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PRACTITIONER ARTICLES

[754] Taxation consequences of testamentary trust distributions - Part II

- by Matthew Burgess and Patrick Ellwood, Directors, View Legal

Part I of this article (at 2014 WTB 19 [658]) considered a number of specific aspects of the transfer of assets under a deceased estate testamentary trust. Part II of the article now considers:

- distributions from testamentary trusts to beneficiaries;
- the proposed changes to CGT event K3; and
- the proposed changes where an intended beneficiary dies.

Distributions from testamentary trusts

In 2003, the ATO released PS LA 2003/12, which states that its purpose is to inform ATO staff that the

Commissioner will not depart from the long-standing administrative practice of treating the trustee of a testamentary trust in the same way as a legal personal representative (LPR) is treated for the purposes of Div 128 of the ITAA 1997.

In the 2011-12 and 2012-13 Federal Budgets, it was proposed that the current ATO practice set out in PS LA 2003/12 of allowing a testamentary trust to distribute an asset of a deceased person without a capital gains tax (CGT) taxing point occurring would be codified.

While draft legislation to effect the change was prepared, the Federal Government announced that it was reviewing the progress of a large number of unenacted legislative announcements and ultimately confirmed on 14 December 2013 that the amendments would not be implemented - see 2013 WTB 53 [2270] and also 2014 WTB 12 [399].

As set out at 2014 WTB 16 [561], the ATO recently republished PS LA 2003/12 confirming that it intends to continue to consider itself bound by it. Despite the ATO apparently acknowledging that the Government will not proceed with any legislative changes, some amount of confusion has been caused by the ATO stating in updates on its website that it will "accept tax returns as lodged during the period up until the proposed law change is passed by Parliament". Those comments are contained in the ATO update entitled "*Refinements to the income tax law in relation to deceased estates*" (dated 22 April 2014). It is assumed these comments are simply an oversight by the ATO and that PS LA 2003/12 (as amended) will continue to be applied indefinitely into the future.

The position therefore appears to remain that there is exemption roll-over from CGT covering the "transfer" of assets from the LPR to the trustee of the testamentary trust in the first instance and the subsequent transfer by the trustee to an eventual beneficiary of the testamentary trust. The subsequent transfer may either involve a capital distribution being made by the trustee of the trust to a beneficiary during the lifetime of the trust, or a payment of capital upon vesting of the trust.

The result of PS LA 2003/12 is that, on the subsequent disposal of a CGT asset from a testamentary trust trustee to a beneficiary of the testamentary trust:

- any capital gain or loss that the testamentary trust trustee makes is disregarded under s 128-15(3); and
- the beneficiary will be taken to have acquired the CGT assets of the deceased at the date of the deceased's death (rather than on the date they were distributed by the LPR) and the first element of the cost base and reduced cost base for the beneficiary will be:
    - for pre-CGT assets in the hands of the deceased - the market value of the asset on the day the deceased died; and
    - for post-CGT assets in the hands of the deceased - the deceased's cost base (or reduced cost base) at the date of their death.

Ultimately under PS LA 2003/12, Div 128 (in particular ss 128(2), (3) and (4)) effectively applies twice:

- initially, when the LPR is the "LPR" for the purposes of Div 128 and the testamentary trust trustee is the "beneficiary"; and
- subsequently, when the testamentary trust trustee is treated as an "LPR" for the purposes of Div 128 and the beneficiaries of the testamentary trust are treated as the "beneficiaries".

CGT event K3

The ATO has indicated that the position in PS LA 2003/12 is subject to CGT event K3, which covers assets passing to tax-advantaged entities.

CGT event K3 operates to ensure that, where assets pass to concessionally taxed entities from a deceased estate, a capital gain or loss is recognised in the deceased's final tax return. This prevents assets with embedded capital gains from avoiding capital gains when they are later disposed of by the concessionally taxed entity. CGT event

K3 has, in the past, been avoided by ensuring an asset does not pass to a concessionally taxed entity until after the deceased's standard amendment period (generally 4 years after the assessment) has expired.

As part of the 2011-12 Budget measures, it was announced that amendments would be made to ensure that where CGT event K3 happened outside of the deceased's standard amendment period, a CGT liability still arose in the deceased's tax return. It was proposed this could be achieved by excluding CGT event K3 from the standard amendment period.

In particular, the CGT event would have been deemed to happen to the relevant entity that passed the asset to the concessionally taxed entity (rather than with the beneficiary), avoiding the need to amend the deceased's tax return. This change would have allowed the entity to which CGT event K3 applied to be able to utilise its realised capital losses against CGT event K3, instead of the deceased utilising their capital losses against their capital gain from CGT event K3.

The change would have been consistent with how Div 128 operates under PS LA 2003/12 where an LPR or testamentary trust trustee sells an asset to a third party, rather than passing the asset to the intended beneficiary of the estate.

However, as with other proposed changes mentioned below, the announced changes to CGT event K3 were abandoned in late 2013.

Where an intended beneficiary dies before administration is completed

The Federal Government released a proposal paper "*Minor amendments to the capital gains tax law*" in June 2012 which specifically addressed the circumstance where an intended beneficiary dies before administration of an estate is completed. Generally, in that situation, s 128-15 provides a CGT roll-over provided that the asset passes from the first deceased's LPR to the beneficiary's LPR.

However, no CGT roll-over exists where the asset passes (ultimately) from the first deceased's LPR via the second deceased's LPR to the trustee of a testamentary trust or a beneficiary of the intended beneficiary's (ie the second deceased) estate because the asset was not one which the intended beneficiary owned when they died.

The former Labor Federal Government proposed to introduce measures to allow the intended beneficiary's LPR to access the roll-over where the intended beneficiary died before an asset that the first deceased owned passed to them, regardless of whether it passed first to a testamentary trust trustee. Again, however, the Coalition Government confirmed the amendments would not be implemented.

Arguably, PS LA 2003/12 can be relied on to provide relief in this type of situation.

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2014 BUDGET FOLLOW-UP

[755] Super excess contributions: IGT recommendations to improve ATO admin

As part of the 2014 Federal Budget, the Government announced that it will allow individuals the option of withdrawing superannuation contributions in excess of the non-concessional contributions cap made from 1 July 2013 and any associated earnings, with these earnings to instead be taxed at the individual's marginal tax rate. The measure will seek to provide a process to addresses all inadvertent breaches of the superannuation contribution caps where the error would result in a disproportionate tax penalty. Final details of the policy will be settled following consultation with key stakeholders in the superannuation industry.

The Acting Assistant Treasurer said the proposal to allow the withdrawal of excess non-concessional contributions deals with both policy recommendations made in the Inspector-General of Taxation's report on the Tax Office's approach to superannuation excess contributions tax (ECT). (See also 2014 WTB 20 [718]).

Senator Cormann said the Inspector-General's ECT report also made 9 other recommendations to improve the ECT system. Those recommendations, in the main, seek to improve the administration of the ECT through further ATO assistance being provided to taxpayers in monitoring their contribution levels. The ATO has agreed in full, in part or in principle with 8 of the 9 recommendations. The ATO has disagreed with a specific recommendation directed at the *de minimis* concession.

Mr Noroozi said in identifying excess contributions and determining assessments, the Commissioner adopts the view that it is appropriate to not issue an ECT assessment where the excess contribution is below a certain pre-set threshold. This is generally referred to as a *de minimis* approach. The Inspector-General said ATO statistics have indicated that between the 2009-10 and 2011-12 financial years (inclusive) a large number of taxpayers who have exceeded either or both of the contributions caps have benefited from the *de minimis* approach.

The IGT considered the ATO should publish more details about its *de minimis* approach. The IGT recommended that the ATO:

- publish further information on its ECT *de minimis* approach, including how the ATO identifies and treats such cases and what taxpayers can do if they consider that their case qualifies for *de minimis* consideration but have nonetheless received an ECT assessment; and
- inform taxpayers when the *de minimis* approach has been taken in relation to their excess contributions.

The ATO said the recommendation could lead to the *de minimis* threshold being known or reasonably estimated and that this could give rise to individuals unfairly obtaining a benefit by making excess contributions up to the threshold on an ongoing basis. Informing taxpayers when they are under the de minimis would also increase administration and compliance costs. However, the ATO said it agreed to publish on its website general information on the *de minimis* approach. The ATO also reiterated its agreement to explore options to assist taxpayers understand and monitor their contributions, including those individuals who may be getting close to exceeding their caps.

Other ATO responses to some of the key recommendations are as follows:

- ***Bring forward trigger*** - The ATO has agreed to explore options for promptly notifying taxpayers when they have triggered the "bring forward".
- ***Genuine mistakes*** - The ATO has agreed to the IGT's recommendation to update public guidance on genuine mistakes leading to excess contributions to reflect those circumstances in which mistakes may be effectively corrected and those in which it may not.
- ***Test case re contributions limiting clauses*** - The ATO has agreed to the recommendation that it seek an appropriate test case vehicle to obtain a judicial declaration on the effectiveness of contributions limiting clauses to cap the amount of contributions made to superannuation funds.
- ***Commissioner's discretion*** - The ATO has agreed to: update its public guidance to include guidance on commonly occurring factual scenarios in discretion applications; and review existing public guidance to ensure that wording used, particularly in examples of the exercise of the Commissioner's discretion, does not create perceptions of insensitivity.

The report, including the Tax Office's response, is available on the IGT website.

Source: Acting Assistant Treasurer's media release, 13 May 2014

by Lisa Lynch

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[756] Some planning issues around Budget measures: 2% budget deficit levy; CSHC

The advent of the 2% deficit/debt tax (levy) has no doubt got minds working on what it means in a practical sense and whether there are planning opportunities. Of course, it must be remembered that the legislation for the levy is still before Parliament and amendments to it are always possible.

Application of levy to superannuation benefits

Generally speaking, the 2% debt levy will not apply to superannuation benefits to the extent such amounts are received by a taxpayer as "non-assessable non-exempt income" (ie tax-free). For example, a superannuation lump sum or a superannuation income stream benefit (eg an account-based pension or annuity) will not be subject to the Levy when received by a person aged 60 or over from a taxed source. However, the taxable component of a superannuation benefit (lump sum or income stream) paid to a person under age 60 is included in the taxpayer's assessable income (and a tax offset applies to cap the maximum rate). Therefore, certain superannuation benefits paid to a taxpayer under age 60 (eg a transition to retirement pension) will potentially be caught by the Levy if the taxpayer's total taxable income for the year is above $180,000.

The application of the Levy to a taxpayer's "taxable income" means that it is necessary to trace precisely which income items fall within "taxable income" (ie assessable income less deductions). Assessable income includes ordinary income and statutory income, but excludes "exempt income" and "non-assessable non-exempt income" (eg superannuation benefits paid from a taxed source to a person aged 60 or over). Assessable income includes statutory income like grossed-up dividends and net capital gains for the income year (after reducing the capital gain for any capital losses and applying the 50% CGT discount, where applicable). Likewise, the taxable component of an employment termination payment (ETP) is also included in assessable income. See further Thomson Reuters *Australian Tax Handbook* for further information on which items of income flow through to a taxpayer's taxable income.

Commonwealth Seniors Health Card income test to include untaxed super

The Government announced in the Budget that it will include untaxed superannuation income in the assessment of income to determine eligibility for the Commonwealth Seniors Health Card (CSHC) from 1 January 2015. All superannuation account-based income streams held by CSHC holders before the implementation date will be grandfathered under the existing rules.

Currently, to qualify for the CSHC, a person's annual "adjusted taxable income" (ATI) must be less than:

- $50,000 (singles);
- $80,000 (couples combined); or
- $100,000 (couples combined separated by illness, respite care or prison).

The threshold is increased by $639.60 for each dependent child. Introducing indexation for these thresholds will mean more people will satisfy the adjusted taxable income test and therefore qualify for the CSHC. Note that the CSHC is not subject to an assets test.

This proposal to include untaxed superannuation amounts for the purposes of the CSHC income test will require existing CSHC holders to do some long-term planning for their account-based pensions and annuities ahead of the 1 January 2015 start date. Budget Paper No 2 [p 193] suggests that, "All superannuation account-based income streams held by CSHC holders before the implementation date [1 January 2015] will be grandfathered under the existing rules."

Subject to the final rules, it appears that it will be necessary to have a CSHC before 1 January 2015 and have any account-based pensions in place before 1 January 2015 to access the grandfathering rules. It is also likely that grandfathered pensions will need to continue uninterrupted from that day. For example, commuting an existing account-based pension after 1 January 2015 would be likely to trigger the new rules. Therefore, it is worth reviewing account-based pensions ahead of the 1 January 2015 start date for both this CSHC measures and the social security deeming rules for account-based pensions.

by Stuart Jones and Terry Hayes

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[757] New Restart subsidy for employers hiring Australians 50 years or over

In the 2014-15 Budget, the Government announced that employers can receive up to $10,000 over 24 months in Government assistance if they hire a job-seeker aged 50 or older under its new "Restart" program - see 2014 WTB 20 [749]. A requirement is that the job seeker must have been on income support for at least 6 months. The program will replace the Seniors Employment Incentive Payment and will start on 1 July 2014.

Employers that hire mature-aged job seekers on a part-time basis (12-29 hours per week) will be eligible for a pro-rated subsidy based on actual hours worked.

Under the program, eligible employers will receive $3,000 if they hire a full-time mature-age job seeker who was previously unemployed for a period of 6 months and employ that person for at least 6 months. A requirement is that the job seeker must have been on income support for at least 6 months. Further, once that job-seeker has been working for the same employer for 12 months, the employer will receive another payment of $3,000. Finally, the employer will then receive a further $2,000 once the same job seeker has been with them in full-time employment for 18 months, and $2,000 again at 24 months. Therefore, the maximum Restart payment is $10,000 over 24 months. Employers that hire mature-aged job seekers on a part-time basis (12-29 hours per week) will be eligible for a pro-rated subsidy based on actual hours worked.

To be eligible for the assistance, employers will need to demonstrate that the job they are offering is "sustainable and ongoing", and that they are not displacing existing workers with subsidised job seekers.

Eligibility for Restart

If history is any guide, employers will need to satisfy various strict conditions to qualify for the $10,000 over 24 months under the proposed Restart program. Until the full details and final eligibility rules for Restart are confirmed, employers planning to access this generous Restart program from 1 July 2014 can start preparing by reviewing the conditions for similar employment programs offered in the past. For example, the former Government had offered a $1,000 Jobs Bonus for employers who recruited and retained a worker aged 50 or over for at least 13 weeks from 1 July 2012. The Jobs Bonus was announced in the 2011-12 Budget to implement a recommendation of the Henry Report. The Jobs Bonus was open to all employers who satisfied the basic requirements, such as being a legal entity. Unfortunately, the catch with the Jobs Bonus was that it was only available for up to 2,500 employers each financial year as the former Government only committed $10m over 4 years to the program: see 2013 WTB 10 [399].

by Terry Hayes and Stuart Jones

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[758] Help for small exporters with export fees and charges

The Government announced in the 2014-15 Budget that it would provide additional funding of 415m over 4 years to help small exporters with the cost of export fees and charges. A rebate will be available in 2014-15 to cover 50% of export registration charges up to a maximum of $5,000.

For the remainder of 2014-15, the export sectors will work with the Dept of Agriculture to review the export certification fees and charges through existing committees.

Source: Minister for Agriculture media release, 13 May 2014

by Terry Hayes

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[759] Other Budget measures

The 2014-15 Federal Budget also announced the following:

- The Government confirmed in the Budget that, from 1 July 2015, it would introduce its Paid Parental Leave Scheme which will provide 6 months paid leave. It will have an income cap of $100,000 per annum, and will include superannuation. No other details were given.
- The Government said it expected total revenue for 2014-15 to be $391.3bn, an increase of 4.6% on estimated revenue in 2013-14. However, it said total expenses for 2014-15 are expected to be $414.8bn.
- The Government announced that there would be a $200m boost to the Export Finance and Insurance Corporation's capital base, and a $50m boost to the EMDG program.

by Terry Hayes

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TAX PRACTICE UPDATE

[760] Foreign resident CGT Principal Asset Test: draft legislation released

On 14 May 2013, as part of the 2013 Federal Budget, the previous Government announced amendments to the foreign resident CGT Principal Asset Test. Specifically, the proposal involved changes to the Principal Asset Test in Subdiv 855-A of the ITAA 1997 to ensure that indirect Australian real property interests are taxable if disposed of by a foreign resident. The proposal consisted of 2 components:

- First, intercompany dealings between entities in the same tax consolidated group will not form part of the Principal Asset Test calculations, ensuring that assets cannot in effect be counted multiple times (thereby diluting the true asset value of the group).
- Second, in determining the value of the TARP assets of the entity in which the interest is held, intangible assets connected to the rights to mine, quarry or prospect for natural resources (notably mining, quarrying or prospecting information, rights to such information and goodwill) will be treated as part of the rights to which they relate. See 2013 WTB 20 [849].

On 4 November 2013, the Government announced that it would proceed with the announced amendments to the Principal Asset Test. See 2013 WTB 47 [1983].

On 13 May 2014, Treasury released exposure draft legislation for consultation. Treasury noted the proposed amendments in the exposure draft also include a change that has been made to the scope of the asset duplication measure. In particular, it said the scope of the measure is not restricted to entities that are members of the same consolidated group or MEC group. That is, the proposed amendments are broader than those announced by the previous Government.

Treasury also noted that the exposure draft explanatory memorandum notes the Government's decision to defer proceeding with the valuation measure pending the outcome of ongoing litigation of the issue (see in particular the decision of the Full Federal Court in *FCT v Resource Capital Fund III LP* [2014] FCAFC 37 handed down on 3 April 2014: reported at 2014 WTB 14 [508]). However, Treasury noted the community's views were still sought on the proposal through the exposure draft.

Accordingly, the exposure draft legislation only contains proposed amendments relating to the asset duplication measure. The amendments are designed to help prevent the double counting of certain non-TARP assets that can distort the application of the Principal Asset Test. The amendments to s 855-30 of the ITAA 1997 are proposed to be contained in *Tax and Superannuation Laws Amendment (2014 Measures No 3) Bill 2014*.

Under the proposed changes, where the assets of 2 or more entities are included in the Principal Asset Test, the market value of new non-TARP assets arising from transactions between those entities will be disregarded for the purposes of the Principal Asset Test. In particular, certain assets that relate to liabilities located elsewhere in the corporate group will not be counted because they do not represent the group's underlying economic value.

Date of effect

Where the entities involved in the creation of the new non-TARP asset are members of the same tax consolidated group, or MEC Group, the amendments will apply to CGT events that occur after 7.30pm on 14 May 2013 (Budget Night). For all other entities, the amendments will apply to CGT events occurring on or after the day on which this exposure draft is released for public consultation (ie 13 May 2014).

Submissions

Comments are due by 9 June 2014 and can be sent to: Senior Adviser, Corporate and International Tax Division, The Treasury, Langton Crescent, PARKES ACT 2600 - email: ForeignResidentCGT@treasury.gov.au. Enquiries can be directed to Peter Peters (Policy) (02) 6263 2969 or Jesse Murphy (Law Design) (02) 6263 3690.

by Lisa Lynch

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[761] G20 Tax Symposium Tokyo: closing remarks by Commissioner

On 10 May 2014, the Tax Commissioner made his closing remarks at the G20 Tax Symposium held in Tokyo, Japan. A key issue raised by a broad range of representatives was the need to improve the international tax system. "While there are differences of opinions, the discussion over the past 2 days demonstrated a significant amount of goodwill and a willingness to cooperate on what will be difficult issues as we get to the sharper end of addressing the deficiencies in the international tax system," Mr Jordan said.

In relation to fostering greater cooperation, Mr Jordan said the ATO was "already working with other tax agencies on sharing intelligence, risk assessments and compliance action". Further he said: "16 Tax Commissioners from across Asia will join me in November to further our regional response to BEPS and increase tax transparency. Like the Symposium, we will be listening to each other's views, supporting each other and developing multipronged actions to reach common goals."

by Lisa Lynch

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[762] Implementation of FATCA in Australia - Regulation Impact Statement released

The Office of Best Practice Regulation has released a Regulation Impact Statement, certified by Treasury, on the implementation of the US Foreign Account Tax Compliance Act (FATCA) in Australia.

On 28 April 2014, the Treasurer announced the signing of an intergovernmental agreement (IGA) between Australia and the US regarding FATCA – see 2014 WTB 18 [626]. Australia's current regulatory environment – including its anti-discrimination and privacy laws – creates certain difficulties and uncertainties for Australian financial institutions in complying with the requirements of FATCA. The IGA is aimed at supporting industry by establishing a legal framework that will enable financial institutions to comply with FATCA.

Compared with the status quo (under which the Government would take no action), each of the model IGA options considered sought to reduce the compliance costs and other impacts of FATCA on Australian financial institutions, primarily through: (i) streamlining information reporting requirements; (ii) resolving apparent conflicts between FATCA compliance and Australian laws; and (iii) reducing the scope of the reporting requirements by excluding certain categories of accounts.

All of the 3 options (including the status quo) were likely to impose significant compliance costs on the Australian financial sector. The precise nature and magnitude of those costs under each scenario would have depended on how individual financial institutions chose to respond to FATCA. The adoption of the preferred option – the model 1 IGA – is expected to result in average annual compliance cost savings of around $58m. These compliance cost savings have been assessed relative to the estimated compliance costs that could have been incurred in the absence of Government action.

The agreement has been assessed as likely to have a major impact on the Australian financial sector with flow-on effects to the broader economy. A Regulation Impact Statement (RIS) was prepared and certified by Treasury and has been assessed as adequate by the Office of Best Practice Regulation. Given the significance of the proposal, a post-implementation review will be required within 5 years.

by Terry Hayes

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[763] Tax Office website updates

From the ATO website:

- ***Activity statement reminders*** – The ATO says there are several options taxpayers might want to use to remember when activity statements are available online after the ATO transitions them to be fully electronic. From 1 July 2014, if taxpayers lodge their activity statements via an electronic channel, the ATO will stop sending them paper activity statements. Instead, their next activity statement will become available in an electronic channel.
- ***Do your clients need to make a GST adjustment for property?*** – The ATO says tax agent clients may need to make an adjustment on their June activity statement in relation to GST credits they have previously claimed, particularly if they use their property differently from the way they originally planned. When this occurs, the change in creditable purpose affects the amount of GST claimable on that purchase and they may have to make a GST adjustment.

- **PAYG reporting: common errors** – The ATO says it has identified some common errors when reporting quarterly PAYG instalment income in activity statements. It provides information on how to avoid these errors and report PAYG instalments correctly.
- **ATO multi-use lists** - A multi-use list (MUL) is a list of pre-qualified potential suppliers of nominated goods or services that have satisfied the conditions for inclusion. A MUL is a procurement tool available under the Commonwealth Procurement Rules and is intended for use in more than one procurement process. The lists include those of official court-appointed liquidators.
- **R&D tax incentive: related party transactions** - To claim the R&D tax offset for expenses incurred to related parties, taxpayers need to be aware of the specific R&D tax incentive rules.
- **Current year performance** - The ATO says it will progressively report its results against performance standards over 2013-14.
- **myGov - available for individuals** - The ATO has advised tax professionals that if their individual clients use ATO online services they will now need to register for myGov to access their tax and super information.
- **Online security - are you at risk?** - Tips from the ATO to help keep client documents and records secure.
- **Retirement Villages Industry Partnership - Scenic Retirement Village - example C** - Sets out the application of GST to the operations of a retirement village run by a charitable institution, a trustee of a charitable fund or a gift-deductible entity.
- **SuperStream data and payment standard - Gateway testing period now open** - Information on gateway testing.

by Lisa Lynch

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[764] Student assistance debts - indexation factor

Pursuant to s 140-20 of the *Higher Education Support Act 2003*, 1.026 is the indexation factor to be used in working out accumulated HELP debts for the 2013-14 financial year. The effective percentage increase is 2.6%.

Pursuant to s 12ZF(7A) of the *Student Assistance Act 1973*, 1.026 is also the indexation factor that is applicable in working out any Financial Supplement and accumulated Financial Supplement debts of a person on 1 June 2014. The effective percentage increase is also 2.6%.

Source: Commonwealth Gazettes C2014G00746, 8 May 2014, and C2014G00750, 9 May 2014

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[765] Two ATO IDs withdrawn

The ATO has withdrawn the following ATO IDs with effect from 16 May 2014:

- **ATO ID 2003/329** – Non-Commercial Losses: Commissioner's discretion - Sale of business activity as a going concern in the lead time. Has been withdrawn as it is a straight application of the law and does not contain an interpretative decision.
- **ATO ID 2004/120** - CGT concession amount of discount capital gain - net exempt income. Has been withdrawn as the current ATO position on this issue is contained in Taxation Ruling TR 2007/6 (Non-commercial business losses: Commissioner's discretion).

by Terry Hayes

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LEGISLATION

[766] Temporary Budget Repair Levy: package of 15 Bills introduced

Following the 2014 Federal Budget handed down on 13 May 2014 (see 2014 WTB 20 [698]), the ***Tax Laws Amendment (Temporary Budget Repair Levy) Bill 2014*** along with 14 additional supporting Bills were introduced into the House of Representatives.

The Bills propose to amend the ITAA 1997, the *Income Tax Rates Act 1986*, the *Income Tax (Transitional Provisions) Act 1997* and other taxation imposition and ratings Acts to introduce a 3-year progressive budget repair levy in the primary form of additional income tax (2%) on Australian resident and foreign resident individuals commencing in the 2014-15 financial year.

The temporary budget repair levy (also known as the "deficit levy or tax") will also be reflected in a number of tax rates that are currently based on the top personal marginal tax rate (45%), as well as those based on a calculation comprising the top personal rate and the Medicare levy (currently 1.5%, but legislated to increase to 2% from 1 July 2014), to maintain the integrity and ensure the fairness of the tax system, and minimise opportunities for avoiding the levy.

The levy will be payable at a rate of 2% of each dollar of a taxpayer's annual taxable income over $180,000. No levy is payable where the taxpayer has a taxable income of $180,000 or less except in cases where a tax law integrity rule applies the top personal marginal tax rate as a flat rate to certain types of income.

According to the Government, in 2014-15, around 400,000 taxpayers (or less than 4% of taxpayers) would directly incur the levy on their personal taxable income.

The 14 additional supporting Bills are:

- ***Income Tax Rates Amendment (Temporary Budget Repair Levy) Bill 2014***;
- ***Family Trust Distribution Tax (Primary Liability) Amendment (Temporary Budget Repair Levy) Bill 2014***;
- ***Fringe Benefits Tax Amendment (Temporary Budget Repair Levy) Bill 2014***;
- ***Income Tax (Bearer Debentures) Amendment (Temporary Budget Repair Levy) Bill 2014***;
- ***Income Tax (First Home Saver Accounts Misuse Tax) Amendment (Temporary Budget Repair Levy) Bill 2014***;
- ***Income Tax (TFN Withholding Tax (ESS)) Amendment (Temporary Budget Repair Levy) Bill 2014***;
- ***Superannuation (Departing Australia Superannuation Payments Tax) Amendment (Temporary Budget Repair Levy) Bill 2014***;
- ***Superannuation (Excess Non-Concessional Contributions Tax) Amendment (Temporary Budget Repair Levy) Bill 2014***;
- ***Superannuation (Excess Untaxed Roll-Over Amounts Tax) Amendment (Temporary Budget Repair Levy) Bill 2014***;
- ***Taxation (Trustee Beneficiary Non-disclosure Tax) (No 1) Amendment (Temporary Budget Repair Levy) Bill 2014***;
- ***Taxation (Trustee Beneficiary Non-disclosure Tax) (No 2) Amendment (Temporary Budget Repair Levy) Bill 2014***;
- ***Tax Laws Amendment (Interest on Non-Resident Trust Distributions) (Temporary Budget Repair***

- ***Levy) Bill 2014***;
- ***Tax Laws Amendment (Untainting Tax) (Temporary Budget Repair Levy) Bill 2014***; and
- ***Trust Recoupment Tax Amendment (Temporary Budget Repair Levy) Bill 2014***.

The package of 15 Bills has been referred to the Senate Economics Legislation Committee for report by 16 June 2014.

Key details of the proposed levy include:

- Individuals with a taxable income of more than $180,000 will pay a 2% levy on that part of their taxable income above $180,000.
- Individuals with a taxable income of $180,000 or less will not pay the levy except where their income (or part thereof) is subject to some other tax rate based on the top personal marginal tax rate or based on a calculation comprising the top personal rate.
- When a trustee has income that is taxed as if the income were that of an individual, they will be liable for the levy where the net income of the trust to which the trustee is liable to be assessed and pay income tax exceeds $180,000. This is designed to ensure that trustees who pay tax in place of an individual will bear the same level of taxation as if the individual paid tax themselves.
- To ensure that adults do not divert income to their children to avoid the levy, the income tax rates that apply to the unearned income of a minor will be increased by 2 percentage points in cases where that income is not otherwise subject to the levy because it is at or below the $180,000 threshold.
- An important integrity component of the measure requires the FBT rate to increase from 47% to 49%, so that the rate of FBT remains equal to the top personal marginal tax rate. However, to prevent lower income employees of not-for-profit institutions and hospitals and ambulance workers being adversely affected, changes are being made to existing exemption and rebate caps to maintain the cash value of those caps for the duration of the increased rate. That is:
  - For public benevolent institutions and health promotion charities, the exemption from FBT for benefits will increase to a grossed-up annual cap of $31,177 per employee (currently $30,000). For public and not-for-profit hospitals and public ambulance services, the exemption from FBT for benefits will increase to a grossed-up annual cap of $17,667 per employee (currently $17,000).
  - For certain other tax-exempt entities, such as charitable institutions, that are entitled to a 48% rebate of the FBT otherwise payable up to a grossed up cap of $30,000 per employee, the Bills align the rate of the rebate with the FBT rate from 1 April 2015. This means the rebate rate would increase to 49% for the 2015-16 and 2016-17 FBT years, and then fall to 47% from 1 April 2017. In addition, the cap would be increased from $30,000 to $31,177.
- As the FBT year commences on 1 April and concludes on 31 March, the increase in the FBT rate is to be applied from 1 April 2015. The increase in the FBT rate will cease on 31 March 2017.
- The levy cannot be reduced by non-refundable tax offsets. That is, the taxpayer's income tax liability for an affected financial year is calculated as the taxpayer's basic income tax liability on taxable income less their tax offsets, to which the levy liability is then added. However, a taxpayer with excess foreign income tax offsets after applying their foreign income tax offsets against their basic income tax liability may apply those excess offsets against their levy liability.
- For those taxpayers whose employer withholds tax throughout the year according to ATO withholding schedules, new withholding schedules will be issued by the Commissioner to take account of the levy, so that contributions are made towards the end of year tax liability throughout the year.
- Upon enactment of the Bills, the Commissioner will generally be able to take account of the levy in determining the PAYG instalment amounts.
- The levy will also be reflected in a number of tax rates that are currently based on the top personal marginal tax rate, as well as those based on a calculation comprising the top personal rate and the Medicare levy. This will maintain the integrity and ensure the fairness of the tax system, and minimise opportunities for avoiding the levy.

The following income tax rates that are aligned with the top personal marginal tax rate will be increased by 2 percentage points so as to incorporate the levy:

- Trustees liable to taxation under s 99A of the ITAA 1936 (about trust income that is not allocated to beneficiaries) - 45% to 47%.
- Trustees liable to taxation under s 98(4) of the ITAA 1936 (about foreign resident individual beneficiaries) - 45% to 47%.
- Non-complying superannuation funds - 45% to 47%.
- The non-arm's length component of the taxable income of a superannuation fund - 45% to 47%.
- Non-complying approved deposit funds - 45% to 47%.
- The non-arm's length component of the taxable income of an approved deposit fund - 45% to 47%.
- The non-arm's length component of the taxable income of a pooled superannuation trust - 45% to 47%.
- The non-TFN contributions income of a superannuation fund or retirement savings account provider - 47% to 49% (less the ordinary rate of tax paid by the fund or provider).
- The share of the net income of a partnership attributable to a partner not having control and disposal of that income - 47% to 49%.

Other taxes affected by the incorporation of the levy include:

- FBT - 47% to 49% (see above re application to FBT years and changes to prevent lower income employees of not-for-profit institutions and hospitals and ambulance workers being adversely affected).
- Family Trust Distribution Tax (Primary Liability) - 47% to 49%.
- Income Tax (Bearer Debentures) - 45% to 47%.
- First Home Saver Accounts Misuse Tax - 47% to 49%.
- TFN Withholding Tax (ESS) - 47% to 49%.
- Departing Australia Superannuation Payments Tax (DASP) - The rates of tax applied to a DASP depend upon the make-up of the payment:
  - The tax-free component will continue to be tax-free following the introduction of the levy.
  - DASP payments from a taxed superannuation fund will be subject to a tax rate of 38% during the period in which the levy applies.
  - DASP payments from an untaxed superannuation fund will be subject to a rate of 47%.
- Superannuation Excess Non-Concessional Contributions Tax - 47% to 49%. If a taxpayer chooses to retain excess concessional contributions in super and have it become subject to excess non-concessional contributions tax, the rate of tax would be a maximum of 95% (and not otherwise 98%).
- Superannuation Excess Untaxed Roll-over Amounts Tax - 47% to 49%.
- Trustee Beneficiary Non-disclosure Tax under ss 102UK and 102UM of the ITAA 1936 - 47% to 49%.
- Interest on non-resident trust distributions - 45% to 47%.
- Untainting tax under Div 197 (concerning tainted share capital accounts) - the relevant rate will be increased to reflect the 2% Medicare levy from 1 July 2014 and the proposed 2% temporary budget repair levy in the year to which the levy applies.
- Trust Recoupment Tax re certain trust stripping arrangements - the relevant tax rate will be increased by 2% to take account of the proposed levy in the years to which the levy applies.

Date of effect

The levy is proposed to be payable with respect to the 2014-15 financial year and the next 2 financial years.

The ordinary income tax rules around substituted accounting periods apply to determine the corresponding income year that aligns with the financial year in which the levy applies, for those taxpayers who operate on an annual period that is not the financial year.

by Lisa Lynch and Terry Hayes

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[767] Bills passed and await Royal Assent

The following Bills have now passed all stages *without amendment* and await Royal Assent:

- ***Tax Laws Amendment (2014 Measures No 1) Bill 2014*** - contains amendments: (i) to amend the GST Act and the *Taxation Administration Act 1953* to ensure that excess GST paid is only refundable in certain circumstances; and (ii) to make changes concerning the Farm Management Deposits Scheme - see 2014 WTB 13 [462].
- ***Tax Bonus for Working Australians Repeal Bill 2013*** - repeals the *Tax Bonus for Working Australians Act (No 2) 2009* (Tax Bonus Act) to ensure that the Commissioner of Taxation does not make any further tax bonus payments. The Bill also makes consequential amendments to the taxation laws as a result of the repeal of the Tax Bonus Act. See 2013 WTB 52 [2246]. Tax bonuses were paid to Australian residents who paid tax in the 2007-08 income year and who met certain income tests. Eligible taxpayers received $900 where their taxable income was up to $80,000; $600 where their taxable income was over $80,000 but less than $90,000; or $250 where their taxable income was over $90,000 but less than $100,000.
- ***Amending Acts 1901 to 1969 Repeal Bill 2014*** and ***Statute Law Revision Bill (No 1) 2014*** - together with the *Omnibus Repeal Day (Autumn 2014) Bill 2014*, these Bills amend or repeal legislation across 10 portfolios, including Treasury. The Bills also include measures that repeal redundant and spent Acts and provisions in Commonwealth Acts. In total, the 3 Bills will repeal over 1,000 Commonwealth Acts - see 2014 WTB 12 [417].
- ***Social Security Legislation Amendment (Increased Employment Participation) Bill 2014*** - amends the *Social Security Act 1991*, the *Social Security (Administration) Act 1999*, and the ITAA 1997 to enable the implementation of the Government's Job Commitment Bonus and the Relocation Assistance to Take Up a Job programme - see 2014 WTB 9 [296]. Young Australians aged from 18-30 who have been receiving Newstart Allowance or Youth Allowance (other than as an apprentice or a full-time student) for a period of at least 12 months will be eligible to receive a tax-free payment of $2,500 if they remain in gainful work and off income support for a continuous period of at least 12 months.

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[768] Regs amended re defined benefit super contributions

The ***Tax and Superannuation Laws Amendment (2014 Measures No 2) Regulation 2014*** was registered on 16 May 2014.

Section 50 of the *Superannuation (Unclaimed Money and Lost Members) Act 1999* (SUMLM Act) and s 909-1(1) of the ITAA 1997 provide that the Governor-General may make regulations prescribing matters required or permitted by the relevant Act to be prescribed, or necessary or convenient to be prescribed for carrying out or giving effect to the relevant Act. The purpose of the *Tax and Superannuation Laws Amendment (2014 Measures No 2) Regulation 2014* is to make the following amendments to the *Income Tax Assessment Regulations 1997* and the *Superannuation (Unclaimed Money and Lost Members) Regulations 1999*:

- Method for calculating the amount of defined benefit contributions - Division 293 tax applies to high income earners, broadly those whose income and concessionally taxed superannuation contributions exceed $300,000 in an income year. Individuals are liable to pay the tax imposed at 15% on certain superannuation contributions that exceed the $300,000 threshold. The Regulation provides that an individual's defined benefit contributions is an estimate of the amount of employer contributions that would be made if contributions to fund all the employer provided benefits expected to paid were made annually. The Regulation also amends the *Income Tax Assessment Regulations 1997* to provide the meaning of defined benefit contributions and to specify a method of determining an individual's defined benefit contributions for the 2013-14 financial year and subsequent years.

- Unclaimed money – prescribes a number of South Australian public sector superannuation schemes.

by Terry Hayes

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RULINGS

[769] FBT: car parking threshold for 2014

- Taxation Determination TD 2014/11

On 14 May 2014, the ATO released ***Taxation Determination TD 2014/11***. It specifies that, for the purposes of s 39A of the FBTAA, the car parking threshold for the FBT year that commenced on 1 April 2014 is $8.26 (up from $8.03 that applied in the previous year).

by Jane Tu

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[770] Employee share plan

- Class Ruling CR 2014/43

On 14 May 2014, the ATO released a ***Class Ruling CR 2014/43***. It applies to Australian resident employees of Goodman Property Services (Aust) Pty Ltd and Moorabin Airport Corporation Pty Ltd who are granted securities in the group under the tax exempt plan. The Ruling states that the securities acquired by participants in the tax exempt employee share plan are ESS interests as defined under s 83A-10(1) of the ITAA 1997. It also states that s 83A-35 reduces the amount included in the participants' assessable income up to a maximum of $1,000 where their taxable income does not exceed $180,000. It applies from 1 July 2012.

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[771] Addendum to Taxation Ruling: reimbursement of legal costs

On 14 May 2014, the ATO released ***Addendum to Taxation Ruling TR 2012/8*** (Assessability of amounts received to reimburse legal costs incurred in disputes concerning termination of employment) to improve the terminology used in Example 3, to ensure there is no confusion in the application of the Ruling having regard to current employment and industrial laws. It applies on and from 14 May 2014.

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CASES

[772] Cayman Island liquidators lose out to Tax Commissioner re Aust tax debt

- Akers as a joint foreign representative of Saad Investments Company Limited (in Official Liquidation) v DCT

Cayman Island liquidators have lost an appeal before the Full Federal Court which sought to defeat a Deputy Commissioner of Taxation's claim to recover a local tax debt from the Australian assets of a Cayman company in liquidation. This was notwithstanding the existence of orders made under the Model Law on Cross-Border Insolvency of the United Nations Commission on International Trade Law (UNCITRAL) recognising the Cayman liquidation: *Akers as a joint foreign representative of Saad Investments Company Limited (in Official Liquidation) v DCT* [2014] FCAFC 57 (Full Federal Court, Allsop CJ, Robertson and Griffiths JJ, 14 May 2014).

The lengthy unanimous decision of the Court was given by the Honourable Chief Justice Allsop.

Background

The case involved issues concerning international cross-border insolvency regarding a Cayman Islands company and whether the Australian tax authorities could recover claimed tax and penalties from the company.

This was an appeal by the joint foreign representatives of Saad Investments Company Limited (in official liquidation) (a company registered in the Cayman Islands) against orders made by a judge of the Court on 29 August 2013 ("the Modification Orders") – in *Akers v Saad Investments* [2013] FCA 738 - that modified orders previously made by him on 22 October 2010 ("the Recognition Orders") concerning the company's liquidation in the Cayman Islands.

The Court said the appeal raised important questions about the proper construction and interpretation of the Model Law made part of Australian law by the *Cross-Border Insolvency Act 2008* (CBI Act), s 6. The particular question at the centre of the appeal was the treatment of a claim by the Deputy Commissioner that Saad was liable to Australian tax and penalties. Saad is not a registered foreign company, does not carry on business in Australia, and, as was common ground before the primary judge and on appeal, cannot be wound up by an Australian court under the *Corporations Act 2001*.

Saad is being wound up in the Cayman Islands. The appellants are the joint foreign representatives of the Cayman Islands liquidators.

The question at issue was whether the CBI Act and the Model Law permitted the primary judge to vary orders made by him in the recognition of the foreign representatives and the foreign main proceedings, in effect, by refusing to remit the remaining funds in Australia (in the order of $7m) to the Cayman Islands, and by permitting the DCT to proceed against the funds within Australia for the claimed tax and penalties. The difficulty for the DCT in the liquidation of the company in the Cayman Islands was that under Cayman Islands law, his or her proof would not be accepted, on the basis that to do so would be to enforce foreign revenue laws.

Decision

Among other things, the appellants argued that the terms of s 468(4) of the Corporations Act destroyed the right of the DCT to employ provisions and remedies under the *Taxation Administration Act 1953*. By that provision, "any attachment, sequestration, distress or execution put in force against the property of the company after the commencement of the winding up by the Court is void". However, the Full Federal Court held that no part of relevant Australian statute law, relevantly, the CBI Act, the Model Law and the Corporations Act, and no part of the general law, to the extent still applicable, destroyed the rights of the DCT and in particular any right to seek leave to proceed and to proceed against the company, or to employ the enforcement provisions of the Taxation Administration Act against it. Thus, there were rights of a local creditor and power was available under the Model Law (Arts 20.2 and 22.3) to protect its position.

The Full Federal Court dismissed the liquidators' appeal and found that the Model Law allowed a variation of orders recognising of the Cayman proceedings, in effect, by refusing to remit the remaining funds in Australia (around $7m) to the Cayman Islands, and by permitting the DCT to proceed against the funds within Australia for the claimed tax and penalties. The Court rejected the submission that by lodgment of proof in the Cayman Islands, the DCT became disentitled to the Modification Orders.

Thomson Reuters comment

This case was complex and involved consideration of important issues under the Model Law on Cross-Border Insolvency of the United Nations Commission on International Trade Law.

In an Australian taxation context, the Cayman Islands also featured in an exchange of information matter last year. There, the Cayman Grand Court quashed a decision by the Cayman Islands Tax Information Authority to provide information to the ATO in response to several requests made under a tax information exchange agreement between Cayman and Australia - see 2013 WTB 42 [1791]. It was apparently the first case on the operation of the Cayman Islands law governing the procedure for complying with Tax Information Exchange Agreements. It is understood that the Court directed the Tax Information Authority to write to the ATO to formally revoke its consent that the information given could be used in court proceedings and confirm that the ATO would not divulge the content of the documents. The Court also directed the Authority to demand from the ATO the immediate return of the documents and the destruction of the copies, as these had been unlawfully provided by the Authority.

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[773] **Tax credits claimed in years when tax not withheld; penalty reduced to 50%**

- *AAT Case [2014] AATA 242, Re Research Scientist and FCT*

The AAT has partially allowed a taxpayer's objection to an administrative penalty of 75% for "intentional disregard" and held the penalty should be reduced to 50% for "recklessness" for the 2001, 2002 and 2003 income years.

The Tribunal heard details of a "controversy" relating to the taxpayer's employment with a research institution leading to a purported "termination" and legal proceedings between the parties. It heard that in March 1996, the employer paid an amount to the taxpayer, which included an amount treated by the employer as a Lump Sum A Payment (ie an amount paid for unused long-service leave and annual leave). Tax instalments had been deducted from the total payment made by the employer. The Tribunal also heard that in August 1998, the taxpayer received an amount from his super fund calculated as a gross amount less tax withheld.

In May 2004, the taxpayer lodged his returns for the years 1996 to 2003 inclusive. The Tribunal understood the taxpayer's position as being that the amounts should have been characterised as compensation receipts, capable of apportionment over later income years and assessable to him only when paid out to him from a "defence fund". The taxpayer declared the money he later received in his 2001, 2002 and 2003 income tax returns, and he also claimed tax credits in those returns for the tax withheld in 1996 and 1998. A penalty at the rate of 75% was imposed on the "tax withheld" claims made by the taxpayer in his 2001, 2002 and 2003 income tax returns.

The Tribunal said there was "precious little material" before it on the issue of why the taxpayer had claimed credits for tax withheld in the relevant years when no such withholdings were made in those years. However, the Tribunal said it was satisfied that the shortfall amounts did not result from "intentional disregard" of a tax law; but rather, it found they resulted from "recklessness" as to the operation of a tax law. The Tribunal said that "recklessness" was demonstrated by the taxpayer's not having sought or taken advice on the specific question of entitlement to the tax credits. Note the decision was released on 8 May 2014.

AAT Case [2014] AATA 242, Re Research Scientist and FCT, AAT, Ref No: 2012/2098-2100, Frost DP, 28 April 2014

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[774] Termination of tax agent's registration confirmed for unwitting involvement in fraud

- AAT Case [2014] AATA 299, Re Li and Tax Practitioners Board

The AAT has confirmed that a tax agent was not a fit and proper person to continue to be registered as a tax agent and that his registration should be terminated in view of his apparent unwitting involvement in fraud by third parties that had sought his services. In arriving at its decision, the AAT took into account the objects of *Tax Agent Services Act 2009*, its findings about the tax agent's conduct and, in particular, his failure to keep client information confidential, to take reasonable care in establishing client's circumstances and his failure to provide tax agent services competently: *AAT Case [2014] AATA 299, Re Li and Tax Practitioners Board* (AAT, Ref Nos 2013/3896 and 2013/4154, Redfern SM, 14 May 2014).

Background

The Tax Practitioners Board had disqualified the tax agent from re-applying for registration for a period of 3 years following an investigation into his apparently unwitting involvement in fraud by third parties, which resulted in the tax file numbers of over 450 taxpayers being compromised. The Board found he had breached the "Code of Professional Conduct" for registered tax agents, was not of good fame, integrity and character and that he had failed to meet the registration requirements that he be a fit and proper person. It also found that he had breached provisions of the relevant regulatory legislation by preparing and lodging tax returns for 370 taxpayers for the 2011 financial year in respect of which he was reckless as to whether the statements made in those tax returns were false or misleading.

The tax agent made an application to the AAT for review of the decisions to terminate his registration, disqualify him from reapplying for 3 years and to reject his application for renewal of his registration. Broadly, he claimed that fraudulent intermediaries held themselves out as representatives of well-known recruitment agencies and who had claimed to have been engaged by a number of clients to lodge tax returns on their behalf. As a result, he had prepared and lodged tax returns for the purported clients, which resulted in tax refunds being paid into a bank account nominated by the intermediaries. He also argued in defence that he notified the ATO of the fraud as soon as practicable, and cooperated with the investigation of the Board.

In short, the tax agent argued that he did not deliberately disclose any information about clients' affairs to these representatives and otherwise prepared the returns with due diligence and care and that he was the innocent victim of an extremely well-planned, clever and executed scheme.

The issues for determination before the AAT were: (a) whether the tax agent had breached the various provisions of the Code alleged; (b) whether the decisions to terminate his registration, ban him from reapplying for registration for a period of 3 years and refuse his application for renewal were warranted in the circumstances; and (c) whether, notwithstanding these breaches, he was a "fit and proper person", and therefore eligible to be a registered tax agent.

Decision

The AAT affirmed the Board's decision that the tax agent was not a fit and proper person to be registered as a tax agent and to terminate his registration as a tax agent and to disqualify him from reapplying for a period of 3 years (and, also, to reject his application to renew his registration). It did so on the basis that this "mid-range of the potential prohibition period" was appropriate in the circumstances in view of the following:

- the guiding principles in such disqualification proceedings as set out in *ASIC v Adler* [2002] NSWSC 483;
- the objects of the *Tax Agent Services Act 2009*;
- its findings about his conduct and his breaches of the breached the "Code"; and
- his failure to accept the gravity of the breaches and to satisfy the AAT they would not reoccur.

In particular, the AAT emphasised that there had been numerous serious breaches of the Code which had resulted in loss and inconvenience to taxpayers. It also emphasised that while there was no evidence of dishonesty on the tax agent's behalf, there was evidence of incompetence and negligent, if not wilful, breach of the Code (eg in failing to use the ATO portal to check relevant information properly). The AAT also noted that while the tax agent had expressed remorse, he had also sought to minimise his role and the extent of his responsibility for the fraud.

The AAT also pointed out that "specific deterrence" was a relevant consideration to maintain tax agent standards. It also took into account that while the tax agent would suffer hardship from the decision, there was no evidence he would be unable to find alternative employment until his period of disqualification expired (especially in view of his experience). In this regard, the AAT also found it was necessary to balance personal hardship of the person against the public interest, and that in this case, the public interest was in favour of termination and a sufficiently lengthy disqualification to ensure the public was protected and so that other tax agents would be deterred from engaging in any similar conduct.

Finally, the AAT also rejected a proposed plan of supervision as an alternative to the agent's termination and disqualification given the circumstances of the case. In this regard, it noted, among other things, that there was no evidence as to how the proposed plan for supervision would be implemented and that the plan would be difficult to monitor and would be costly and impractical. The AAT noted that as the tax agent had not demonstrated a good understanding of the serious consequences of his breaches, such a plan that would allow him to continue to practice would not address the significant regulatory concerns raised by the Board's investigations.

by Kirk Wilson

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[775] **Property investment: some deductions allowed; penalty affirmed**

- AAT Case [2014] AATA 210, Re Thorpe and FCT

The AAT has allowed some deductions claimed by the taxpayer in relation to a property investment, but refused other deductions. It also affirmed the 50% penalty for recklessness: *AAT Case [2014] AATA 210, Re Thorpe and FCT* (AAT, Ref No 2008/4784-5 and 2010/5083-4, Ettinger SM, 10 April 2014).

Background

The taxpayer was previously a legal practitioner in Perth and was subsequently struck off in 2008 after proceedings in the Supreme Court of Western Australia by the Legal Practitioners Complaints Committee (*Legal*

Practitioners Complaints Committee v Thorpe [2008] WASC 9).

In 2007, following an audit of the taxpayer, the Commissioner issued amended assessments for years ending 30 June 2003 and 30 June 2004 to increase the taxpayer's assessable income substantially in relation to undisclosed income related to sale of units in a property investment. The taxpayer objected and proceedings followed in the AAT and the Federal Court.

The Federal Court in *Thorpe v FCT* [2012] FCA 997 (reported at 2012 WTB 39 [1606]) remitted the matter to be heard again and decided again by the AAT after finding that the AAT in *AAT Case [2011] AATA 638, Re Thorpe and FCT* (reported at 2011 WTB 39 [1490]) had made an error of law. The issues before the Tribunal were:

- whether the taxpayer derived income from the sale of units in a property investment;
- whether the taxpayer could substantiate the deductibility of the expenses claimed in relation to a property investment;
- the characterisation of funds lent by a long term client (ie whether they were lent to the taxpayer, the legal practice previously run by the taxpayer, or investment in a project); and
- whether the repayment of the money to the long term client is deductible to the taxpayer; and
- whether any discretion should be exercised to reduce the penalty.

Decision

The Tribunal was satisfied that the starting point for the taxpayer's assessable income included income from the sale of units in a property investment. In considering whether the taxpayer was entitled to various deductions claimed in relation to the property investment, the AAT noted the comments of the Supreme Court of Western Australia that the taxpayer's "record keeping was grossly inadequate...over a prolonged period of time". It did however allow the taxpayer's claims in relation to certain expenditure (including building supplies from hardware stores) which was evidenced from an American Express credit card account statement.

In relation to the issue of the characterisation of funds lent from a long term client, the AAT held that on the evidence before it, and taking into account the findings in *Legal Practitioners Complaints Committee v Thorpe*, the funds were not an investment in a project and was most likely loaned to either the taxpayer and/or his practice. Therefore, it held that regardless of the provenance of the funds, the repayment of the loan by the taxpayer and/or his practice to his long term client would not be deductible.

On the issue of penalties, the Tribunal held that the reduction in assessable income which resulted from the taxpayer being able to substantiate the deductibility of some of the expenses in the property investment do not warrant a remission of the penalty which arose due to the non-declaration of the income.

by Jane Tu

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[776] **GST: input tax credit claims mostly refused; penalty affirmed**

- *AAT Case [2014] AATA 279, Re Yates and FCT*

A taxpayer has been mostly unsuccessful before the AAT in a matter concerning claims for GST input tax credits.

The Commissioner had denied the taxpayer's claims for certain input tax credits relating to monthly tax periods ending 31 January 2008 to 30 September 2011 (inclusive). The Commissioner also imposed a penalty at 50% of the shortfall amounts for "recklessness".

The taxpayer provided some evidence to substantiate some of the claims. The Commissioner also conceded some further claims before the hearing as a result of additional information provided by the taxpayer. However, the Tribunal noted there remained a significant number of items which were still in dispute due to what the Commissioner asserted was a lack of evidence to support the input tax credit claims.

The key items that remained in dispute were grouped into 3 categories: (1) "credit card items" – items described by reference to the credit card that was used to pay for the items; (2) "Mine Automation Development" – amounts listed in a table with the descriptor "Mine Automation Development"; (3) "other disallowed items" – expenses relating to the installation of a security door and gas system at the taxpayer's domestic residence.

The Tribunal found there was a lack of evidence to support the disputed claims. It said: "The absence of tax invoices is one thing but a total lack of any evidence of what the specific amounts refer to is another. The [taxpayer] must at the very least provide detail as to who the payment was made to and some indication of what it was paid for."

The taxpayer claimed that providing supporting evidence such as invoices could "compromise the secret nature of certain defence R&D" and could amount to an offence under certain defence-related legislation. However, the Tribunal said the taxpayer did not explain how providing the information to the ATO would offend the legislation referred to by the taxpayer. The Tribunal remitted the matter to the Commissioner to vary the decision to allow for the input tax credits the Commissioner had conceded and to recalculate the penalty, but it otherwise affirmed the Commissioner's decision. Note the case was released on 9 May 2014.

AAT Case [2014] AATA 279, Re Yates and FCT, AAT, Ref No: 2013/2651, Deutsch DP, 30 April 2014

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[777] **Litigation funding agreement: application to vary freezing order refused**

- DCT v Oswal (No 2)

A taxpayer has been unsuccessful before the Federal Court in seeking to vary a freezing order to give effect to a proposed further amended litigation funding agreement.

The Deputy Commissioner of Taxation had obtained a judgment against the taxpayer in the sum of $186m. In November 2011, an existing freezing order was varied by the Federal Court (Gilmour J) precluding the taxpayer from removing, or dealing with, or diminishing the value of her assets in Australia up to the unencumbered value of the judgment sum, other than to pay the judgment debt. According to the evidence, the taxpayer's main asset was legal claims made against other parties in Australia. The Deputy Commissioner had also issued garnishee notices to those parties in the proceedings brought against them by the taxpayer, requiring those parties to pay any compensation which would otherwise be payable to the taxpayer to the Deputy Commissioner

The matter concerned a litigation funding agreement the taxpayer had entered into with a company registered in Dubai in the United Arab Emirates (a copy of the agreement before the Court was dated 16 December 2013). Importantly, the litigation funding agreement provided for the assignment by the taxpayer to the company of all right, title and interest in the taxpayer's litigation claims. The Deputy Commissioner objected to the operation of the assignment clause which, said the Deputy Commissioner, would have the effect of transferring the taxpayer's potentially principal asset offshore to the company and, thereby, rendering the freezing order nugatory.

The taxpayer sought to renegotiate the terms of the agreement with the Deputy Commissioner. However, the proposed amended terms did not accommodate the Deputy Commissioner's objections. Accordingly, the taxpayer asked the Court to rule on her application to vary the terms of the freezing order, insofar as may be necessary, so that she would be permitted to give effect to the proposed further amended litigation funding agreement.

The proposed further amended litigation funding agreement, among other things, would provide that the taxpayer pay the company a premium and also reimburse the company's costs incurred under the agreement. Those amounts would be paid from any proceeds of the litigation ("the Recovery"). The amended agreement also proposed to provide, in favour of the company, a charge over all right, title and interest in the Recovery. The amended agreement also contained a certain undertaking to the Federal Court and instructions that monies comprising any Recovery would be deposited into solicitors' trust accounts, and that amounts would not be withdrawn without giving the Deputy Commissioner 7 days' notice.

The Court dismissed the taxpayer's application to amend the freezing order. It said the effect of the taxpayer's application amounted to "an application to set aside the freezing order rather than merely seeking a variation of the freezing order". If the proposed further funding agreement were to take effect, it said the object of making the freezing order would be largely defeated and that this was because the proposed agreement created "a charge over the whole of the Recovery".

Furthermore, the Court said if the freezing order was to be amended to give effect to the proposed funding agreement, "not only would the creation of the charge undermine the purpose of the freezing order, but it would also give rise to the potential for further disputation in relation to a priority between [the company], the beneficiary of the newly created charge, and the Deputy Commissioner as the beneficiary under the garnishee notices issued pursuant to s 260–5 of Sch 1 of the Taxation Administration Act."

DCT v Oswal (No 2) [2014] FCA 463, Federal Court, Siopis J, 9 May 2014

by Lisa Lynch

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STATE TAXES

[778] NSW: State Revenue Legislation Amendment Bill awaits Assent

The ***State Revenue Legislation Amendment Bill 2014*** (NSW) has passed all stages of the NSW Parliament and effectively awaits Assent. The Bill was amended in the NSW Legislative Assembly with 8 Government amendments (see 2014 WTB 14 [518]). The main amendments to the *Duties Act 1997* (NSW) remaining in the Bill will:

- re landholder duty: require an acquisition statement for an acquisition that is subject to duty to be lodged with the Chief Commissioner within 3 months after it is made;
- specify new exceptions to rules relating to the aggregation of interests of related persons and associated persons; and
- make other minor miscellaneous amendments (eg update definitions of "matrimonial property" and "relationship property" to reflect the power of the Family Court to order that property be treated as property of parties to a marriage or de facto relationship).

The amendments to the *Land Tax Management Act 1956* (NSW) and to the *Tax Administration Act 1996* (NSW) remain (as originally introduced). See 2013 WTB 23 [1052] for further details.

Date of effect

The amendments are proposed to commence on the day the Bill receives Assent, except for the amendments to the Duties Act which are proposed to commence on 1 July 2013.

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[779] NSW payroll tax: employment agency contract provisions applied

- Freelance Global Ltd v Chief Comr of State Revenue

The NSW Supreme Court has affirmed a taxpayer's payroll tax liability after finding that the employment agency contract provisions under the relevant Payroll Tax Acts applied.

The Commissioner had assessed the taxpayer to be liable to payroll tax or additional payroll tax for the periods from 1 April 2003 to 30 June 2009. The Supreme Court said the taxpayer provided services to independent contractors who desired to provide their services to corporate entities (called clients). The taxpayer entered into contracts with companies who desired the services of independent contractors.

The Supreme Court said one of the "engagement models" for independent contractors, and the one of which the case was concerned, was that contractors whom the taxpayer assessed satisfied the criteria for being an independent contractor were invited to apply to become a beneficiary of a discretionary trust (of which the taxpayer was the trustee). The taxpayer regularly invoiced the client company for the services provided by the individual contractor and paid the individual contractor the moneys received on payment of the invoice less an agreed free. The payments to the independent contractors were treated as advances. As a matter of practice, the taxpayer determined to make distributions to the contracted beneficiaries in the same amount as the advances and there was a set-off of those advances against the income notionally distributed.

The taxpayer submitted that it did not "procure" the services of beneficiary contractors for the clients, rather the contractors would have identified the assignment and negotiated the terms of that assignment with the client prior to the taxpayer's involvement, which involved providing services to facilitate the provision of the services of the beneficiary contractors to their clients.

The Supreme Court said the issue was whether the amounts so distributed by the taxpayer to its contractors/beneficiaries were taxable wages within the meaning of the relevant Payroll Tax Acts. The Court concluded that they were. In the Court's view, the taxpayer "procured the services of its contractors to its clients by producing them by endeavour".

Freelance Global Ltd v Chief Comr of State Revenue [2014] NSWSC 127, NSW Supreme Court, White J, 28 February 2014

by Lisa Lynch

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[780] Vic: State Taxation Legislation Amendment Bill receives Royal Assent

The ***State Taxation Legislation Amendment Bill 2014*** (Vic) received Royal Assent on 13 May 2014 as Act No 34 of 2014. It had passed all stages of the Victorian Parliament with 4 Government amendments made in the Legislative Assembly. The Bill implements a number of measures announced in the Victorian State Budget Update for 2013-14 (handed down in December 2013), including measures in relation to the congestion levy and gaming arrangements. Among other things, the Bill also makes changes to the fire services property levy to address various technical and administrative issues, and to ensure that the fire services property levy can be adjusted retrospectively, where a supplementary valuation gives rise to a change in the levy: see 2014 WTB 6 [199]. The Government amendments concern transitional arrangements in relation to changes to the *Gambling Regulation Act 2003* (Vic).

Date of effect

The changes concerning the *Congestion Levy Act 2005* (Vic), the *Gambling Regulation Act 2003* (Vic), and the *Valuation of Land Act 1960* (Vic) will commence on the day after the Bill receives Royal Assent. The amendments to the *Fire Services Property Levy Act 2012* (Vic) will commence from 1 July 2014 to coincide with the beginning of the new levy year.

Further information

The Victorian State Revenue Office (SRO) has issued ***General Information Bulletin GEN 1/14*** (Changes to State Taxes - May 2014) to explain the changes made by the Amending Act.

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[781] NT Budget 2014-15: FHOG targeted to new homes

The 2014-15 Northern Territory Budget was handed down on 13 May 2014. The NT Treasurer announced that from 13 May 2014, the First Home Owner Grant will be increased to $26,000 (from $25,000) for first homebuyers purchasing or building a new home. The $600,000 value cap will also be removed. From 1 January 2015, the Grant will be directed to new homes only, and the scheme for existing homes will cease from that date.

The Territory Revenue Office (TRO) has issued ***Revenue Circular RC-GEN-015*** (2014-15 Budget Measures) which contains further details on the Budget proposal.

Budget Bill introduced

The ***Treasury Legislation Amendment Bill 2014*** (NT) was introduced into the NT Legislative Assembly on 13 May 2014. The Bill proposes to implement the above Budget proposal.

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