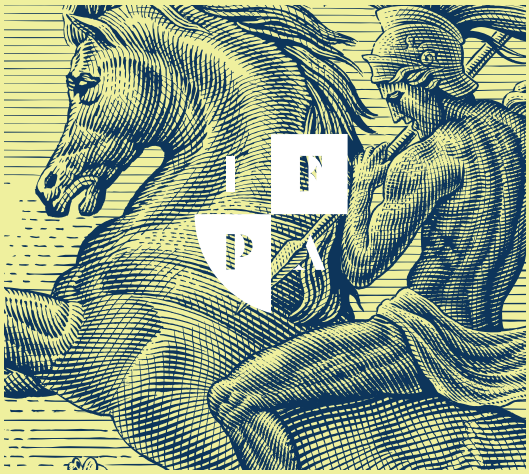
Monthly Tax Update

April 2024

INSTITUTE OF FINANCIAL PROFESSIONALS AUSTRALIA



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Monthly Tax Update

April 2024

These notes are a compilation of key case law, regulator updates and industry insights for you to easily stay abreast of the ever-changing tax landscape.

We hope you enjoy this update.

Warm regards,

The Team at the Institute of Financial Professionals Australia

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Taxpayer wins part IVA appeal on stapled arrangement

What you need to know

In a decision that may help calm the nerves of some family businesses operating through trust structures, the Full Court of the Federal Court has overturned a decision at first instance that Part IVA ITAA 1936 can apply to the exercise of a trustee's discretion to make distributions to lower rather than higher taxed beneficiaries.

Facts

Since 2002, the business of the Minerva Financial Group has involved the pooling of debt instruments into securitisation trusts, with the profit margin plus management fees being taxed at the corporate rate of 30%.

Based on external advice, the group undertook a restructuring process through 2007 and 2008 ahead of a planned IPO comprised of stapled securities. In effect, the group was restructured into separate corporate and trust silos, with companies in the corporate silo holding special units in a newly formed intermediate holding trust (IHT). Due to impact of the GFC in 2008, the IPO was delayed for many years, but the restructure nevertheless went ahead as Minerva expected to enter the market using a stapled structure in an IPO at some point. This did not occur until 2020.

Following the restructure, new securitisation trusts were established under the IHT and the net interest income was distributed to the head trust, which in turn distributed the interest to the non-resident controllers. The trust deed empowered the trustee to make distributions to the corporate silo by way of the special units, but it largely refrained from doing so after the restructure. Following the restructure, the corporate silo continued to derive some management fees and other income, which remained subject to 30% tax.

Quite apart from the legal and commercial ramifications of the restructure, the upshot was that almost all of the group's net interest income was now subject to 10% withholding tax instead of 30% corporate tax, an outcome that was not much to the Commissioner's liking.

Part IVA determinations

The Commissioner identified three separate schemes to which he said Part IVA applied, although they can be conveniently regarded as two: firstly, the decision to restructure the business into the two silos and issue stapled shares and secondly, the trustee's failure to exercise its discretion to make distributions to the corporate side of the business in the income years ended 30 June 2012 to 2015.

In each case the Commissioner determined there was a scheme in connection to which someone obtained a tax benefit and that the dominant purpose for entering into or carrying out the scheme was to obtain that tax benefit.

Decision at first instance

The appellant conceded there was a scheme with a connected tax benefit but argued that neither scheme was entered into for the dominant purpose of obtaining a tax benefit.

O'Callaghan J at first instance ruled against the Commissioner in relation to the first scheme, finding that the restructuring clearly attracted commercial benefits as expert evidence established that having the silo structure with the stapled securities was likely to maximise the value of the upcoming IPO.

In relation to the second scheme, however, the court held that its dominant purpose was to benefit from the 20% reduction in tax imposed on the profits generated by the securitisation business. In making this finding, the court took the view there were no logical reasons, other than the tax benefit, for the trustee failing to make distributions to the corporate side of the group:

> *"The applicant was unable to provide any cogent reason, other than the tax benefit, why the decision was taken in each of the relevant years to direct no more than 2% of MHT's net income to the special unitholders." [Primary Judgment at 564]*

Minerva appealed to the Full Federal Court in respect of this decision.

Full Court decision

The Full Court observed that the Trial Judge had failed to consider evidence adduced by Minerva about the tangible commercial benefits that arose from directing the net interest distributions to the trust silo, having regard to the profile of likely investors and the fundamental changes in the commercial position of the group's corporate entities. And in searching for reasons for the trustee's failure to make distributions to the corporate silo the Full Court felt the Trial Judge strayed into the subjective motives of the decision makers, which is not what the law requires:

> *"(Section 177D(2)) requires a conclusion about purpose to be drawn from the eight objective matters; it does not require or even permit any inquiry into the subjective motives of the taxpayer or others who entered into or carried out the scheme or any part of it: Hart at [65]." [at 60]*

The Full Court also ruled that the scheme or transaction has to be viewed in its entirety, including all the commercial and other consequences that flowed to Minerva and its associated entities as a result of the restructure:

> *"... the conclusion to be drawn under s 177D is not drawn by looking only at the consequences of what was done or by comparing the tax consequences of what was done with the tax consequences of another possible transaction that achieved different commercial outcomes. It is a conclusion to be drawn by reference to the eight factors applied to the totality of the scheme considered in its wider context." [at 61]*

Accordingly, the Full Court held that the requisite dominant purpose had not been established by the Commissioner and the Part IVA assessments could not be sustained:

> *"It was not disputed that a tax benefit had been obtained by the appellant. If distributions had been made differently more Australian tax would have been payable. But the identification of a tax benefit does not answer the question posited by s 177D. Nothing in the surrounding context objectively supports a conclusion that any party to any of the schemes either entered into or carried out any of the schemes for a dominant purpose of enabling the appellant to obtain a tax benefit." [at 123]*

But beware a potential legislative 'fix'

It's sometimes a little unnerving when taxpayers enjoy success before the courts on Part IVA matters. Back in 2013 the definition of a "tax benefit" was amended to overcome a series of setbacks the Commissioner suffered at the hands of the courts and, subject to a possible Special Leave application to the High Court in this case, there is a risk that the Commissioner will look for the Parliament to lower the purpose threshold to something less than dominant, heaven forbid.

But for the moment, at least, the taxpayer should celebrate the win.

Implications for family trusts

At the time the decision at first instance was handed down in 2022 and following the earlier decision in *Guardian,* the association voiced concerns about the Commissioner's use of Part IVA to attack the exercise of a trustee's discretion to make distributions of trust income in a particular way. Could your typical family trust be next in the firing line or does the Full Court's recent decision now take that off the table?

The best answer is probably that while the recent Full Court decision in *Minerva* is unlikely to make much difference either way, the Commissioner would face considerable political (rather than legal) obstacles in using Part IVA to attack the time-honoured practice of loading up low income adult beneficiaries with trust distributions out of the family business (subject, of course, to the reimbursement agreement rules in s100A).

On a strict legal basis, many family trust distribution practices would arguably be highly susceptible to the application of Part IVA. Almost any course of conduct is a scheme and there will be a tax benefit which arises from distributing income to low tax adult family members rather than to the controlling individuals with a higher marginal tax rate. That only leaves the dominant purpose box to be ticked and it is hard to see, when viewed objectively, that the annual trust distribution cherry picking process is done for any reason other than to minimise the overall tax paid by someone in the family. In most cases the practice would be unlikely to produce the sorts of commercial advantages the Full Court identified in *Minerva.*

So why isn't the ATO not already pushing out Part IVA determinations by the dozen?

Political barriers

In theory, the Commissioner is an independent statutory officer who administers the law without fear or favour, regardless of the complexion of the government of the day. But decades of administrative practice have created well-established channels of communication between the ATO and the Treasurer's office, and it is inconceivable the ATO would embark on a Part IVA based attack on family trusts without first informing the Treasurer.

The scars from the 2019 Federal election, when Labor proposed a 30% minimum tax on trust distributions (among other contentious tax policies) remain relatively fresh, so it must be unlikely the Labor government would encourage such a move, regardless of what they might really want to do. For what it is worth, Labor formally ditched its 30% trust brainwave in the leadup to the 2022 election. And they'd never go back on something they've said, would they?

No ATO appetite for it

In the s100A debate that lasted for most of the first half of 2022, the ATO tried its best to reassure the tax and business community that its "beneficiaries must benefit" mantra would not in most cases be applied retrospectively, while its guidance material outlined some limited exceptions going forward by way of the ordinary family dealing carve-out.

There was also the following public comment from a senior ATO officer about making distributions to lower tax adult beneficiaries:

> *"That's fine, we accept or understand that that's a part of the tax landscape," Louise Clarke, a deputy commissioner at the ATO who runs the agency's private wealth division, said.*
>
> *"What concerns the ATO is where the person who is in line to receive the money from the trust doesn't get the benefit of the distribution and it actually goes to another party", she said.*
>
> *[Source: The Guardian 26 June 2022]*

While these comments are not legally binding on the ATO, it does reflect the ATO's practice over many decades of tolerating the tax focused distribution practices engaged in by many family trusts and it is difficult to see that changing absent a law change. But there is a new Commissioner in the job now, so who knows what might happen?

Section 100A will be the ATO's primary weapon

It seems clear the ATO will mostly rely on s100A and its "beneficiaries must benefit" principle to rein in what it sees as the inappropriate use of trusts.

By and large, s100A audits will look to establish that the appointment of trust income to low tax adult beneficiaries (and indeed, all beneficiaries) is actually paid out and applied to the benefit of those beneficiaries.

Practitioners should be familiar with the ATO guidance material on s100A that was issued in December 2022 – TR 2022/4 and PCG 2022/2. Of particular interest are the following paragraphs in the PCG:

- **Para 25(b)(i)**

  There is no trustee retention of funds if the retention of funds ends within two years. In most cases the PCG applies to the appointment of present entitlements made on or after 1 July 2022, which for most family trusts will be the trust distribution resolutions made in June 2023. Those distributions will not be regarded as UPEs until June 2025, so trustees have until that time (if they wish) to work out how beneficiaries would like to settle their 2023 present entitlements.

  The day of reckoning will arrive eventually, but the two-year rule effectively gives trustees up to two years of distributions that are available as working capital for the family business.

- **Para 50(d)**

  The ATO can be expected to ask for details of how the present entitlement to trust income was satisfied and, where practical, used by the beneficiary. A useful checklist item when arranging for the 2024 trust distributions might be to ask how the beneficiaries used last year's distribution.

Minerva Financial Group Pty Ltd v C of T [2024] FCAFC 28 (8 March 2024)
(Besanko, Colvin and Hespe JJ)

Transfer pricing rules apply to interest of $894 million

Facts

The taxpayer (a resident Australian company) claimed $894m in interest deductions incurred on a Loan Note Issuance Agreement (LNIA) (ie a "bond issue") with a related foreign company (which also involved the acquisition of shares in the taxpayer). Both the taxpayer and the related company were 100% owned by SingTel, a company resident in Singapore.

The LNIA amounted to $5.2billion with interest being claimed over four income years. The original interest rate was the one-year Bank Bill Swap Rate plus 1% per annum (as adjusted by the required rate of 10/9ths mark-up). However, the agreement was later amended which increased the rate by 4.55% and then amended again to result in a rate of some 13.25%.

The Commissioner issued transfer pricing determinations and amended assessments to deny the taxpayer a deduction for the interest of $894m on the basis that the taxpayer obtained a "transfer pricing benefit". The taxpayer's objections against the assessments were disallowed.

On appeal, the Commissioner argued *(as required by Subdiv 815-A) that* he had formed a "*reliable hypothesis" that* the agreement was not one that would have been expected between parties dealing at arm's length and that as a result *(as required by Subdiv 815-A)*, an amount of profit that the taxpayer might have made was not otherwise made.

On the other hand, the taxpayer argued that the effective rate of interest it incurred over the life of the agreement was in fact lower than might have been expected in an arm's length agreement between independent parties.

Decision at first instance

In *Singapore Telecom Australia Investments Pty Ltd v FCT* [2021] FCA 1597 the Federal Court said that the taxpayer's approach *"depart[ed] too far from the actual transaction and the characteristics of the parties to that transaction, and thus depart[ed] from the approach required under Subdiv 815-A".* In this regard, it emphasised that *"the actual transaction…did not involve a DCM bond issue… [and] there are significant differences between the terms of the LNIA and the terms of a typical DCM bond issue."*

The Court also said that the other major difficulty with the taxpayer's approach was that it involved the calculation *(in hindsight)* of the effective credit spread of the LNIA, rather than focussing on what independent parties in the positions of the taxpayer and the "creditor" party, dealing independently with each other, might be expected to have originally agreed at the time of each relevant amendment to the LNIA.

Accordingly, the Court held that:

- the financial relations between the taxpayer and the "creditor" company differed from those which might be expected to operate between independent parties
- a reliable hypothesis is that independent parties in the positions of the parties might have been expected to have agreed that interest under the loan notes could be deferred and capitalised and that there would be a parent guarantee of some sort

- a reliable hypothesis was that independent parties in the positions of the parties would not have agreed to make the changes contained in the later amendments.

The Court therefore concluded that for the relevant years of income an amount of profits might have been expected to accrue to the taxpayer and that because of the LNIA, the amount of profits has not so accrued.

Appeal

On appeal to the Full Federal Court, the taxpayer argued that, among other things, the primary judge erred in:

- formulating the hypothesis required by Subdiv 815-A (and Div 13 of the ITAA 1936)
- finding that moving to an increased interest rate for the last 3 years of the loan term was not commercially justified, and
- finding that the capitalisation of interest should be on an annual basis.

However, the Court unanimously found that the taxpayer had not made out these grounds of appeal - and therefore dismissed the appeal.

Note the taxpayer was also unsuccessful in its appeal from the decision at first instances to seek a deduction (as a carried forward loss) of $259m – being the interest incurred under the original loan as unamended, which the taxpayer claimed was rightly incurred. However, the Court essentially ruled that the transfer pricing legislation in Subdiv 815 operates on an income by income year basis and that it was therefore inconsistent with the statutory scheme to take into account a carried forward loss in this way.

Comment

One would think that intercompany "capital raisings" where the interest is not set (and held) at an arm's-length rates would be an easy target for the transfer pricing rules.

Singapore Telecom Australia Investments Pty Ltd v FCT [2024] FCAFC 29

Life insurer succeeds on input tax credit apportionment

What you need to know

An Australian life insurer, Hannover Life, has seen off the Commissioner's appeal over the apportionment of input tax credits relating to certain overhead expenses in circumstances where Hannover was making both input taxed and GST-free supplies.

Facts

Hanover is a wholly owned Australian subsidiary of a German reinsurance group, Hannover R. Its business includes:

- **Making input taxed supplies (no ITC entitlement).**

  This includes writing life insurance and reinsurance policies in Australia.

- **Making GST-free supplies (entitled to ITCs).**

  Hannover also supplied reinsurance on life policies issued by other insurers in New Zealand and by Hannover R.

In making both the input taxed supplies and the GST-free supplies, Hannover made acquisitions relating to business overheads such as rent, audit and legal fees, advertising costs, IT expenses, telephone expenses and office supplies. Hannover claimed a portion of the ITCs relating to these overhead acquisitions as being referrable to its GST-free business.

The question for determination was whether any of the overhead acquisitions related partly to the GST-free supplies or whether, as argued by the Commissioner, they were all related to the input taxed supplies made by Hannover.

The Commissioner had also denied Hannover's claim for ITCs relating to commissions paid for services relating to its Australian life insurance business. This was upheld in the decision at first instance and was not appealed to the Full Court by Hannover.

The court at first instance ruled in Hannover's favour in relation to the apportionment of overhead related ITCs. The Commissioner appealed to the Full Court.

The law and ATO guidance

As one would expect, the GST Act 1999 provides for apportionment where acquisitions are made partly for a creditable purpose – ss11-5(a), 11-15, 11-25 and 11-30(3).

In GSTR 2006/4 the ATO states that the method of apportionment used must be fair and reasonable and refers with approval to the apportionment of ITCs relating to overhead acquisitions in several places – eg, para 52, para 113. And in example 11 in para 142, the ruling includes a worked example where 60% of the overheads are attributed to making taxable supplies.

There is nothing remarkable in either the law or the ATO guidance, which makes it difficult to understand why the Commissioner persisted in his argument that Hannover was not entitled to any ITCs in relation to its overhead acquisitions.

Commissioner's arguments

The Commissioner sought to establish that the GST-free reinsurance supplies only arose "by and through" the input taxed supplies made by Hannover (the Australian life policies). In doing so, he was seeking to make a tenuous link to *Rio Tinto* (2015), which dealt with the provision by a mining company of residential premises to employees and contractors in the Pilbara region. In the alternative, the Commissioner argued that the method of apportionment was not fair or reasonable.

Full Court decision

Neither the Primary Judge nor the Full Court bought into the Commissioner's argument, however, with the Full Court ruling that the overheads applied in an undifferentiated way to both Hannover's input taxed supplies and its GST-free supplies.

The Full Court also held that the Primary Judge had not erred in law in deciding that the revenue based method of apportionment, with one minor adjustment already made by the Primary Judge, was a fair and reasonable method of apportionment.

The Commissioner's appeal was therefore disallowed.

Comment

The Commissioner's appeal in this case rested on what the Full Court decided was the wrong view about the relationship between the overheads and the two different kinds of supplies made by Hannover.

As a revenue collector, the Commissioner has an understandable aversion to taxpayers claiming ITCs. Hopefully the decision will encourage him to more closely follow his own ruling on overhead apportionment and taxpayers who make mixed supplies can confidently continue to apportion overheads going forward. A Decision Impact Statement to that effect would be welcome.

C of T v Hannover Life Re of Australasia Ltd [2024] FCAFC 23 (4 March 2024)
Derrington, Thawley and Hespe JJ

Defined lifetime pensions not excluded from excess transfer balance calculations

What you need to know

The Full Federal Court held that defined benefit lifetime pensions that are subject to commutation restrictions (ie "capped defined benefit income streams") are not excluded from the calculation of excess transfer balance for the purpose of the transfer balance cap.

Facts

The taxpayer was in receipt of three retirement phase pensions. The first two pensions were defined benefit lifetime pensions, which were classified as CDBISs. This means they have commutation restrictions and restrictions on the ability to convert them into a lump sum or make partial withdrawals (per s294-130 of the ITAA97). The third pension was a market-linked flexi-pension which did not fall under the CDBIS category.

In December 2017, the Commissioner determined that the taxpayer's transfer balance of $3,452,308.57 exceeded the $1.6m transfer balance cap (TBC) that existed at the time. The amount of $3,452,308.57 was made up of the two CDBISs, valued at $1,826,422.46 and $1,371,642.72 respectively, the market-linked flexi-pension (ie the non-CDBIS) valued at $243,955.48 and excess transfer balance earnings of $10,287.91.

Note: If an individual receives both a CDBIS and another type of superannuation income stream that is not classified as a CDBIS that individual may exceed both their TBC and their capped defined benefit balance. If this applies to an individual, they will have an excess transfer balance and the Commissioner will issue them with an excess transfer balance determination in accordance with s136-10 of Sch 1 to the *Taxation Administration Act 1953* (TAA).

In January 2018, the Commissioner issued an excess transfer balance determination to the taxpayer in accordance with s136-10(1). The determination requested the taxpayer to commute the excess amount of $254,243.39 out of his non-CDBIS by 6 March 2018. Furthermore, the determination specified that if the taxpayer failed to do so, the Commissioner would send a commutation authority to his super fund, instructing it to commute the excess amount from his non-CDBIS.

The taxpayer's objection against the determination was disallowed. He then sought review by the AAT.

AAT at first instance

Before the AAT, the taxpayer argued that:

- the actions of the Commissioner amounted to the acquisition of property by the Commonwealth on unjust terms, thus contravening s51(xxxi) of the Constitution, which grants the Commonwealth the power to acquire property "on just terms"; and

- both of his CDBISs should be excluded from the excess transfer balance calculation under Division 294 as both were subject to commutation restrictions. If so, that would have meant that he had no excess transfer balance at all.

In *Stern and FCT* [2023] AATA 2010, the AAT first noted that Div 294 provides for a modified calculation of the excess transfer balance in cases involving the receipt of a CDBIS. It then reasoned that if all CDBISs were excluded from the calculation, the specific provisions of Div 294 would serve no purpose. Consequently, the AAT rejected the taxpayer's interpretation and on the basis that:

> *"... the plain meaning of s 294-140(3) is not ambiguous and does not lead to a result that is absurd or anomalous, particularly when understood in the larger context of the legislative scheme. The interpretation proposed by the taxpayer is impossible to square with the plain text of the provision."*

The taxpayer appealed to the Federal Court from this decision.

Issues/arguments before Federal Court

The central issue in the appeal was whether s294-140 should be interpreted to exclude defined benefit lifetime pensions from the calculation of the excess transfer balance.

The taxpayer argued that it would be absurd or unreasonable for the legislation to be construed in a way that treats the income from defined benefit lifetime pensions as assessable while also including those pensions in the calculation of the excess transfer balance.

Further, the taxpayer claimed s294-140 should be interpreted to avoid what he perceived as an illogical or unreasonable outcome.

Court decision

The Full Federal Court rejected the taxpayer's view stating that *"section 294-140 makes clear that CDBISs are also taken into account in determining whether a person has excess transfer balance".*

The Court also dismissed the taxpayer's claim that such an interpretation was "ambiguous or manifestly absurd or unreasonable". It found that such a view was contrary to the underlying purpose and objectives of the provisions and that they should be construed in accordance with words in fact used. It also said that it would not be sensible to interpret s294-140 as excluding any CDBIS with commutation restrictions.

In other words, the Court held s294-140 is designed to address and account for the specific circumstances and considerations related to CDBISs with commutation restrictions. It said that the section, along with s294-130, work together as part of the legislative framework to ensure consistent treatment and appropriate calculations regarding these particular income streams.

***Stern v FCT* [2024] FCAFC 21, 1 March 2024**

ATO's application for security order for costs granted

What you need to know

If you are a foreign resident with no significant assets in Australia and you appeal a large assessment issued to you from the ATO, expect the Commissioner to apply for an order for security for costs – and expect the ATO to be successful.

Facts

The facts can be summarised as follows:

- The taxpayer was a foreign resident of Australia and had been since 2019.
- He was issued with both amended and default assessments for income years in which he was a resident of Australia. These substantially increased his assessable income in relation to alleged entitlements to income from offshore entities.
- His objections to the assessments were disallowed and he lodged appeals.
- The Commissioner sought orders for security for costs of some $606,000 under s56(1) of the *Federal Court of Australia Act 1976* and relevant Federal Court Rules.

Issues and arguments

The taxpayer argued that it was not appropriate for a costs order to be made against him because he was under the operation of the tax laws, in effect, the "defendant" in the proceedings. The Commissioner argued that there was a "real risk" that the taxpayer would not satisfy any order for costs if he failed in the proceedings – as he was a foreign resident with no significant assets in Australia (but substantial ones overseas, including bank accounts).

Decision

The Court ordered that the taxpayer provides security for $450,000 (and not $606,000). In arriving at this decision, the Court noted the following matters:

- While there *"were some defensive elements to his claim…by and large, [the taxpayer] was the aggressor"* in the proceedings.
- The taxpayer invoked the jurisdiction of an Australian court where he was resident overseas and the most of his assets were beyond the reach of Australian courts.
- On the material before the Court, there was a risk that the taxpayer would be unwilling to meet any adverse costs order made against him.
- There was no threat that the requirement that the taxpayer provide security would stifle the prosecution of his action.

- The respective merits of the parties' arguments on the issues which will arise in the appeal has little impact to the cost order.

In relation to the reduction in the amount of the security, the Court said that reductions were needed to take into account that: the Commissioner had already spent a not inconsiderable amount in the action; the proceedings might terminate prior to the completion of a trial; and the proceedings conceivably involve some defensive element on the taxpayer's behalf.

***Gumm v FCT* [2024] FCA 71**

Australian tax residency sticks to Dubai based engineer

What you need to know

The uncertainty that continues to surround the question of tax residency for individuals was again on display in a recent AAT decision involving an Australian engineer on a long-term assignment to Dubai. Given Dubai's lack of personal income tax, there are obvious advantages in a taxpayer employed in Dubai being treated as a non-resident for Australian tax purposes. In this case, however, the applicant's ongoing family ties to Australia and his failure to establish personal connections in Dubai weighed against a finding that he was not an Australian tax resident.

Facts

Mr. Quy is a mechanical engineer who commenced employment with CBI Constructions in 1986. He accepted a posting to Dubai in 1998, when his wife and three young daughters accompanied him there. When the Dubai work of the firm declined as a result of the GFC, the applicant and his family returned to Perth in 2009 to continue his employment with CBI. He bought a home in Perth in 2010 and also owned two investment properties in Sydney.

In 2015 the applicant accepted a new posting to Dubai, but this time his daughters remained behind in Perth as the eldest two were at university and the youngest was completing High School. Mrs. Quy did accompany her husband to Dubai initially, but ended up spending far more time in Perth over the years in question in order to support her daughters and also to care for her sick mother. In Dubai Mr. Quy lived in accommodation provided by his employer where his employer was the lessee of the apartment.

The applicant returned to Perth when taking leave and stayed in the family home when he did. According to immigration records he spent 47 days, 29 days, 34 days and 41 days in Australia in the 2017, 2018, 2019 and 2020 income years respectively, having left for Dubai in September 2015. With so little time in Australia, this clearly takes the 183-day test off the table. The Dubai assignment came to an end in 2021, when the applicant accepted a posting to Thailand. During his time in Dubai, CBI paid his salary into a Dubai bank account.

Mr. Quy supported his family financially throughout this period, allowing his daughters to reside in the Perth property rent-free while paying the mortgage and all other costs, including utilities.

While living in Dubai, he also maintained registration for three cars and a motor cycle, and renewed his driver's licence using his Perth home as the address. He maintained private health insurance in Australia for the entire period, even though his employer provided health cover in Dubai.

Did applicant's wife live in Dubai or Perth?

This became a relevant (although not determinative) issue for the Tribunal, and one where the applicant and his wife tried to gild the lily a bit by submitting after the hearing that Mrs. Quy resided in Dubai with the applicant throughout the period. At the hearing, however, the applicant conceded that his wife resided in Perth with their daughters and sometimes came to visit him in Dubai. In the Tribunal's view, this strengthened his ties to Australia.

Retirement plans

In evidence given at the hearing and in the ATO residency questionnaire completed by the applicant plans were revealed to eventually retire in Sydney where much of the applicant's family resides – another factor which tended to point to an intention to take up residency in Australia. In submissions made after the hearing, however, it was claimed that the applicant and his wife instead planned to retire in Thailand where living costs are much lower. The Tribunal took the view that during the years in question (while he was working in Dubai) the applicant intended to retire in Sydney and seemed uncomfortable with some of the self-serving inconsistencies in the applicant's story. If he changed his mind after later spending time in Thailand that was not a relevant consideration.

Ordinary concepts test

In canvassing the case law covering the ordinary concepts test, the Tribunal observed that providing financial support to family members remaining in Australia is usually an important indicator of residency (*Harding*). Other relevant findings of fact pointing to Australian residency included:

- not selling or letting his Perth residence during his absence;
- maintaining vehicle registrations and his driver's licence;
- his intention to eventually retire in Sydney to be near his and his wife's family;
- the fact that his visa and accommodation were tied to his employment did not allow him to establish any real personal connection with Dubai;
- he did not take any of his Australian furniture with him to Dubai, nor did he take any furniture acquired by him in Dubai to his next posting in Thailand; and
- he maintained his Australian health cover throughout the period.

Domicile test

Section 6(1)(a)(i) ITAA 1936 provides that a person is an Australian resident where they are domiciled in Australia unless the Commissioner is satisfied that they have a permanent place of abode outside Australia. The Tribunal held that the applicant had a domicile by choice in Australia and there was no evidence suggesting that his permanent place of abode was in Dubai. In particular:

- the limited way in which he engaged with Dubai throughout his assignment was not consistent someone who permanently resides in Dubai;
- his accommodation was leased and paid for by his employer, as were his utility costs;
- his Dubai bank account revealed only limited discretionary or leisure spending aside from food purchases;

- his furniture use was not indicative of someone setting up a new home in Dubai; and
- there was no evidence of Mr. Quy's involvement in any local clubs or social networks while working in Dubai.

The Commissioner's decision disallowing the objections was accordingly upheld.

Comments

Mr. Quy was away from Australia for almost six years and followed up his Dubai assignment with another posting to Thailand. This seems like a long stretch during which he spent very little time in Australia. Yet his ongoing family ties in Perth and his failure to establish roots in Dubai meant that he was unable to shake off his Australian tax residency.

The outcome might have been different if his wife had also moved to Dubai, but while she had family reasons for remaining in Australia it could not be said on any reasonable basis that she resided in Dubai and was not an Australian resident. The applicant's case was probably not advanced by attempts to stretch the truth about Mrs. Quy's situation and the last minute alleged change in their retirement plans.

One wonders, however, how realistic it is to expect expats working in the Middle East to form personal ties with the local community and use that as one of the indicia for residency. Expats in those locations tend to mix with other expats, although in this case the evidence was that Mr. Quy kept largely to himself on work days and at weekends.

The outcome might also have been different under the Board of Taxation's 2019 report on residency. The proposed ceasing residency 45-day rule for permanent residents would have made him a non-resident in 2020, while the proposed overseas employment rule may have taken him out of the Australian tax net for one or two of the earlier years as well. But that report has gone back to Treasury for further consultation and who knows what it will look like when it eventually resurfaces.

Quy v Commissioner of Taxation [2024] AATA 245 (26 February 2024), Member D Mitchell

Division 7A – getting the basics right

What you need to know

The ATO has recently raised concerns that some tax agents and their clients are not getting the basics of Division 7A right and is embarking on an education program to help get taxpayers back on the right track.

Division 7A

Division 7A is a well-established integrity measure designed to prevent company profits from being passed on to shareholders or their associates tax-free.

It can apply to loans, payments and other benefits, including the use of company assets. Unless loans, payments or benefits are repaid or converted to a s109N compliant loan, shareholders will be taken to have received an unfranked dividend from the company.

ATO concerns

The ATO claims it has uncovered many instances where shareholders of private companies are treating the company as their personal bank account without complying with the fundamental aspects of the provision. This includes a lack of basic record keeping, borrowing from the company to make minimum yearly repayments (MYR), not keeping up with the MYR requirements at all and other issues.

Year long lecture series

The ATO proposes to run a lecture series through 2024 to help taxpayers and practitioners better understand the basic requirements of Division 7A. At this stage it is not clear whether this will happen in person or on-line.

Some of the ATO's concerns can be found on webpage QC 101226, which also has a link to an ATO webinar on the topic that was run on 28 February 2024.

What to do

Our experience in talking to members is that practitioners are well enough across the requirements of Division 7A, but that some of their clients are sometimes a little too informal in using company funds that they understandably (but wrongly) regard as their own.

But where the ATO expresses concerns and sets off on a lecture series, audits are sure to follow, so it may not hurt to pay extra attention to the use of company funds or other assets by shareholders and their associates when preparing company tax returns and generally keep Division 7A compliance in good order.

GSTR 2024/1: GST exemption for food: What is a "combination of one or more foods"?

This Determination provides the Commissioner's view on when, under s38-3(1)(c) of *GST Act 1999*, a supply is a supply of food that is a "combination of one or more foods" of at least one of which is food of a kind specified in the third column of the table in cl 1 of Sch 1 to the GST Act. If this is the case then the food product is not GST-free.

The Determination arises following the decision of the AAT in *Chobani Pty Ltd and FCT* [2023] AATA 1664 (*Chobani*) in which it was ruled that the food product in question was a combination of one or more foods at least one of which is food of a relevant kind – and therefore it was not GST-free.

Decision in *Chobani*

The Chobani Flip Strawberry Shortcake flavoured yoghurt product comprised flavoured yoghurt in a plastic tub compartment with dry inclusions (cookie pieces and chocolate chips) in a smaller compartment of the tub. Each of the dry inclusions was a taxable food. It was expected that the dry inclusions would be flipped into the yoghurt before consumption.

The AAT found that it was 'inescapable' that the product was a combination of flavoured yoghurt, cookie pieces and chocolate chips, within which the latter components were *"not insignificant; remain readily identifiable; and are not subsumed into a separate product"*.

In doing so, it noted that the classification of a food product involves questions of fact and degree, objectively taking all factors into account, to arrive at an answer by way of 'overall impression'. It also stated that the word 'combination' takes its ordinary meaning, as the *"product or outcome of joining two or more things together in some way"*. Finally, it emphasised that the product was to be classified at the point of supply.

The Ruling does not consider what is a taxable food, or the extent to which a supply of food is a taxable supply. Nor does it apply to issues of how to apportion the consideration for a supply that includes taxable and non-taxable parts (see GSTR 2001/8).

Ruling

The following three principles apply in determining if there is a supply of a combination food:

- There must be at least one separately identifiable taxable food.
- The separately identifiable taxable food must be sufficiently joined together with the other components of the overall product at the time of sale.
- The separately identifiable taxable food must not be so integrated into the overall product, or be so insignificant within that product, that it has no effect on its characterisation.

Principle 1 – at least one separately identifiable taxable food – key points:

- A food is separately identifiable when it can be perceived as such by ordinary visual inspection by way of looking carefully at the food -albeit this may involve some interaction with the food (eg by removing packaging)
- The food does not need to be physically separated from the other components nor does it need to be capable of being eaten separately.
- A food is not a combination food solely because it is made from ingredients ie being listed as an ingredient in a food alone is not sufficient to establish that a food is separately identifiable for these purposes.

See Example 1 – circumstances where food does not include at least one separately identifiable taxable food.

Principle 2 – sufficiently joined together – key points:

- The separately identifiable taxable food must be sufficiently joined together with the other components of the overall product at the time of sale.
- To be sufficiently joined together, the components must be supplied as a single item for consumption, as opposed to 2 or more distinct supplies of food.
- The components of the combination food do not need to be physically mixed, whether at the time of sale or afterwards, for the taxable food to be sufficiently joined together.
- Whether food is sufficiently joined together is determined at the time of sale. Relevant factors include physical appearance and packaging, labelling, marketing etc.

Example 2 illustrates that whether separately identifiable foods are sufficiently joined together, so that they are a combination food, is a matter of overall impression taking into account various factors.

Principle 3 – so integrated into or insignificant within the overall product

Key points:

- There will be cases where the separately identifiable taxable food is so integrated into the overall product, or is so insignificant within that product, that it would not affect its characterisation (eg where it is merely an incidental accompaniment to the product).
- Such cases require a qualitative assessment and are a matter of overall impression. Where a percentage quantity exists, this is just one relevant factor and does indicate that there is a bright-line test if a product is a combination of food.

See Example 3 for food that is not a combination food – integrated foods.

> ***Comment***
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> *When the GST was first proposed, one of its aims was to avoid the classification issues that bedevilled the old Sales Tax system. But this objective required all supplies to be subject to GST, with no exemptions. As a result, this well-meaning design feature was a dismal failure – as illustrated by this case.*

NOTE: This writer has recollections of a case from the 1990s where the judge or tribunal member got very angry about having to determine whether "edible undies" (whatever they may be!) was food or clothing for sales tax classification purposes!

DIS on *Wood* decision – deduction for settlement payment

What you need to know

The availability of a deduction under s8-1 of the ITAA 1997 for the payment of settlement moneys is unusual. The decision of the Federal Court to allow a deduction in this case has limited application beyond its own factual circumstances. This decision does not represent a departure from established principles concerning s8-1.

Facts

The taxpayer owned a financial consultancy firm (Carina) which provided services to a third party (Alleasing) – which paid fees to Carina for its services and Carina in turn paid a salary to the taxpayer. When the consultancy arrangement came to an end Carina and Alleasing entered a Separation Deed and the taxpayer then took up new employment elsewhere.

Alleasing later sued the taxpayer for $2.4m alleging that he had negotiated unauthorised transactions when performing consultancy services for Alleasing. The claim included claims of misleading or deceptive conduct. At the same time, the taxpayer threatened a defamation claim against Alleasing on the basis that it made defamatory statements about him to his new employer concerning the allegations about the unauthorised transactions.

Sometime later, the first proceedings were settled on the basis that the taxpayer pay Alleasing $200,000 (the settlement sum). The threatened defamation action was also settled on the basis that Alleasing pay the taxpayer $180,000. Both settlements were concluded by way of a set-off, resulting in an obligation on the taxpayer to pay Alleasing $20,000.

The taxpayer claimed a deduction under s8-1 of the ITAA 1997 for the amount of the settlement sum ($200,000) he was required to pay under the first settlement agreement.

Comment

Presumably the taxpayer brought the $180,000 payment into his assessable income - thereby justifying his claim for a deduction for the full $200,000, despite the requirement to only pay $20,000 under the set off arrangement.

AAT decision

At first instance, in *Wood and FCT* [2022] AATA 4147, the AAT ruled that s8-1 operated to allow the taxpayer a deduction in respect of the $200,000 payment on the basis that *"from a 'practical business point of view' it bore the essential character of a payment related directly to the activities that the [taxpayer] performed in the work that he did for Alleasing – and that this work produced assessable income for him by reason of his position with Carina".* The AAT also ruled that the payment did not have the features of a capital payment in the sense that it was not made for producing some longer-term benefit that might endure.

Federal Court decision

The Commissioner's appeal in *FCT v Wood* [2023] FCA 574 involved two issues:

- ***Issue 1 – whether the Settlement Sum was deductible under paragraph 8-1(1)(a)***

  The Court held that the settlement sum was properly characterised as having been incurred in gaining the taxpayer's assessable income as its payment bought to an end the litigation in which some $2.4m was claimed – and thereby avoided the risk of a judgment, which would have amounted to a considerable reduction in income gained in subsequent tax years.

  The Court also said that it was calculated to bring to an end a litigation risk *which had as its source* the taxpayer's employment with Carina and its consultancy agreement with Alleasing.

- ***Issue 2 – whether the Settlement Sum was of a non-deductible capital nature***

  The court rejected the Commissioner's characterisation of the Settlement Sum as a loss or outgoing of a capital nature. It did so on the basis that *"the payment of the sum was primarily aimed at protecting [his] reputation in the future, and to compensate him for any defamation in the past".* The Court also said that "to otherwise characterise the Settlement Sum as capital or of a capital nature would *"elide the different nature and purposes behind the Settlement Deed and the Deed of Release when [t]hey were legitimately directed to different ends".*

ATO view

The Commissioner accepted, on the facts found by the AAT, that this conclusion was available to the Court. It was also the Commissioner's view that this decision has limited application beyond its own factual circumstances, saying that *"the decision does not represent a departure from established principles concerning s8-1, and the application of these principles always turn on the facts of the particular case".*

DIS: *Bowerman* case – deduction for loss on sale of home

What you need to know

The unusual facts and findings in this case will mean that it will have limited application. However, you may need to be wary if a home is bought for a profit-making purpose and later sold for a profit – in circumstances where there is profit making activity that is clearly carried on in a "businesslike manner".

Facts

- The taxpayer was a retiree who, with her husband, had run successful businesses and had invested in property. They lived in a large matrimonial home.
- In July 2015, after her husband's passing, the taxpayer entered into a contract to purchase an apartment (the Foreshore apartment) that was under development - with the intention of moving into it as her home after its completion in 2019.
- In November 2017, after being advised that construction of the Foreshore apartment would be extended into 2020, the taxpayer acquired a similar off-the-plan apartment to be built at an earlier stage in the development (the Dune apartment) – and to move in as her home on a temporary basis. She resided there for approximately two years.
- The taxpayer "considered" she could make a profit on the acquisition and resale of the Dune apartment when it was time to move into her ultimate residence.
- In July 2020, when construction of the Foreshore apartment was completed, she sold the Dune apartment (as she needed the funds to purchase the Foreshore apartment), incurred a loss on the sale of $265,936 and moved into the Foreshore apartment.
- The taxpayer unsuccessfully objected to the assessment which denied the deduction and applied to the AAT for review.

Issues

- Whether the Dune apartment was held on revenue account ie whether she acquired it for a profit-making purpose that was carried out in a business-like manner (per the principles in *FCT v Myer Emporium Ltd* [1987] HCA 18) – and therefore whether the loss was deductible under s8-1(1)(a) of the ITAA 1997.
- Whether the loss was of a non-deductible capital, private or domestic nature.
- In what income year the loss was incurred – in the 2020 income year when the contract of sale of the Dune apartment became unconditional (as the taxpayer claimed) or in the 2021 income year upon the completion of the contract.

Tribunal decision

1. **First Limb of *Myer Emporium* test:** One of the taxpayer's purposes for acquiring the Dune apartment was to live in it. But this was secondary to her more significant profit-making purpose.
2. **Second Limb of *Myer Emporium* test:** The taxpayer was a businessperson and was opportunistic in the purchase of the Dune apartment. The acquisition and sale of the apartment was treated to be a "commercial transaction" as it was ***the sort of thing a business person would do*** (per the test in *Greig v FCT* [2020] FCAFC 25).

Therefore, the *Myer Emporium* principles were met – and the loss on sale was deductible.

The loss had not lost its connection with her profit-making intention and therefore, the loss was found not to be categorised as essentially private or domestic in nature.

The loss was incurred in 2020 income year (and not the year of settlement of the contract) because the taxpayer relied on a statement in para 9 of TR 97/7 (below) which indicated the taxpayer had incurred the loss in that year when the contract for the sale of the apartment became unconditional.

In these circumstances, subject to the propositions outlined above, a taxpayer who uses a cash receipts based accounting system need not necessarily have paid or borne a loss or outgoing in order for that loss or outgoing to have been "incurred" for the purposes of section 8-1.

ATO view of the decision

- The AAT's factual findings and decision was open to it on all the evidence – despite the "unusual" nature of both (something the AAT also acknowledged).
- The AAT's conclusion on the taxpayer's intention was open to it on the particular facts. However, it is important to note that a profit-making purpose *alone* is insufficient to engage the *Myer Emporium* principle.
- In relation to the second limb the ATO stated: *"The decision applies the approach of Steward J in* Greig v FCT, ***which remains the most authoritative explanation of the concept of a 'business operation or commercial transaction'*** *within the meaning of the principle established in* Myer Emporium*".*
- The ATO concluded by saying that *"cases concerning the application of the principles in* Myer Emporium *always turn on the facts of the particular case, and that the unusual factual findings in this case will limit its application in future cases".*
- The ATO accepted the finding that the non-application of the exclusions for private or domestic outgoings *"was informed by its finding that the taxpayer's most significant reason for acquiring and selling the apartment was her profit-making purpose".*

Finally, the ATO agreed with the AAT's observation that existing authority supports the conclusion that the taxpayer did not 'incur' the loss until the contract of sale of the Dune apartment had been completed. But the ATO takes a different view to the AAT as to the interpretation of TR 97/7 – and is considering whether to update TR 97/7 to remove any perceived ambiguity or uncertainty as to its interpretation.

Comment

This decision may give the ATO some ammunition to capture the profits made on the sale of a home that is clearly bought for a profit-making purpose where the profit making activity is clearly carried on in a businesslike manner (and currently the bar for this test is low). And you only have to regularly read the glitzy property section of the newspapers on a Saturday to see that the decision may not have as limited application as suggested.

Status of Tax Matters @ 22 March 2024

(This table is not intended to be comprehensive)

Status of Tax Matters @ 22 March 2024	
Legislation	**Status**
Fair Work Legislation Amendment (Closing Loopholes) Bill 2023 • Contains provisions introducing several changes to the workplace relations framework, including undoing the High Court decisions in in *CFMMEU v Personnel Contracting Pty Ltd* [2022] HCA 1 and *ZG Operations Australia Pty Ltd v Jamsek* [2022] HCA 2.	Royal assent 26 February 2024 Act No 2, 2024
Treasury Laws Amendment (Making Multinationals Pay Their Fair Share – Integrity and Transparency) Bill 2023 • Requires Australian public companies to disclose information about their subsidiaries in their annual financial reports for financial years commencing from 1 July 2023. • Tightens the thin capitalisation rules for MNEs to limit debt deductions to 30% of EBITDA in most circumstances, also commencing from 1 July 2023.	Remains before the Senate
Treasury Laws Amendment (Support for Small Business and Charities and Other Measures) Bill 2023 • $20,000 instant asset write-off for small business entities • Small business energy incentive • New class of deductible gift recipients • Deductible gift recipients—specific listings • Exemption for Global Infrastructure Hub Ltd • Income tax amendments for updates to the accounting standard for general insurance contracts • Non-arm's length expenses of superannuation funds • AFCA scheme	Before the Senate (since 27 November).

Status of Tax Matters @ 22 March 2024	
Treasury Laws Amendment (Tax Accountability and Fairness) Bill 2023 • PwC response — Promoter penalty law reform • PwC response — Extending tax whistleblower protections • PwC response — Tax Practitioners Board reform • PwC response — Information sharing • Petroleum resource rent tax deductions cap Note: The Information Sharing Bill gives the ATO and TPB the ability to disclose protected information with prescribed professional disciplinary bodies (to be defined) where the ATO or TPB reasonably suspects acts or omissions may constitute a breach of the prescribed disciplinary body's code of conduct or professional standards (EM p4).	Passed by the House. Before the Senate since 18 March 2024.
Administrative Review Tribunal Bill 2023 *Administrative Review Tribunal (Consequential and Transitional Provisions No. 1) Bill 2023* *Administrative Review Tribunal (Consequential and Transitional Provisions No. 2) Bill 2024* • Replaces the AAT with an Administrative Review Tribunal and an Administrative Review Council.	Introduced into the Senate on 25 March 2024.
Treasury Laws Amendment (Cost of Living Tax Cuts) Bill 2024 • Contains the amendments to the Stage 3 tax cuts.	Act No 3, 2024
Treasury Laws Amendment (Cost of Living—Medicare Levy) Bill 2024 • Changes the various Medicare thresholds for the 2023-24 year.	Act No 4, 2024
Foreign Acquisitions and Takeovers Fees Imposition Amendment Bill 2024 Treasury Laws Amendment (Foreign Investment) Bill 2024 • triples the foreign investment fees for the purchase of established homes; • doubles vacancy fees for all foreign owned dwellings purchased since 9 May 2017; • enhances the ATO's compliance regime to ensure foreign investors comply with the rules, including selling their residence when required.	Before the Senate since 26 February 2024.

Status of Tax Matters @ 22 March 2024	
Superannuation(Objective) Bill 2023 • This bill enshrines the objective of superannuation in legislation and requires that any future changes to superannuation laws are consistent with the legislated objectives. • The main objectives are the preservation of savings and the delivery of income to fund retirement.	Before the Senate since 20 March 2024
Scheduled Parliamentary sitting days	
Both the House of Representatives and the Senate are having a break during April and will resume sittings for the Budget session in May.	
Appeals	
There are no appeals to report.	