where withholding tax obligations in relation to the payment of interest to foreign residents are not met. While this denial can be temporary (that is, the deduction is restored once the withholding tax obligation is met), this rule still needs to be assessed before applying the thin capitalisation rules.

Where taxpayers apply the fixed ratio test (broadly limiting net debt deductions to 30% of their tax earnings before interest, taxes, depreciation and amortisation), any disallowed deductions may be carried forward for up to 15 years. This is subject to an integrity rule and the entity continuing to use the fixed ratio test. The availability of any carried forward disallowed deductions also practically may be influenced by whether a taxpayer has current or prior year tax losses and its future forecast earnings.

Whether the carried forward disallowed deductions may qualify as a deferred tax asset subject to meeting the recognition criteria under *AASB 112 Income taxes* is a new question that should be discussed with auditors early. Some considerations could include:

- forecasting future excess fixed ratio limit capacity to utilise the disallowed amounts within the 15-year limit; and
- factoring in potential failure of the integrity rules which would limit the ability to utilised carry forward disallowed amounts (eg similar to the integrity rules to carry forward tax losses).

Pillar Two interaction

Some June-balancing taxpayers may be subject to the Pillar Two measures for their next fiscal year commencing on 1 July 2024. Fluctuations in permanent and timing differences may have a flow-on impact to the income tax expense amount for transitional country-by-country report safe harbour calculations (under the simplified ETR test) or global anti-base erosion calculations (where safe harbour is not available).

Under the draft Pillar Two transitional rules, pre-existing deferred tax assets and deferred tax liabilities can only be transitioned into the regime to the extent that they are reflected or disclosed in a constituent entity's financial accounts at the beginning of the transition year (ie the year ending immediately prior to the first year in which no safe harbour is relied on and the full Pillar Two rules apply). This can include unrecognised deferred tax assets or those with a valuation allowance against them, so long as they are reflected or disclosed.

The takeaway

The new thin capitalisation rules can be difficult to navigate and will require careful and due consideration. At a minimum, it is recommended that taxpayers should consider the following thin capitalisation issues for the year ended 30 June 2024:

- confirm whether they do in fact fall within the new thin capitalisation rules and/or if any exemptions continue to apply;
- identify debt deductions and net debt deductions, taking into account the changes to the definition of "net debt deductions";
- work through the order of priority of the various tax provisions that may apply to deny all or a portion of the debt deductions for the income year;
- model the impact of the new thin capitalisation rules and consider which test they will choose to use for the year ended 30 June 2024;
- consider the tax accounting reflex and impact on ETR for any potential denial under the new thin capitalisation rules, such as any permanent impact on the ETR or the potential to book a deferred tax asset for deductions denied under the fixed ratio test that can be carried forward to future income years; and
- consider the impact of the debt deduction creation rules from 1 July 2024.

It is important to note that any restructure of financial arrangements in light of the new thin capitalisation rules should consider the potential application of the general anti-avoidance rules.

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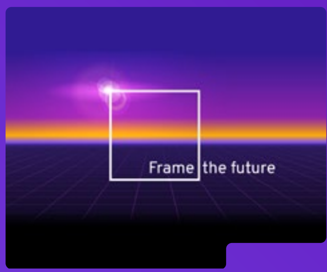
Events Calendar

Upcoming months

SEPTEMBER
11–13
Wed–Fri

NSW

The Tax Summit



20 CPD hours

OCTOBER
10–11
Thu–Fri

QLD Online

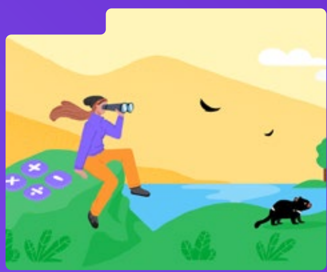
Death & Taxes Conference

12 CPD hours

OCTOBER
17–18
Thu–Fri

TAS

Tasmanian Convention



12 CPD hours

OCTOBER
17–18
Thu–Fri

VIC

National GST Conference

13 CPD hours

OCTOBER
24–25
Thu–Fri

VIC

National Transfer Pricing Conference

10 CPD hours

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Giving back to the profession

The Tax Institute would like to thank the following presenters from our July CPD sessions. All of our presenters are volunteers, and we recognise the time that they have taken to prepare for the paper and/or presentation, and greatly appreciate their contribution to educating tax professionals around Australia.

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