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CASES UPDATE FOR PRIVATE GROUPS

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Date: 12 September, 2016

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Published with kind permission of The Tax Institute and was originally presented at the Vic 4th Annual Tax Forum, held on 5-6 October, 2016.

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VIC 4th Annual Tax Forum

Cases update for Private Groups

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Victorian Division
5-6 October 2016
Park Hyatt, Melbourne

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CONTENTS

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1 Overview

This paper focuses on court and AAT decisions during the period from 1 September 2015 to 31 August 2016 of relevance to private groups. It also refers to relevant ATO Rulings and legislative developments. The paper focuses on those areas considered to be of greatest interest to private groups, including Division 7A, CGT small business concessions, SMSFs, trusts and the types of information to which the Commissioner can have recourse in making assessments and in the course of disputes.

The paper reviews a total of 45 cases from the AAT to the Federal Court, Full Federal Court and High Court. Predominantly, the Commissioner has been the successful party, but there are notable cases where the taxpayer has been successful. Some of the highlights include:

- The High Court gave its stamp of approval to trustees using the power of advancement to distribute capital amounts to beneficiaries arising from the revaluation of assets of the trust in *Fischer v Nemeske Pty Ltd* [2016] HCA 11.
- In relation to the CGT small business concessions *Miley v Commissioner of Taxation* [2016] AATA 73 and *Commissioner of Taxation v Devuba* [2015] FCAFC 168 were interesting decisions in favour of the taxpayer with respect to the valuation of shares on the one hand, and the effect of a dividend access share on the calculation of the small business participation percentage on the other.
- There were some big decisions of the Full Federal Court regarding the meaning of a unit trust for the purposes of the public trading trust provisions (*FCT v Elecnet (Aust) Pty Ltd (Trustee)* [2015] FCAFC 178), the residency of companies (*Bywater Investments Limited v Commissioner of Taxation* [2015] FCAFC 176) and the question of the characterisation of payments made under an employee incentive scheme (*Blank v Commissioner of Taxation* [2015] FCAFC 154) with all three of these having gone on appeal to the High Court.
- There were a number of cases where the Commissioner argued there was a "sham": *Millar v Commissioner of Taxation* [2016] FCAFC 94, *Sunraysia Harvesting Contractors Pty Ltd and Others v Commissioner of Taxation* [2015] AATA 764 and *Normandy Finance Pty Ltd v Commissioner of Taxation* [2015] FCA 1420.
- And it seems it has become even more difficult to challenge assessments for jurisdictional error following the Full Federal Court decision in *FCT v Donoghue* [2015] FCAFC 183.

The author gratefully acknowledges the assistance of Kate Little, a graduate of Deakin University Law School, in researching for and preparing this paper.

In this paper the:

- *Income Tax Assessment Act 1936* (Cth) is referred to as **ITAA 1936**,
- *Income Tax Assessment Act 1997* (Cth) is referred to as **ITAA 1997**, and
- *Taxation Administration Act 1953* (Cth) is referred to as **TAA**.

2 ATO Innovations

2.1 Law Companion Guidelines (LCGs) and Practical Compliance Guidelines (PCGs)

The Commissioner has released the first Law Companion Guideline and Practical Compliance Guideline to explain the role of these are new advice products from the ATO.

2.1.1 LCG 2015/1

A law companion guideline (LCG) is a type of public ruling, in whole or in part. It is the ATO view, informed by a reasonable understanding of the intended policy and the compliance realities facing taxpayers, on how the recently enacted law applies. This view is usually developed at the same time as the drafting of the Bill. An LCG is normally published in draft form for comment when the Bill is introduced into Parliament and finalised after the Bill receives Royal Assent (unless issues arise during consultation or the Bill is significantly amended in the Bill's passage through Parliament). Where it is the case that only parts of a Guideline will have the status of a public ruling, it will be clear on the face of the Guideline which parts are binding and which parts are not.

It is usually published when the new law introduces a new regime, or new and unfamiliar concepts; or where taxpayers need to take additional action to comply with the law, in order to provide certainty about what needs to be done. An LCG is not issued when new law is straightforward, limited in its application or does not relate to an obligation to pay tax, penalties or interest. The date of effect of a Guideline will be in reference to the date from which the new law applies.

As LCG's are prepared at such an early stage of legislation, they will not be informed by experience of the new law operating in practice. While they offer the same protection in relation to underpaid tax, penalties or interest as a normal public ruling, this will only apply if you rely on the law companion guideline in good faith. If a statement in a Guideline is later found to be incorrect, that part of the Guideline may be withdrawn or amended. Changes that are less favourable to taxpayers usually have a prospective effect only.

In 2015, 15 LCGs were issued which were mainly in relation to managed investment trusts. In 2016, 7 have been issued to date mainly in relation to the small business restructure roll-over and the foreign resident CGT withholding scheme.

2.1.2 PCG 2016/1

A practical compliance guideline is a not generally a type of public ruling, it is a guideline that contains practical compliance solutions and often the ATO's view of relative levels of tax compliance risk across a spectrum of behaviours or arrangements. Practical Compliance Guidelines can provide useful insights into the practical implications of tax laws and associated ATO administrative approaches. The provision of such guidelines is to assist the taxpayer to manage tax affairs, and to

provide good management of the taxation system. Through PCG's the ATO can provide 'safe harbours', conduct that is taken to comply with a rule or law that might ordinarily apply on the basis of more uncertain standards, which provides the taxpayer with certainty and the ATO with an efficient and consistent means of assessing levels of taxpayer compliance (allowing compliance resources to be directed to higher risk areas of the law). PCG's are in effect from date of issue.

Compliance guideline topics or issues are identified by the ATO in the course of the administration of taxation system or by taxpayers or industry groups or tax professionals through consultation. Only significant tax law issues will have a draft PCG issued for public comment, otherwise due to the importance of timely and informed advice the PCG is usually formally issued without public comment.

As PCG's are not public rulings, there is no legally binding effect however they will contain clear statements of how they can be relied upon by taxpayers and descriptions of the relevant classes of taxpayer to which they apply. They may also include statements concerning expectations of taxpayers in adopting relevant administrative approaches, and are subject to periodic review. Where a taxpayer has relied on an approach in good faith and the ATO changes its opinion and/or the PCG is withdrawn or altered, any action of applying the ATO's view of the law will occur on a prospective basis only and not to prior years.

In 2016, 9 have been issued to date mainly in regard to fuel tax credits.

2.2 Income tax assurance notifications

These notifications were introduced in 2015 and in that year the ATO provided over 32,000 low risk privately owned and wealthy group clients with income tax assurance notifications to provide them with assurance as to their tax position for the relevant income years. This has now been extended to include clients with GST obligations on a quarterly BAS. During April and May 2016 over 40,000 assurance notifications for income tax and GST were issued.

This product is to provide groups with certainty that based on risk assessment of the income tax return the ATO do not intend to make further enquiries about a specific year, it contains information only and does not require a response.

2.3 Income Tax Profile (ITP)

In 2015 the ATO issued income tax risk report in May and June to over 2,100 privately owned and wealthy groups assessed by the ATO systems to be in the moderate risk bank.

This year the report has been reframed as the Income Tax Profile (ITP). About 7,500 ITPs were issued in the period from April to June 2016. The ITP contains information only and does not require a response. However, it provides information regarding the ATO view of the group structure, ownership, relationships, tax themes of interest to the ATO. It also provides ATO internal calculations of peer comparison in relation to income tax performance and economic performance.

2.4 Corporate tax transparency report

On 22 March 2016 the ATO published the tax details of 321 Australian-owned resident private companies with revenues of $200 million or more following the release of similar data on 17 December 2015 relating to large corporate taxpayers with a total income of $100 million or more.

The corporate tax transparency report was introduced by Parliament in order for Australia's wealthiest companies to disclose tax arrangements to address community concern about tax evasion by large Australian and multinational companies. There has been some controversy in regard to this public release of tax data relating to private companies. In the process of the Bill passing through the legislative houses, a standoff in the Senate resulted in the Coalition agreeing to a deal with the Greens to increase the limit for private companies from $100 million or more to $200 million or more, allowing multiple large corporations to be exempt from disclosing tax arrangements and details. The increased threshold has resulted in private companies restructuring to avoid disclosure requirements. Private companies also lobbied against the laws being passed, resulting in watered down disclosure legislation for reasons such as fear of kidnapping and ransom demands, and commercial disadvantage.

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3 Small Business Concessions

3.1 Overview

There is a growing body of case law regarding the maximum net asset value test (MNAV) and how it is to be interpreted and applied. This includes:

- *Bell v Commissioner of Taxation* [2012] FCA 1042 (Gordon J) and on appeal [2013] FCAFC 32 which was concerned with whether a debt "related" to a CGT asset and should therefore be deducted from the market value of the assets under s 152-120(1). In that case the trustee borrowed funds in order to make a distribution of capital and the Full Federal Court held that, having disposed of the cash which represented the borrowing, the borrowing no longer related to any assets of the trust.
- The cases reported in last year's paper:
    - *Re Excellar Pty Ltd v FCT* [2015] AATA 282 where a number of findings were made about the assets to be included in the maximum net asset value test, including that the sale price for property was generally the best evidence of its market value, that liabilities refers to the GST-inclusive amount regardless of the taxpayer's entitlement to input tax credits and that guarantees are not liabilities for the purposes of s152-20(1) because they are contingent;
    - *Re Track v FCT* [2015] AATA 45 where the AAT held that intergroup debt between the vendor Unit Trust and associated discretionary trust creditors was related to the business sold (distinguishing *Bell*) but upheld the Commissioner's Part IVA argument because the debt was only created shortly before sale in order to ensure access to the small business CGT concessions; and
- the cases summarised below of *Breakwell* and *Miley*.

Together with the ruling regarding the treatment of UPEs in determining whether the maximum net asset value test is satisfied, which was finalised as TR 2015/4 on 25 November 2015, this provides a considerable wealth of material to draw upon in determining whether a taxpayer meets the maximum net asset value test in any given situation.

The case of *Commissioner of Taxation v Devuba* [2015] FCAFC 168 provides Full Federal Court authority about another aspect of the CGT small business concessions. This case is another illustration of the complexity of the provisions and gives taxpayers cause to tread cautiously when structuring their affairs if they wish to have access to the concessions.

3.2 Cases

3.2.1 *Breakwell v Federal Commissioner of Taxation*

[2015] FCA 1471, White J, 22 December 2015

Outcome: appeal dismissed, Commissioner's amended assessments upheld.

This case concerned the application of the small business CGT concessions to Mr Breakwell and Breakwell Investments Pty Ltd and in particular whether a loan by the family trust to Mr Breakwell (the trustee) should be included in the applicants' maximum net asset value test. The applicants argued that the loan was statute barred and therefore had no value.

The matter arose because the East Terrace Unit Trust (**Unit Trust**) made a capital gain of $500,000 in the 2008 tax year when it sold its finance broking business. It claimed the small business 15 year exemption in relation to the whole of that capital gain. The Allan Breakwell Family Trust (**Family Trust**) was a beneficiary of the Unit Trust and Mr Breakwell and Breakwell Investments Pty Ltd were beneficiaries of the Family Trust.

After an audit, the Commissioner issued amended assessments for the 2008 year on the basis that the capital gain of $500,000 was taxable in the hands of Mr Breakwell and Breakwell Investments Pty Ltd.

The matter turned on whether the maximum net asset value test was met. The parties were agreed that there were net total assets of $5,930,913, being $69,087 below the $6 million threshold. The parties disagreed as to whether a loan of $1,144,934 from the Family Trust to Mr Breakwell made prior to 1998 should be included. If it was included, then the maximum net asset value test would be failed.

The applicants argued that the cause of action under the loan accrued before 1998 and was therefore statute barred under section 35(a) of the *Limitation of Actions Act 1936* (SA) (**LAA**), which provides for a 6 year limitation period for actions founded on simple contract. In the alternative they argued that the funds had been used for business purposes and therefore the loan constituted a liability of Mr Breakwell which was related to the finance broking business of the Unit Trust and should be deducted from the net assets. However, the taxpayer was unable to produce documents in support of this argument.

The Tribunal rejected both arguments. The Tribunal held that Mr Breakwell's signing of the balance sheets of the Family Trust in each of the 2003 to 2008 financial years, where those balance sheets contained a line item for the loan, was sufficient acknowledgement in writing by him of the debt, and therefore section 42 of the LAA applied to extend the limitation period to 6 years from the date of each acknowledgement.

The appeal to the Federal Court was limited to the argument that the loan was statute barred and that the signing of the balance sheets each year did not constitute an acknowledgement of a debt for the purposes of the Limitation of Actions Act.

White J found, however, that the debt was not statute barred at all, and therefore it was unnecessary to consider whether the signing of the balance sheets was an acknowledgement of it. He cited authorities at [26] for the proposition that the LAA barred the remedy but not the cause of action, such that the Family Trust could bring proceedings to pursue the debt and it would then be up to Mr Breakwell to raise the limitation period as a defence.

White J also referred to the provision of the LAA that allows courts to extend the period of limitation.

White J then at [33] considered whether Mr Breakwell would have raised the limitation period as a defence had the Family Trust pursued the debt and concluded that "It is not easy to see how Mr Breakwell, acting consistently with his duties as trustee, could have raised a limitation defence against the [Family Trust]".

Accordingly, White J found that the debt claim was not absolutely statute-barred and thus the loan "cannot be regarded as having no value".[1]

White J then went further and said that in his view section 35 LAA was not the applicable section and rather section 32(1) was applicable as the action would be an action by the Family Trust to recover trust property and for such actions there is no limitation period.

White J concluded at [53] that "...there is no incongruity in the conclusion that the pre-1998 debt is not statute-barred. On the contrary, it would be a surprising result if the trustee of a trust like the [Family Trust] could take a loan from the trust, not repay the loan, and then rely successfully on the expiry of the limitation period in defence to a claim for repayment."

See by way of comparison PSLA 2006/2(GA) which provides that the Commissioner will take no active compliance action that would treat statute-barred private company and trustee loans made prior to the enactment of Division 7A (4 December 1997) as giving rise to a deemed dividend under Division 7A.

3.2.2 *Miley v Commissioner of Taxation* [2016] AATA 73

Deputy President S.E. Frost, 15 February 2016

Outcome: Taxpayer successful, satisfied maximum net asset value test and Commissioner's assessments set aside.

This case concerned Mr Miley who held 100 shares in AJM Environmental Services Pty Ltd (the **Company**). He and the two other shareholders sold the shares for $17,700,000 such that Mr Miley was entitled to $5,900,000. The Commissioner contended that the market value of the shares immediately before the sale was the actual consideration paid for them. The likely result of this would have been that Mr Miley failed the net asset value test. Mr Miley contended that the shares were worth less than what he was entitled to as a result of the sale of the company and in fact the Tribunal noted that any valuation under $5,810,000 would result in Mr Miley satisfying the MNAV.

The Tribunal held that the question is not what the capital proceeds were that the taxpayer received for disposal of the asset, but rather what the market value of the asset was immediately before disposal. Deputy President Frost held at [25] that it is often, but not always, the case that the actual selling price of an asset at a particular time represents its market value just before that time. However, he said that this case is different because the subject matter of the sale was the entire 300 shares in the company whereas what needed to be valued was the 100 shares held by Mr Miley. He accepted the valuation presented by Mr Miley which applied a 16.7% discount for a lack of control (mathematically equivalent to a 20% premium for control).

[1] At [38]

3.2.3 Commissioner of Taxation v Devuba Pty Ltd [2015] FCAFC 168

30 November 2015, Greenwood, Jagot and Pagone

Outcome: Joint judgment dismissed the Commissioner's appeal against the AAT decision in *Devuba Pty Limited v Commissioner of Taxation* [2015] AATA 255.

On 19 May 2010 Devuba Pty Ltd (**Devuba**) sold 404,545 ordinary shares in Primacy Underwriting Agency Pty Ltd (**Primacy**) for $4,381,645 and made a capital gain of $4,376,896. It claimed that it could reduce the capital gain to nil by application of the small business CGT concessions. In order to do so it had to demonstrate that CGT concession stakeholders in Primacy together had a small business participation percentage in Devuba of at least 90% (s152-10(2)(b)). The following definitions were relevant:

1. A CGT concession stake holder is a significant individual in the company or a spouse of a significant individual if the spouse has a small business participation percentage in the company that is greater than zero (s 152-60).
2. A significant individual is an individual having a small business participation percentage in the company of at least 20% (s 152-55).
3. An entity's small business participation percentage is the sum of the entity's direct and indirect small business participation percentages (s 152-65)
4. The direct small business participation percentage is the percentage that the entity has because of holding the legal and equitable interests in shares in the company:
    a. the percentage of the voting power in the company; or
    b. the percentage of any dividend that the company may pay; or
    c. the percentage of any distribution of capital that the company may make

    or, if they are different, the smaller or smallest (s 152-70).

5. The indirect small business participation percentage is obtained by multiplying the direct small business participation percentage in an intermediate entity (or, where there is more than one intermediate entity, then the sum of the percentages in relation to each intermediate entity) by the sum of the intermediate entity's direct and indirect small business participation percentages (s 152-75).

Immediately before the sale Devuba held 45% of the shares in Primacy and the issued shares in Devuba comprised one ordinary share held by Mr John van der Vegt, one ordinary share held by VDV Nominees Pty Ltd as trustee for the Van der Vegt Family Trust and one dividend access share held by Mrs van der Vegt.

VDV Nominees Pty Ltd atf the Van der Vegt Family Trust made distributions in the 2010 tax year of 20% to Mr Van der Vegt, 70% to Mrs Van der Vegt and 10% to Devuba.

Thus, ignoring the dividend access share:

- Mr Van der Vegt was a CGT concession stakeholder in Primacy because he held 50% of Devuba which held 45% of Primary and so indirectly held 22.5% of Primacy. In addition, he was entitled to 20% of a further 50% in Devuba through the Family Trust, which equated to a further 4.5% of Primacy.

- Mrs Van der Vegt was also a CGT concession stakeholder in Primacy because she was the spouse of Mr Van der Vegt and she had a small business participation percentage greater than zero because she held 70% of 50% of Devuba through the trust, which equated to 15.75% of Primacy.
- Mr and Mrs Van der Vegt together held a small business participation percentage in Devuba of at least 90%, because Mr Van der Vegt held a small business participation percentage of 60% and Mrs Van der Vegt held 35% and thus they easily satisfied this test.

However, the Commissioner argued that the dividend access share meant that the holders of the ordinary shares in Devuba might obtain a zero distribution and this would mean that the small business participation percentages of Mr Van der Stegt and the Trust in Devuba (and consequently in Primacy) would be zero. Mrs Van der Stegt's direct small business participation percentage in Devuba, despite a distribution of dividends, would still be zero because she held no voting rights and the smaller of the two percentages would apply under s 152-70(1). Accordingly, the case turned upon the question of whether a dividend could have been declared under the Dividend Access Share immediately prior to 19 May 2010.

The Court considered the terms of Devuba's constitution and the relevant resolutions creating the dividend access share and altering the rights attaching to it. It found that on the proper construction of the documents Mrs Van der Vegt had an entitlement under the 2007 resolution creating the dividend access share to be considered for payment of a discretionary dividend by the directors but that the 2008 resolution removed that right and deprived the company of an ability to declare a dividend on her shares unless and until the directors first resolved that the holders of the dividend access shares had a right to payment of a dividend. As there had not been a determination by the directors to that effect prior to 19 May 2010 the company could not as of that date declare a dividend to the holder of the dividend access share. The appeal was dismissed with costs.

3.2.4 *PFGG v Federal Commissioner of Taxation* [2015] AATA 972

16 December 2015, Siopis J and CR Walsh (Deputy President & Senior Member)

Outcome: Assessments upheld, taxpayer not entitled to small business concessions.

This case concerned a taxpayer who, in 1997, received WA gold mining leases from his sister for no consideration. In 2001 they expired and were reissued to the taxpayer. On 17 July 2008 the taxpayer sold the leases for total capital proceeds of $11,509,456. For the 2009 year the taxpayer declared taxable income of $5,612,632, including a gross capital gain of $11,509,456. In 2013 the taxpayer objected to the assessment on the basis that the 50% CGT reduction in Subdivision 152-C ITAA 1997 should apply to reduce the capital gain (after the application of capital losses and the 50% reduction reduced it to $5,443,900) to $2,877,364.

It was accepted by the taxpayer that he did not satisfy the MNAV and therefore the case turned on whether his aggregated annual turnover was under $2 million for the 2008 year (s 328-110(1)(b)(i)). From 1 July 2007 to 30 June 2009 the taxpayer was one of two directors of a company referred to as Drilling Co. It had two ordinary shares on issue together with one B class share and one C class share. The taxpayer beneficially owned one ordinary share and one B class share. It was accepted that Drilling Co was connected with the taxpayer and therefore the taxpayer's aggregate turnover included

Drilling Co's aggregate turnover. The issue came down to whether the annual turnover of Drilling Co for the previous year, that is, the 2008 year, was less than $2 million.

Section 328-120(1) defines an entity's annual turnover for an income year as the total ordinary income that the entity derives in the income year in the ordinary course of carrying on a business.

Drilling Co's 2008 tax return showed total gross income of $2,545,010 but the taxpayer contended that its annual turnover for the purposes of s 328-120 ITAA 1997 was $1,974,323 being the gross income of $2,545,010 less certain expenses. Due to concessions made before the hearing, the matter came down to the question of whether, in calculating the annual turnover of Drilling Co, an amount of $55,106 could be deducted which was money spent on fuel which it had charged its customers. The taxpayer argued that this was not ordinary income of Drilling Co. Alternatively, it argued that it was income from the retail sale of fuel and therefore not part of its annual turnover due to s 328-120(3). The evidence was that it was usual for clients of Drilling Co to supply the fuel used in the drilling services. However, when the client did not provide the fuel the fuel was provided by Drilling Co and the client was invoiced for the fuel.

The Tribunal held that the income from the fuel was ordinary income derived in the ordinary course of carrying on Drilling Co's business. It said at [75] that "The fact that Drilling Co did not derive income in that way in respect of every contract for drilling services that it entered does not alter that characterisation of the income in those circumstances when it did derive income from that source, namely, by charging for the supply of fuel to the rig."

The Tribunal also found that the income was not derived from the sale of retail fuel. It held at [86] that there was no evidence that the fuel was acquired on the client's behalf. "To the contrary, the evidence was that the fuel was purchased by and paid for by Drilling Co, and that it then used the fuel it had purchased to run its own drilling rig in the course of it providing the relevant contracted drilling services to the two companies and that it subsequently recovered that cost from the client. There was no evidence of any intention to transfer property in the fuel to [the customers]."

3.2.5 The Executors of the Estate of the Late Peter Fowler v FC of T [2016] AATA 416

22 June 2016, SE Frost DP

Outcome: Commissioner's assessments upheld.

Mr Fowler and his late wife purchased a property for $590,000 in 1986. In 1994 his wife died and Mr Fowler because the sole owner. He sold the property in 2012 for $4.1 million and declared a capital gain of $3.4 million in his 2012 income tax return. However, he claimed to be entitled to the small business concessions and to be able to disregard the capital gain altogether. The Commissioner disagreed and assessed him to 50% of the capital gain.

Mr Fowler passed away in March 2015 and the objection to his decision was continued by his estate. The argument was that he was running a business of owning and managing the property as a rental property. The Commissioner argued that if that was the case then the gain was a revenue gain. Ultimately, the Tribunal found that there was no business and therefore the assessment was upheld.

3.3 Rulings

On 25 November 2015 TR 2015/D2 was finalised as TR 2015/4 to confirm the treatment of UPEs in determining whether the maximum net asset value test is met. The ruling confirms that UPEs should only be counted once in working out whether the relevant trust satisfies the maximum net asset value test, but the way in which the UPE is counted will depend on whether the funds representing the UPE have been set aside on sub-trust (in which case it is counted as an asset of the sub-trust), whether the funds have not been set aside on sub-trust (in which case the UPE is counted as an asset of the trust), or the beneficiary is absolutely entitled to the UPE (in which case it is counted as an asset of the beneficiary absolutely entitled to it).

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4 General Commercial

4.1 Cases

4.1.1 *FCT v Elecnet (Aust) Pty Ltd (Trustee)* [2015] FCAFC 178

14 December 2015, Jessup, Pagone and Edelman JJ

Outcome: appeal from decision of Davies J allowed. Commissioner's private ruling and objection decision affirmed.

The Federal Court decision in this matter was included in the cases update for 2015. The case went to the Full Federal Court to determine whether the Electrical Industry Severance Scheme (**EISS**) is a unit trust for the purposes of Division 6C ITAA 1936.

The EISS applied for a private ruling in December 2012 to confirm that it is a public unit trust. The sponsors of EISS are the Communications, Electrical, Electronic, Energy, Information, Postal, Plumbing and Allied Services Union of Australia (ETU) and the National Electrical Contractors Associates (NECA). The EISS operates by employers becoming members of EISS. They make weekly contributions to EISS in respect of their workers and EISS credits these contributions to an account in the name of each of the relevant workers. When the worker's employment is terminated, EISS is generally required to make a severance or redundancy payment to the worker.

The EISS wanted to be taxed under Division 6C as a company, rather than under Division 6 as a trust. The Commissioner, however, ruled that EISS was not a public trading trust. The private ruling was objected to and the objection was disallowed in full.

At first instance, Davies J held that EISS was a unit trust. On appeal, the Full Federal Court accepted the Commissioner's argument that she had fallen into error by making use of the definition of "unit" in s 102M of the ITAA 1936 to give content to the meaning of the term "unit trust" as used in Division 6C of Part III of the ITAA 1936.

Pagone and Edelman JJ delivered a joint judgment in which they stated that the attempts by the parties to put forward a single definition of a unit trust for the purposes of Division 6C should not be accepted and rather the approach of Davies J should generally be followed with one addition, being that the interest of the beneficiaries of the trust must have some fit with the functional notion of a unit. Pagone and Edelman JJ said at [13] that "The purpose of Division 6C is to treat particular trusts as if they were companies for tax purposes. That is because some trusts, relevantly those known commonly as unit trusts, have about them features which make it appropriate that they be taxed as if they were companies rather than as the trusts that they are. The single most striking feature making it appropriate to treat "unit trusts" as if they were companies, is that the interests of the beneficiaries (whatever those interests might be) are held through a metaphor of a "unit" which Parliament has treated as analogous to the way that shareholders hold shares."

Pagone and Edelman JJ found that the Workers in the EISS did not have units in any meaningful sense and therefore the trust was not a unit trust. This was said at [106] to [114] to be the effect of three factors in combination:

- any contingent entitlement that a worker might have to payment upon severance is subject to clause 8.1 which requires them to be an active worker. Thus it is likely that there are inactive workers with no entitlements to the trust fund.
- the trustee has the discretion to vary the amount standing to the credit of a worker's account.
- the trust deed provides for the possibility of a payment to a worker being less than the amount in the relevant worker's account.

Pagone and Edelman JJ at [119] left the question open as to whether the workers held a beneficial interest in the property of the trust fund.

Jessup J agreed with the joint judgment of Pagone and Edelman JJ and added some comments of his own. He found that the definition of "unit" in s 102M is limited to the circumstances of a "prescribed trust estate" and this indicates that the definition of "unit" was not intended to have broad application. Jessup J held at [5] that, contrary to Davies J view, *BERT Pty Ltd atf BERT Fund No. 2 v Commissioner of Taxation* [2013] AATA 584 was correctly decided. Jessup J concluded at [6] that: "There is no indication in the 1936 Act that Div 6C, or that s 102S in particular, uses the term "unit trust" in anything other than its ordinary meaning. Central to that meaning is the requirement that the interests in the trust, whatever other characteristics they might have, be divided into units - or "unitized". There needs to be an irreducible, discrete, "unit" or, as the Administrative Appeals Tribunal said in BERT, parcel of rights, by reference to which those interests are held, such that every person or entity with an interest in the trust will have one or more such units. It is uncontroversial that the Electrical Industry Severance Scheme does not entail such a trust."

This is perhaps a welcome decision for those discretionary trusts that conduct trading activities and would prefer not to be taxed as companies!

Special leave to appeal to the High Court was granted on 28 July 2016. The hearing is scheduled for 11 October 2016.

4.1.2 *Cable & Wireless Australia & Pacific Holding BV (In Liq) v Federal Commissioner of Taxation* [2016] FCA 78

Pagone J, 11 February 2016

Outcome: Commissioner's objection decision upheld,

There was a buy back of shares by Cable & Wireless Optus Ltd ("Optus") on 6 September 2001. On that day Optus bought back approximately 43% of its shares for a total consideration of $6,225,502,631.68. $2,306,705,228.26 of the total consideration was debited to its share capital account (which was calculated to be 43% of the total in that account of $5,327,193,221) and $3,918,797,343.42 was debited to a "buy-back reserve account" in the ledger of Optus.

The Applicant was a non-resident shareholder in Optus prior to 6 September 2001. Optus withheld an amount of $586,983,026 from the amount paid to the Applicant and paid it to the Commissioner as dividend withholding tax, of which $452,013 was paid from the buy-back reserve account.

The Applicant then applied to the Commissioner under s 18-70(1)(b) for a refund of money withheld or paid in error. The Commissioner is obliged to refund the amount where the conditions in s 18-70(2) are satisfied. One of those conditions is that the Commissioner is satisfied that it is fair and reasonable to refund the amount having regard to the matters specified in s 18-70(2)(d) to (f).

The Commissioner refused the application stating that the money had not been withheld in error and therefore did not consider whether it would have been fair and reasonable to refund the amount. The parties agreed that the matter would be remitted to the Commissioner for further consideration if the Applicant succeeded on the question of whether the amount had been withheld or paid in error.

The Applicant argued that the buy-back reserve account was a share capital account within the meaning of s 6D of the ITAA 1936 and therefore that the amount debited to that account in payment to the applicant for the shares bought back by Optus is not taken to be a dividend paid by Optus pursuant to section 159 GZZZP of the ITAA 1936 and therefore the Applicant was entitled to a refund of tax withheld by Optus from the payments. The Applicant said the withholding tax was paid in error and the error was realised when the High Court of Australia handed down its decision in *Commissioner of Taxation v Consolidated Media Holdings Ltd* on 7 December 2012.

The Commissioner contended that the amount paid to the Applicant and debited to the buy-back reserve account is taken to be a dividend paid out of profits derived by Optus by virtue of s 159GZZZP(1) of the ITAA 1936. s 159GZZZP(1) provides that the difference between the purchase price of a share buy back and that part of the purchase price debited against amounts standing to the credit of the share capital account of the company is taken to be a dividend paid by the company.

The definition of share capital account is contained in s 6D which provides that a share capital account is an account which the company keeps of its share capital or any other account created on or after 1 July 1998 where the first amount credited to the account was an amount of share capital. The definition allows for more than one account to satisfy these conditions, in which case all such accounts are taken to be a single account for the purposes of the Act.

Pagone J held that *Consolidated Media* does not stand for the proposition that every account called a buy-back reserve account is a share capital account. He said at [9] that: "The facts in Consolidated Media involved a buy-back of shares by Crown from its sole shareholder for the purpose ... of returning to its shareholder "capital that was in excess of the needs of Crown"... The return of capital in that case may, to that extent, be seen as a return by a company to its shareholder of capital that was in the company before the buy-back and which, upon its return, reduced the share capital in the company."

He held at [10] that "The buy-back of the applicant's shares was different in substance and form..." Pagone J found at [10] that "The buy-back of the applicant's shares in Optus occurred in the context of the applicant, as the majority shareholder in Optus, disposing of its shareholding in Optus as part of a takeover by the SingTel group. ... Optus, unlike the company in Consolidated Media, was neither reducing nor seeking to reduce its capital by the proposed buy-back, but was seeking to facilitate the substitution of its shareholders."

Pagone J held that the buy back reserve account was not a share capital account and thus upheld the Commissioner's objection decision.

4.1.3 *Case 3/2016: FLZY and Commissioner of Taxation* [2016] AATA 348

27 May 2016, SE Frost DP

Outcome: case remitted to the Commissioner for reconsideration in accordance with a direction that the profit from the sale of the Glasshouse was a capital gain.

This case concerned the capital/revenue distinction as it applied to the sale by a family trust of an office building constructed on a site formerly used as a car park. The trust distributed the gain on sale to beneficiaries after application of the 50% CGT discount. The Commissioner issued an amended assessment on the basis that the gain was a revenue gain and therefore removed the 50% CGT discount and applied a 50% penalty.

The trust bought an office building and a carpark in Woden Town Centre in Canberra in early 1999, both of which were leased to a Commonwealth Agency until 2002 with good prospects of that Agency continuing to lease them beyond that period. It then emerged that the building and carpark had not been built in accordance with the ACT Building Certificate Code and did not have a Certificate of Occupancy as they had previously been owned by the Commonwealth which did not have to so comply. It was also no problem as long as the Commonwealth was the sole occupier. The Commonwealth extended the lease over the building to 2007 but not the carpark. This meant that the undercover portion of the carpark had to be closed.

After a number of different development proposals for the carpark, eventually in 2004 the trust obtained development approval to construct an eight storey office building on the site to be leased by one or more Commonwealth Departments. The building was known as the Glasshouse and DA was issued in May 2005. Construction was essentially completed by August 2006 and by late 2006 leases had been secured for the entire building.

From 2001 the trust continued to received offers to purchase the site. In August 2006 an offer was received from Mirvac for $70 million which was some $9 million in excess of the valuation the trust had obtained. The trust considered that the price was over-inflated and therefore that the offer should be accepted. Contracts were exchanged in June 2007 and settlement occurred in July 2007.

Deputy President Frost, in determining whether the asset was held on capital or revenue account, examined the activities of the group as a whole, and not just of the trust, however he said at [53] that he would have reached the same result on either analysis. He rejected the Commissioner's description of the group's activities as the acquisition, development and disposal of properties, stating that a careful analysis of all activities showed that the group had an approach of carefully assessing the best use of a particular property and then putting the property to that use.

He found that the carpark site had been acquired to produce rental income and that even once it was planned to develop it, the intention was to retain it on completion of the development and that only changed when an offer to purchase was made which was too good to refuse. Accordingly, he held that the profit from the sale was on capital account.

4.1.4 *Rosgoe Pty Ltd v Commissioner of Taxation* [2015] FCA 1231

Logan J, 13 November 2015

Outcome: Appeal successful, Commissioner's private ruling successfully objected to.

In this case the taxpayer acquired two lots of land, one on 28 March 2006 and the other on 23 August 2007, for the purpose of development and sale as part of a joint venture. However, negotiations with the joint venture partner fell through in the 2010 financial year. The taxpayer then engaged a development management company to obtain a DA, which was obtained on 20 September 2013, following which the property was sold at a profit. On appeal from the AAT, Justice Logan expressed the view that the facts described by the Commissioner involved the carrying out of a profit making scheme which later came to be abandoned, and the profit did not arise until the scheme had been abandoned. Accordingly, the correct conclusion was that the profit was not income because what occurred was the mere realisation of a capital asset. However, care must be taken with this case as it involved an appeal from a private ruling and the private ruling had not stated that the taxpayer was engaged in a business of property development. Therefore the case had to proceed on this basis.

4.1.5 *Bywater Investments Limited v Commissioner of Taxation* [2015] FCAFC 176

11 December 2015, Robertson, Pagone and Davies JJ

Outcome: appeal from Perram J's decision at first instance dismissed. Applicants were held to be residents of Australia and their shares held as trading stock.

This case concerned seven proceedings involving five companies, although one company settled with the Commissioner before the appeal was heard. The case raised the following questions:

1. whether the relevant companies were residents of Australia because the central management and control of each of them was in Australia.
2. whether the profits derived from share sales were on revenue account.
3. if the shares were trading stock, then did s 70-40(2) of the ITAA 1997 require the shares to be valued at nil at the start of an income year if no assessment was issued for the preceding year.

The taxpayers were not incorporated in Australia and therefore they were only residents of Australia under the definition in s 6 of the ITAA 1936 if they carried on business in Australia and had their central management and control in Australia. They each conceded that they carried on business in Australia. Three of the companies contended that their place of central management and control was either London or Neuchatel in Switzerland because that was where their directors met and made decisions about the share transactions in question. The fourth company contended that its place of central management was in Apia in Samoa.

The Court reviewed the relevant authorities including *De Beers Consolidated Mines Limited v Howe* [1906] AC 455 and *Koitaki Para Rubber Estates Limited v The Federal Commissioner of Taxation* (1940) 64 CLR 15 and held at [7] that "The focus of the inquiry to determine the residence of a corporation, therefore, is where its activities are controlled from, rather than, for instance, where the

company was incorporated, where its activities may occur or, it may be added, merely the location of its ultimate owner."

The Court examined *Esquire Nominees Limited v The Federal Commissioner of Taxation of the Commonwealth of Australia* (1973) 129 CLR 177 as an example of a case where the decisions of those in control of the company have been heavily influenced by others. However, the Court said at [8] that it was critical to the result in that case that those exerting influence were not those making the decisions of the company.

The Commissioner contended that the central management and control was in Australia because Mr Vanda Gould, an accountant, was in Sydney and was "pulling all of the strings from Sydney".[2] The taxpayers had led evidence to the effect that Mr Gould was not the ultimate owner of the taxpayers but that was rejected by Perram J at first instance. On appeal, the court found no reason to reject Perram J's findings on the evidence that Mr Gould was the ultimate owner and thus found no reason to reject his finding that the companies were residents of Australia.[3]

The taxpayers appealed to the Full Court on the issue of whether the profits were on revenue account, but not on the issue of whether the shares were held as trading stock. The Full Court said that as both parties did not challenge the finding that the shares were trading stock, this necessarily meant the gain was on revenue account and made no finding on this issue.

Section 70-40(2) of the ITAA 1997 provides that the opening value of an item of trading stock is nil "if the item was not taken into account under [Division 70]...at the end of the last income year". None of the appellants had lodged tax returns in the income years preceding the years in dispute. Perram J at first instance held that "taken into account" means "taken into account as part of a process of assessment carried out by the Commissioner" and therefore the value of the taxpayers' shares in each year in dispute had to be valued at nil. The Full Court held that this was the correct interpretation of the provision. The actual declaration made by Perram J was held by the Full Court to be sufficient to dispose of the current matter, but it nonetheless altered the declaration at the Commissioner's suggestion so as to be more precisely worded and to have application to other instances not relevant to the present matter.

Special leave to appeal to the High Court was granted on 5 May 2016. The hearing was held in Canberra on 24 August 2016 but as at the time of writing the decision had not yet been handed down.

4.1.6 *Blank v Commissioner of Taxation* [2015] FCAFC 154

29 October 2015, Kenny, Robertson and Pagone JJ on appeal from Edmonds J

Outcome: Appeal dismissed, primary judge's findings that the payments were ordinary income upheld.

This matter concerns the characterisation for tax purposes of payments made by Glencore International AG (GI) to the Appellant in the 2007 to 2010 tax years following the termination of the appellant's employment by his resignation from Glencore Australia Pty Ltd, a wholly owned subsidiary of GI, on 31 December 2006.

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[2] See paragraph [10] of the decision

[3] See paragraph [17] of the decision

The amount was calculated by reference to the appellant's entitlement under profit participation arrangements made during his employment by companies in the Glencore Group. He was employed by GI or a subsidiary between 1991 and 2006 in a number of countries. He became an Australian resident for tax purposes in 2002. He was issued with Genussscheine under the Swiss Code of Obligations which entitled him to a share of profits each year, which accumulated until termination of employment at which time the employee had to return the Genussscheine and the amount due to him was payable in 20 instalments over five years. The profit participation plan was tied to the appellant's purchase of a corresponding number of shares in Glencore Holding AG (GH).

In 2003 the appellant participated in a profit share plan where he was issued Phantom Units in GI rather than Genussscheine. The Phantom Units were still tied to the appellant's purchase of a corresponding number of shares in GH. In order to realise his entitlements under the Phantom Units he had to assign the shares back to GH for their par value.

In 2005 the appellant was issued Profit Participation Units in place of his Genussscheine and Phantom Units.

Kenny and Robertson JJ held that what the appellant had received was not the equivalent of shares or options that should be taxed on receipt but was rather simply a mechanism for calculation of the appellant's profit share to be paid on termination. Accordingly, they saw no error in the primary judge's finding that the payments were assessable as ordinary income. Kenny and Robertson JJ also agreed with the primary judge's conclusion that the initial two instalments which were paid to the Swiss authorities in the 2007 year did not constitute a derivation of income by the appellant, but subsequent payments starting in January 2008 that were made to the Swiss authorities with the appellant's agreement to fully pay the withholding tax liability before any payment was made to the appellant was relevantly made on the appellant's behalf and constituted a derivation of income by the appellant.

The appellant had sought to reopen the case to argue the section 23AG applied to those parts of the remuneration derived while he was a non-resident. Kenny and Robertson JJ held that it was not possible to apportion the amount received by the appellant between earnings from foreign service and earnings not from foreign service because the agreed method of calculating that amount did not allow for that distinction to be made. Therefore, their honours held at [105] that: "No part of the amount can be properly described as earnings "derived --- from --- foreign service". Rather, the whole of the amount was aptly described as derived from both foreign service and non-foreign service."

Accordingly Kenny and Robertson JJ dismissed the appeal.

Pagone J delivered a dissenting judgment where he characterised the appellant's position at [130] as being "... like that of a shareholder except that enjoyment of its fruits was deferred until the termination of his employment." Pagone J considered it important that the appellant had to sign the declaration of assignment and general release in order to obtain payment and this constituted him disposing of the entire bundle of rights he had accrued up to March 2007, one of which was the right to be paid money. Accordingly, Pagone J held that the payment to the appellant represented the capital proceeds from capital gains tax event C2 and thus the cost base had to be determined as at the date that the appellant became a resident of Australia.

Special leave to appeal to the High Court was granted 16 May 2016. The High Court heard the matter on 23 August 2015 but as at the time of writing the decision had not yet been handed down.

4.2 Rulings

Draft Taxation Ruling TR 2016/D1: deductibility of expenditure on a commercial website. This Draft Ruling states that expenditure in relation to commercial websites is commonly for:

1. labour,
2. off-the-shelf software products, or
3. registration, licensing and other periodic usage fees.

With respect to expenses for labour, the Draft Ruling is that labour costs that are directly referable to the enhancement of the profit-yielding structure of the business are capital in nature and not deductible. It states that expenditure incurred in acquiring or developing a commercial website for a new or existing business is capital expenditure whereas expenditure incurred in maintaining a website is a revenue expense.

Similarly, the Draft Ruling states that expenditure on off-the-shelf software products is of a capital nature where the product provides an enhancement of the profit-yielding structure of the business. However, a deduction may be available under Division 40 where this constitutes in-house software. Further, expenditure on off-the-shelf software products that are licensed periodically is a revenue expense.

Finally, the Draft Ruling states that periodic usage fees are revenue expenses.

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5 Trust Issues

5.1 Cases

5.1.1 *Fischer v Nemeske Pty Ltd* [2016] HCA 11

French CJ, Kiefel, Bell, Gageler and Gordon JJ, 6 April 2016

Outcome: Appeal from NSW SC dismissed with costs (3-2). French CJ, Bell and Gageler JJ formed the majority with French CJ and Bell J delivering a joint judgement.

This case has given the High Court's stamp of approval to the practice of trustees using the power of advancement to distribute a capital amount to a beneficiary of the trust arising from the revaluation of assets of the trust. In this case the Nemes Family Trust held shares in Aladdin Ltd. The trustee, Nemeske Pty Ltd, made a resolution to distribute the entire asset revaluation reserve to specified beneficiaries being Mr and Mrs Nemes. The court upheld the power to advance an unrealised amount and held that it changed the relationship from trustee/beneficiary to debtor/creditor such that an action for money had and received was maintainable.

Clause 4(b) of Deed of Settlement conferred on the Trustee the power "to earmark or assemble capital or income for use and to use it...'for the maintenance education advancement in life or benefit of' any of the specified beneficiaries".

By resolution of 23 September 1994 the trustee:

> "RESOLVED that pusuant [sic] to the powers conferred on the Company as Trustee in the Deed of Settlement of the Nemes Family Trust:-
>
> That a final distribution be and is hereby made out of the asset revaluation reserve for the period ending 30th September, 1995 [sic] and that it be paid or credited to:-
>
> the beneficiaries in the following manner and order:
>
> > The entire reserve if any, to be distributed to:-
> >
> > [Mr and Mrs Nemes]
>
> as joint tenants."

It was not in dispute that the year 1995 in this resolution was a typographical error and should have been 1994.

French CJ and Bell J: The Capital Distribution effected by the resolution of 23 September 1994 and the subsequent entry in the trust accounts was a valid and effective exercise of the Trustee's powers under cl 4(b) of the Deed of Settlement to advance and apply capital or income for the benefit of any of the Specified Beneficiaries, and this would have entitled Mr and Mrs Nemes to bring an action for

money had and received against the Trustee for the amount of the loan. "The Trustee took the risk that the value of the shares might fall below the amount of the debt acknowledged in its accounts. Given that it was created as a trust company and that its only asset of any substantial value was the shares, it was hardly a risk of any significance."[4]

Kiefel J: Did not consider that the resolution was a valid exercise of the trustee's powers, and did not amount to an advancement of capital or income of the trust as the asset revaluation reserve did not contain capital or income of the Trust. At [38] Kiefel J said "The reference to an "asset revaluation reserve" was not to a fund of monies nor to property which had been set aside, as the ordinary meaning of the word "reserve" implies. It was merely the accounting treatment given to an unrealised accretion in the value of the Shares. No monies apart from the settlement sum were ever held by the Trust and no monies were in fact paid to Mr and Mrs Nemes. The only substantial assets of the Trust, the Shares, remained under the ownership of the Trust and were not dealt with or allocated in any way which would detract from the Trust's title in them." Kiefel J also held at [88] that there was no setting aside or allocation of any property for Mr and Mrs Nemes which would amount to an application of capital or income within the meaning of clause 4(b) of the Trust Deed.

Gageler J: Found the resolution was effective and that an advancement could be made without a change in beneficial ownership of assets, but simply the creation of a debt in favour of certain beneficiaries. Gageler J was persuaded by the other subparagraphs of clause 4 of the Trust Deed which referred to other methods of applying capital or income to beneficiaries.

Gordon J: Did not consider the resolution was valid as there was no income or capital of the Trust to be applied. The asset revaluation reserve was a simple accounting entry. There was nothing advanced or raised, paid or applied. Therefore, no valid debt was created.

5.1.2 *Schreuders v Grandiflora Nominees Pty Ltd* [2016] VSCA 93

Kyrou, Ferguson and McLeish JJA, 6 May 2016

Outcome: Leave to appeal from Sifris J granted but appeal dismissed.

A Trust was established by Deed of Settlement dated 29 June 1976. Grandiflora Nominees Pty Ltd became the trustee in 1977. Jan Schreuders was the specified person and the definition of beneficiaries in clause 4 of the trust deed was held to define the beneficiaries in order of priority and therefore each category was mutually exclusive:

(A) the specified person (Jan),

(B) the spouse of Jan as at the date of the trust deed (Kitty),

(C) any future spouse or widow,

(D) the children of Jan,

(E) the issue other than the children of Jan,

[4] At [32]

(F) the children of Kitty and the spouses, widows or widowers of such children and

(G) the issue other than the children of Kitty and the spouses widows and widowers from time to time of such remoter issue.

The four children of Jan and Kitty were the Applicant (Marius Schreuders), Barry, Herman and Neeltje. Jan died in 1989 and Barry in 2006. When Jan died, he and Herman were the directors of the Respondent. Herman then became the sole director.

In December 1990 the Respondent executed a Deed of Variation of Trust which amended Clause 4D to specifically exclude the Applicant and amended clause 5(b)(i) (which enabled the specified person to determine the distribution of the trust fund on the vesting date) by deleting reference to the specified person and instead inserting 'Herman Schreuders'.

The court delivered a joint judgment and held that the Deed of Variation effected a variation to the trust and did not create a new trust, largely because the Deed of Variation expressly stated that "The Trustee otherwise acknowledges and declares that it shall henceforth hold the Trust Fund constituted by and under the Trust upon the trusts of the Trust as amended by this Deed of Variation and shall administer the same accordingly."

The court held that the deed of variation effectively excluded the Applicant as a beneficiary because clauses 4D and 4F were mutually exclusive such that it was only children of Kitty who were not children of Jan who were included by 4F.

Accordingly, this case serves as a wake up call to carefully think through succession strategies and to pay particular attention to who has control of trusts and trustees because your children may not act as you think they might!

It should be noted that this case did not consider whether the amendments made to the deed may have effected a change in beneficial interests for stamp duty purposes.

5.1.3 *Alderton v FC of T* [2015] AATA 807

16 October 2015, PE Hack SC

Outcome: Objection decision upheld.

In this case the taxpayer had a ten year relationship from the time she was 18 years old with a man about 25 years her senior. He was a medical professional. She was entirely financially dependent on him. For the first 6 years he simply transferred money from his account to hers. Then in 2006 he set up the Vo Vo Trust, a discretionary trust of which he was the trustee and he and the taxpayer were beneficiaries. He made regular deposits to the Trust's account and the taxpayer was able to access that account using a debit card in the name of the trust.

In 2010, after the relationship had ended, the Trust lodged a tax return showing net income of $79,880 for the 2009 year that had been distributed to the taxpayer. The Commissioner issued a default assessment to the taxpayer including that distribution from the trust.

The Taxpayer objected on the grounds that she had not known of the trust and that in any event she had disclaimed her interest in it in November 2014.

The Tribunal held that it is immaterial whether the taxpayer knew of the trust or not. An entitlement under a trust is valid notwithstanding that the beneficiary had no knowledge of it. Further, the disclaimer was ineffective because by then the taxpayer had withdrawn and spent the money.

5.2 Rulings

5.2.1 *TD 2012/21A1 - Addendum:* Does CGT event E1 or E2 happen if the terms of a trust are changed pursuant to a valid exercise of a power contained with the trust deed or with the approval of a relevant court?

On 31 August 2016 TD 2012/21 was amended with this addendum to specifically consider examples where the vesting date of a trust is extended (in circumstances where the rule against perpetuities is not offended). It confirms that generally, provided the change is authorised by the trust deed, or made with the approval of a relevant court, it will not give rise to the happening of a CGT event.

6 Superannuation

6.1 Overview

The year was dominated by the proposed legislative changes to the taxation of superannuation. However, the Commissioner's change of attitude to related party lending arrangements for SMSFs also caused a stir. The Commissioner initially gave SMSFs until 30 June 2016 to put their limited recourse borrowing arrangements on an arm's length basis. This was later extended to 31 January 2017 given the large number of SMSFs asking for extensions. PCG 2016/5 was issued which provided SMSFs with some safe harbour lending arrangements for related-party LRBAs for listed shares and real property respectively. The Commissioner has also promised SMSF Trustees further guidance as to when the NALI rules will and will not apply to arrangements other than borrowing arrangements.

6.2 Cases

There were three cases regarding excess contributions tax heard by the AAT and in each case the Commissioner was successful in arguing that there were no special circumstances.

6.2.1 *Brady v Commissioner of Taxation* [2016] AATA 97

SM Lazanas, 23 February 2016

Outcome: Commissioner's decision not to disregard excess non-concessional contributions was upheld. Ignorance of the law and/or deficient advice does not constitute special circumstances.

This was a case concerning excess contributions tax where excess contributions of $179,392.16 had been made by Professor Brady in the 2011 tax year leading to a liability for excess contributions tax of $83,417.35. Professor Brady applied to the Commissioner under ss 292-465(1)(b) and (2) of the ITAA 1997 for a determination that all or part of the non-concessional contributions be disregarded or allocated to another financial year. The Commissioner declined to do so on the basis that there were no special circumstances. The Tribunal upheld that decision.

In this case Professor Brady made personal contributions to superannuation in the 2010 year of $175,600. Initially he had notified his superannuation fund that he would claim a deduction for a personal contribution of $26,000. However, it turned out that this was not permitted because he did not satisfy the 10% rule, which only permits an individual to deduct personal contributions if less than 10%of their total assessable income and reportable employer superannuation contributions are attributable to activities as an employee. Accordingly, he later withdrew this notification to his superannuation fund. This meant that he exceeded his non-concessional contributions in 2010 which automatically triggered the bring forward rule, and meant that he could only contribute $450,000 in non-concessional contributions in the 2010, 2011 and 2012 years. Unfortunately, his financial adviser

advised him to contribute $450,000 on 5 July 2010, on the (false) understanding that the non-concessional contributions for 2010 were under $150,000.

The Tribunal found that there were no special circumstances as ignorance of the law does not constitute special circumstances and nor does the provision of incorrect or deficient advice.

6.2.1 *Azer v FC of T* [2016] AATA 472

SM O'Loughlin, 1 July 2016

Outcome: Commissioner's decision not to disregard excess non-concessional contributions was upheld. No special circumstances.

This was a case concerning excess concessional contributions for the financial year ended 30 June 2014 where Senior Member O'Loughlin found there were no special circumstances justifying the excess contributions being disregarded. Senior Member O'Loughlin found that the excess contributions tax meant that the taxpayer had paid just as much tax as if he had received the remuneration in his hands as cash, and that to disregard the excess contributions would essentially place him at an unfair advantage with respect to other taxpayers who had observed the limits because he would then have paid less tax on that income and still have had it in his superannuation account.

6.2.2 *Ward v FC of T (No 2)* [2015] AATA 919

Deputy President Humphries, 30 November 2015

Outcome: Commissioner's decision not to disregard excess non-concessional contributions was upheld.

This case concerned excess contributions tax in circumstances where the Deputy President was at pains to express his sympathy for the taxpayer and to find some avenue of redress for the taxpayer, but nonetheless did not feel he was able in good conscience to make a finding that special circumstances existed such that the assessment for excess contributions tax could be set aside.

At retirement, Mr and Mrs Ward had a total of approximately $400,000 in superannuation. In 2008 with the onset of the GFC they became fearful that their superannuation accounts would lose value. Therefore, they withdrew their entire superannuation accounts and put them into bank term deposits. On 9 July 2008 they put exactly $450,000 into a BT "cash only" pension fund thus triggering the bring forward rule and using up all non-concessional contributions for three years. The Ward's thought that the interest payable on this pension fund was a fixed rate, but they soon learned it was variable and the interest rates continued to fall, meaning that they continued to receive less and less by way of income. Therefore, from October 2008 to April 2009 they withdrew the money and returned it to term deposit accounts. In 2010 they sought financial advice and were advised to establish an SMSF, which they did in June 2010. In September 2010 Mr Ward made a non-concessional contribution of $450,000. The Wards also sold their home and this enabled Mrs Ward to make a non-concessional contribution of $450,000 at about the same time. This triggered excess contributions tax of $209,250 for Mr Ward.

Deputy President Humphries found that the non-concessional contribution that triggered the excess contributions tax was the same money that Mr Ward had withdrawn from the superannuation fund in 2008 and thus represented superannuation contributions made gradually over the course of Mr Ward's life. Therefore, he held that if he were to make a determination under Division 292 then it would be consistent with the object of the division.

Deputy President Humphries had enormous sympathy for Mr Ward but could not find a way to characterise the circumstances as "special". Deputy President Humphries concluded at [56] that he would be very happy to be found wrong on appeal and that the only other avenue for redress for Mr Ward would be an act of grace payment from the Minister for Finance: "If that is the course of action he adopts, I can only add my strongest commendation to the Minister that such a payment be considered."

6.2.3 *Trustee of the WT & A Norman Superannuation Fund & the Trustee of Mary A Norman Superannuation Fund and Commissioner of Taxation* [2015] AATA 914

SM O'Loughlin, 27 November 2015

Outcome: decision under review upheld.

This case concerns the disallowance of franking credits under Pt IVA of the ITAA 1936. The franking credits were obtained in ‘dividend washing’ arrangements. These arrangements involved selling shares in listed public companies immediately after the shares go ex-dividend and buying the identical number of shares at the same time and in the same companies but on a cum-dividend basis. The Commissioner relied on s 177EA in Pt IVA to disallow the franking credits received in respect to the cum-dividend shares.

Note that last year's paper reported that The *Tax and Superannuation Laws Amendment (2014 Measures No. 2) Act 2014* introduced new integrity rules from 1 July 2013 to limit the ability of taxpayers to obtain a benefit from ‘dividend washing’. However, the transactions considered in this case preceded this legislation.

Accordingly, the Commissioner sought to apply Part IVA, and specifically s 177EA. The Applicants argued that section 177EA does not have application to dividend washing and that was the very reason that s 207-157 of the ITAA 1997 was introduced. Further, the Applicant's argued that the purpose of the scheme was not to obtain an imputation benefit but rather to obtain dividends. Under s 177EA the purpose of enabling the taxpayer to obtain an imputation benefit need not be the dominant purpose but must not be merely an incidental purpose.

The Applicants also raised a procedural issue arguing that the Commissioner is not permitted to make a determination under Part IVA in response to an objection.

The Tribunal dismissed the idea that s 207-157 is a code with respect to dividend washing and thus held that there was no bar to Part IVA applying if the matter satisfied all the requirements of section 177EA. The Tribunal held at [18] that "the franking credits/imputation credits are not part of the dividends received so as to support the proposition that the purpose of entering into the scheme was to obtain the dividends." With respect to the purpose of the Applicants in undertaking the dividend

washing, the Tribunal stated at [28] that three features of the arrangements are striking having regard to the factors required to determine the more than incidental purpose of the scheme:

- at any time the Applicants only had ownership of, and exposure to, one shareholding;
- ignoring the imputation benefits the Applicants cash flow and change of wealth on each integrated transaction was negative, and having regard to those benefits the cash flow was positive; and
- the integrated transactions were entered into and carried out on the same day in different markets such that the different dividend entitlements would be enjoyed.

The Tribunal held that the more than incidental purpose of the Trustees was to obtain the imputation benefits the scheme offered.

With respect to the procedural argument, the Tribunal referred to section 169A(3) of the ITAA 1936 which provides:

> "(3) In determining whether an assessment is correct, any determination, opinion or judgment of the Commissioner made, held or formed in connection with the consideration of an objection against the assessment shall be deemed to have been made, held or formed when the assessment was made."

The Tribunal held at [48] that the Commissioner can rely on this section to the effect that he can make a valid determination under Part IVA as part of the objection decision making process.

6.2.4 Deputy Commissioner of Taxation v Rodriguez [2016] FCA 860

29 July 2016, McKerracher J

Outcome: the respondent, trustee of an SMSF, was found to be in serious contravention of the *Superannuation Industry (Supervision) Act 1993* (SIS Act) and is required to pay a penalty sum of $40,000 to the Commonwealth. He is also barred from acting as a trustee.

In this case the respondent admitted that he, as trustee of the SMSF, had contravened the SIS Act in that:

- he breached the "sole purpose test" in section 62;
- he breached section 65 because he allowed the fund to provide financial assistance to a member of the fund;
- he breached the in-house asset rules in Part 8 of the SIS Act and failed to prepare a written plan specifying the steps that would be taken to dispose of excess in-house assets.

McKerracher J noted at [10] the public policy of providing taxation benefits to trustees of superannuation funds and its members to encourage provision by Australians for their retirement but said that "the particular benefit conferred by parliament on those who wish to make provision for their retirement and allow self-management is a privilege which should not be abused and such serious abuse requires the making of civil penalty orders."

In imposing the penalty of $40,000, the court took into account that the maximum possible penalty for each contravention is $360,000 (at [11]) as well as the deliberateness and seriousness of the

contravention (at [13]) and the dishonesty that was involved (at [15]), but also the high degree of cooperation given by the respondent. The judge noted at [17] that the respondent was “contrite and apologetic", a person of “good character" and that the respondent was “a troubled person at the time when these contraventions occurred."

An interesting aspect of this case is that the judge suggested that the parties explore whether they could agree a penalty and in the event the parties did agree upon the penalty and the judge gave effect to that.

6.3 Rulings

6.3.1 PCG 2016/5

After some initial private rulings indicating that zero interest-rate related party borrowings by an SMSF would not result in non-arm's length income for an SMSF, the Commissioner has changed his mind. Last year ATOID 2015/27 and ATOID 2015/28 issued regarding related party non-commercial LRBAs to acquire listed shares and real property respectively. These ATOIDs confirmed the Commissioner's view that the income derived by an SMSF under a non-commercial related party LRBA would be NALI.

PCG 2016/5 provides taxpayers with safe harbours regarding what related party borrowing arrangements for real property and listed shares respectively will be considered "commercial" such as not to attract the NALI provisions.

The PCG safe harbour for real property requires the:

- interest rate to be the Reserve Bank of Australia Indicator Lending Rates for banks providing standard variable housing loans for investors
- a fixed interest rate can be used for a maximum of 5 years
- term to be a maximum of 15 years
- LVR to be a maximum of 70%
- security to be a registered mortgage over the property
- repayments to be monthly
- loan agreement to be in writing.

The PCG safe harbour for listed shares or units requires the:

- interest rate to be the Reserve Bank of Australia Indicator Lending Rates for banks providing standard variable housing loans for investors plus 2%
- a fixed interest rate can be used for a maximum of 3 years
- term to be a maximum of 7 years
- LVR to be a maximum of 50%
- security to be a registered charge or mortgage or similar
- repayments to be monthly
- loan agreement to be in writing.

7 Anti-Avoidance

7.1 Cases

7.1.1 *Millar v Commissioner of Taxation* [2016] FCAFC 94

Logan, Pagone and Davies JJ, 4 July 2016

Outcome: appeal from AAT (and from Griffiths J at first instance) dismissed (2-1). Commissioner's amended assessments upheld.

In this case Mr and Mrs Millar deposited funds with the Hua Wang Bank Berhad in Samoa (HWBB) drawn from the superannuation fund controlled by Mr and Mrs Millar. They then drew a loan from HWBB. The Commissioner argued that the loan was a sham to enable Mr and Mrs Millar early access to their superannuation funds to fund the purchase of an apartment on Queensland's Sunshine Coast.

Logan J referred to High Court authority in *Equuscorp Pty Ltd v Glengallan Investments Pty Ltd* (2004) 218 CLR 471 and *Raftland Pty Ltd v Commissioner of Taxation* (2008) 239 CLR 516 that in determining whether there is a sham it is the subjective intention of the parties to the transaction in question which is relevant (and not that of their advisers).

He said that Deputy President Frost had made a finding of fact that the subjective intention of the Millars at the time of entering into the loan transaction in question as follows:

> "I accept that the taxpayers themselves were unaware, at the time, that what was being created around them was a fiction. They believed what Mr Gould told them: that they were putting funds on deposit with HWBB, and that they were borrowing money from HWBB. That is despite the fact that, if they had taken a step back from what was taking place, they may well have realised that what Mr Gould was offering them was too good to be true."

Interestingly, this appears to be the same Mr Vanda Gould who was involved in the *Bywater* case (see under "General Commercial" heading).

Logan J held at [8] that because Mr and Mrs Millar believed at the time they executed the loan agreement that they were borrowing money from HWBB that the legal understanding of a sham was not satisfied.

As a result he then had to consider whether Mr and Mrs Millar were obliged to withhold an amount from interest payments to the HWBB in circumstances where no physical payment of interest had been made as the interest was capitalised in the period from 2001 to 2008. The question was whether that amounted to constructive payment of interest under s 11-5 TAA. Logan J held that it did not.

Logan J ordered that the matter be remitted to the AAT for determination of the Part IVA issue.

Pagone J agreed that it is the subjective intention of the Millars that is the relevant question. However, he held at [45] that "... the Tribunal was not bound to find ... that they had discharged their burden of

proof by their evidence of that belief ... To rebut the shamming intention they needed, at least, to establish that they had entered into a legally effective loan with the Samoan entity and not merely that they believed Mr Gould that they had done so by accepting the arrangement he had put to them ... The evidence which the Millars were able to give fell short of disproving sham because they could not prove without further evidence that the transactions were as they purported to be."

Accordingly, Pagone J dismissed the appeal. He did not then need to determine the interest withholding issue but indicated that he would have found for the Commissioner on that issue, if it were necessary to decide the matter.

Davies J held at [85] that the taxpayers had not discharged their onus of disproving a shamming intention. Further, she agreed with Pagone J that the taxpayer's were liable for withholding tax in respect of the capitalised interest under s 12-245 of Schedule 1 TAA.

7.1.2 *Sunraysia Harvesting Contractors Pty Ltd and Others v Commissioner of Taxation* [2015] AATA 764

30 September 2015, Deputy President P E Hack SC

Outcome: Commissioner's amended assessments and penalty assessments upheld.

Alper Harvesting Contractors Pty Ltd (Alper) was incorporated in August 2007 and Mr Erdogan operated a business through it of supplying casual labour for fruit growers. Alper was paid by growers and paid wages to its employees. It withheld PAYG and paid payroll tax.

In June 2011 Mr Erdogan incorporated Sunraysia Harvesting Contractors Pty Ltd which acted as trusted of the Sunraysia Harvesting Contractors Trust, which was a discretionary trust of which Mr Erdogan and his wife were beneficiaries. Sunraysia took over Alper's business but instead of directly engaging employees it engaged Danood Pty Ltd, Jameron Pty Ltd and Kigra Pty Ltd.

The Commissioner argued that these arrangements were a sham. He disallowed input tax credits claimed by Sunraysia in respect of supplies from those three companies and imposed GST shortfall penalties and penalties for failure to deduct and remit PAYG amounts. He also disallowed deductions claimed by Sunraysia for payments made to the three companies and instead allowed deductions on industry standards. This increased the taxable income of the trust and the Commissioner assessed Mr and Mrs Erdogan equally on that and imposed shortfall penalties on them.

It appears that Danood was incorporated on 7 June 2011 before being wound up in the second half of 2012 with nil assets and creditors in excess of $450,000. Jameron was incorporated on 10 September 2012 and was voluntarily deregistered in April 2014. Kigra was incorporated on 9 July 2013, shortly before the last of the transactions on the Jameron bank account and was deregistered on 20 July 2014.

Deputy President Hack disagreed that the Commissioner has the burden of proving that the arrangement were a sham in accordance with the Briginshaw test. He said at [39] that "It is for Sunraysia to show that the assessments were excessive and it seeks to do so by showing that the arrangements with Danood, Jameron and Kigra were genuine and real and that there was no disconnect or inconsistency between appearance and reality of documents and actions." Deputy

President Hack found that the taxpayers had failed to discharge that onus and indeed he said at [40] "Indeed, were it necessary, I would have been affirmatively satisfied that Sunraysia's arrangements with Danood, Jameron and Kigra were never intended to create any legally enforceable obligation between Sunraysia and the subcontractor and were simply part of a scheme devised by SME's R Us to allow Sunraysia to avoid remitting PAYG deductions for persons who were, and remained throughout, its employees." At [67] he held that the arrangements were never intended to create any legally enforceable obligation and were therefore a sham.

7.1.3 *Commissioner of Taxation v Ludekens (No 2)* [2016] FCA 755

Pagone J, 28 June 2016

This was the first ever promoter penalty case, but by the time the penalty was finally applied by Pagone J in June 2016 a few other cases had worked their way through the system ahead of it.[5]

The hearing before Pagone J was the second part of a hearing split between the "contravention stage" and the "penalty stage". Initially Middleton J determined that Dr Andrew Ludekens and Mr Peter Van de Steeg had not contravened s 290-50(1) nor s 290-50(2) of Schedule 1 TAA. However, the Full Court on appeal held that each had contravened s 290-50(1) and remitted the penalty stage of the proceeding for hearing by a Judge of the Court.

Pagone J heard the penalty stage, and determined that a penalty of $180,000 should be applied to each of Dr Ludekens and Mr Van de Steeg from a maximum penalty of over $10 million. Pagone J at [30] was somewhat critical of the exclusion of the subjective reasons and intentions from the contravention stage as he said "There are, therefore difficulties in making the findings of dishonesty in relation to the contravening conduct which the Commissioner submits should be made in the penalty stage. There would be less difficulty in making findings about dishonesty in relation to the contraventions if the contravention stage had been conducted at the same time as the penalty stage leaving, perhaps, only matters in plea of mitigation of penalty for separate submission..."

7.1.4 *BAI v Federal Commissioner of Taxation* [2015] FCA 973

Rares J, 3 September 2015

Outcome: appeal from AAT allowed. Wrong test applied by the AAT regarding the onus of proof of fraud or evasion.

The Commissioner issued an amended assessment for the 2005 year in June 2009 (outside the two year amendment period that otherwise would have applied) on the basis that there was fraud or evasion on the part of the Applicant. The AAT found that the Applicant had not shown that there was no fraud or evasion and accordingly the Commissioner had the power to amend the original assessment. The Applicant appealed to the Federal Court.

The Applicant had three grounds for the appeal, the first being that the Tribunal had to satisfy itself that there had been fraud or evasion or that the Tribunal had applied the wrong onus regarding fraud

[5] See eg Commissioner of Taxation v Arnold (No 2) [2015] FCA 34

or evasion (onus issue); the second being that the AAT erred in treating two receipts for $526,821.97 and $476,261.86 as assessable income of the Applicant (receipt characterization issue); and the third being that if the other two issues were answered adversely to the Applicant, then the AAT denied the Applicant procedural fairness (procedural fairness issue).

Rares J held that the receipt characterization issue and procedural fairness issue failed.

However Rares J held at [21] that the AAT applied the wrong onus of proof when the AAT required the appellant to exclude the possibility of fraud or evasion. Rares J said at [26] that "The question of whether there had been fraud or evasion is one of objective fact." He said that the taxpayer bears the onus of satisfying the Tribunal that there was no fraud or evasion but this is a test on the balance of probabilities.

The court stated at [31]:

> "There is a substantive difference in requiring the exclusion of a possibility and the conventional civil onus of proof of establishing a matter on the balance of probabilities. It is one thing not to be satisfied about a matter because, weighing all the evidence, the decision-maker is not persuaded that it is more likely than not that a fact existed or did not exist, and quite another thing to require the proof of that matter by excluding all other possibilities. The latter is akin to applying the criminal onus of proof beyond reasonable doubt."

The matter was remitted to the AAT to determine the issue in accordance with the correct test.

7.1.5 *Normandy Finance Pty Ltd v Commissioner of Taxation* [2015] FCA 1420

17 December 2015, Edmonds J

This is another case involving the Hua Wang Bank Berhard (HWBB) and accountant Mr Vanda Gould, one of the principals of Sydney-based accounting firm Gould Ralph and Company.

In this case Edmonds J found that the Commissioner's assessments were excessive. Edmonds J held that a number of transactions that the Commissioner had treated as shams were in fact genuine loans. However, with respect to the calculation of certain trust income Edmonds J found for the Commissioner.

Between 2002 and 2009 Normandy Finance Pty Ltd (**Normandy Australia**) received approximately $3.8 million from its parent company Normandy Finance and Investments Asia Ltd (**Normandy Asia**). The Commissioner argued that this was a sham borrowing and assessed Normandy Australia on the amount as income.

Advant Pty Ltd is an Australian company owned by two Australian residents, Mr and Mrs Townsing. In 2002 it received $650,000 as loans from Normandy Asia and $500,000 from Normandy UK. The Commissioner argued that these amounts were sham borrowings and assessed Advant Pty Ltd on the amounts as income and denied deductions claimed by Advant Pty Ltd for interest and other borrowing expenses in 2002 and 2003.

Pilmora Pty Ltd is trustee of the Townsing Family Trust and the beneficiaries of the trust are Mr Townsing, his relatives and any legal entity appointed by Pilmora. The Commissioner argued that

amounts Pilmora claimed to have borrowed from Normandy Asia, Normandy UK and HWBB were assessable income of the trust.

Edmonds J examined the concept of a sham which he said at [46] "lies at the heart of the case." The Commissioner's argument was that the loans were shams that were a disguise or pretence for the bringing into Australia of funds held for Mr Townsing and/or entities associated with him with no obligation on the recipient to repay. Edmonds J referred at [47] to the Raftland case, saying that the plurality there found that because a finding of sham requires a finding of an intent to deceive there is the need for caution in adoption of the description "sham".

Edmonds referred to High Court authority that a loan is not necessarily a sham just because there is no real money lent (*Equuscorp* at [46]-[51]). Further, he held at [58] that just because one person or the same group of persons may be behind two corporate entities that enter into a contract does not mean that the contract is not genuine and just because a contract is unsigned or is only signed by one party does not by itself indicate that it is a sham. At [60] he said that even if an agreement was entered into for the sole purpose of obtaining favourable tax treatment or a tax benefit, it does not necessarily follow that it was not genuinely intended by the parties to have legal effect.

Finally at [66] Edmonds J referred to what the High Court said in *Raftland* that it is the intention of the parties to the transaction that is relevant to a finding of sham. He also referred to the *Millar* decision of the Full Federal Court and queried whether it was correct in light of Raftland. However, he said that the case before him did not require that question to be answered as he had sufficient evidence of the intention of the parties from Mr Townsing and therefore "even if relevant, it is unnecessary to have recourse to some inference to be drawn as to the intention of a professional adviser who did not give evidence."

Edmonds J found in each case that the payments made were intended to be repaid by both of the relevant parties to the transactions and therefore they were not shams. However, with respect to the payments from Normandy Asia to Advant he found that a number of the terms of the document to govern the $650,000 advance were shams and that these terms were intended to give the impression of arm's length dealings. He found similarly with respect to the advance of $500,000 from Normandy UK to Advant. However, at [106] and [112] he held that these terms did not impugn the intention of the parties, which was for a loan to be created.

Note the associated AAT decision in *Pilmora Pty Ltd atf the Townsing Family Trust and Commissioner of Taxation* [2015] AATA 976, 17 December 2015, Edmonds J, which determined that the Commissioner's penalty and shortfall interest charge assessments against Pilmora and the Townsings should stand with respect to the calculation of the trust income of Pilmora and its distribution to the Townsings.

8 Division 7A

8.1 Cases

8.1.1 *Rowntree and Commissioner of Taxation* [2016] AATA 420

24 June 2016, Professor R Deutsch

Outcome: The amounts received were income of the Applicant, other than separate amounts of $1 million and $80,000. Therefore, assessments reduced by this amount and baseline penalty reduced from 75% to 50%.

This case concerns amounts received by the Applicant from various companies with which he was associated, which the Applicant argued were loans and the Commissioner argued were ordinary income of the Applicant.

The Applicant is a qualified practising solicitor in NSW and was involved as director and/or shareholder of numerous entities. From 2009 to 2012 he entered into three arrangements:

1. The first under which the Applicant received amounts of $640,000 from BR Redd Holdings Ltd (**Redd Holdings**), a company limited by guarantee of which the Applicant was the main shareholder, between August 2009 and January 2010, purportedly by way of a loan that was later assigned (in 2011) to Europium Limited and later again (in 2014) to Eugenius Holdings Pty Ltd. The source of the funds was dividends from Voluntary Credits Limited (**Voluntary Credits**), a company incorporated in Malaysia that dealt in carbon emissions trading schemes and of which the Applicant was a director.
2. The second under which the Applicant received amounts of $1.6 million from Eugenius Pty Ltd (**Eugenius**) from 10 August 2010 to 4 July 2011 purportedly by way of a loan. Voluntary Credits was again the source of the funds. Through a number of transactions this loan was purportedly moved to Eugenius Holdings Pty Ltd. A loan agreement was entered into on 22 July 2011 between Eugenius as lender and the Applicant as borrower.
3. The third under which the Applicant received $1.7 million from Galerius Pty Ltd between 19 October 2011 and 18 December 2012. The source of the funds was Voluntary Credits. Through a number of transactions this loan was purportedly moved to Galerius Holdings Limited. A loan agreement was entered into on 19 July 2012 between Galerius Pty Ltd as lender and the Applicant as borrower.

Repayments were started under these loans from 30 June 2014 of approximately $5000 per month and other amounts as and when available. Notably this was after the Commissioner had begun to investigate.

On 15 February 2011, the Commissioner identified a problem with companies limited by guarantee and the application of Division 7A and accordingly released Taxpayer Alert 2011/1 (TA 2011/1) entitled “Loans to members of companies limited by guarantee and the operation of Division 7A.” This

taxpayer alert concerned a structure where a discretionary trust makes distributions to a company limited by guarantee and that company limited by guarantee loans amounts to a member or an associate of a member of the company limited by guarantee. The Alert raises several ways in which such loan amounts may be assessable in the hands of the individual whether through the application of Division 7A or otherwise.

On 8 August 2011, the Applicant gave an Enforceable Voluntary Undertaking (presumably under Subdivision 290-D TAA regarding the promoter penalty provisions) to the Respondent concerning companies limited by guarantee. The undertaking referred to TA 2011/1 and at paragraph 5 provided:

“The entities (**including the applicant**) have undertaken transactions comprising the setting up of companies limited by guarantee on behalf of clients and **on their own behalf**, and given advice to clients on the commercial and taxation consequences of setting up companies limited by guarantee.” (Emphasis added)

Under clause 13.1 of the Enforceable Voluntary undertaking the Applicant covenanted not to "promote, market, or otherwise encourage another entity to participate in, enter into or carry out" a company limited by guarantee arrangement.

The Tribunal had to decide whether the amounts received by the Applicant as loan funds were properly characterised as such or whether they were in fact income.

The Tribunal found that the payments made were not loans largely because there was no loan agreement in respect of the first agreement and because the loan agreement that was purportedly made for the second arrangement only applied to advances made after it was entered into, and it was entered into after all the advances in the second arrangement had been made. With respect to the third arrangement it found that two separate payments of $1 million and $80,000 fell within the loan agreement that was purportedly made for the third arrangement because the $80,000 was advanced after the date of the loan agreement and the $1 million was advanced only two days before it was entered into and therefore (at [60]) "it is in such close temporal proximity that it is difficult to conclude that it was not made as part of the overall loan arrangement based simply on the timing."

Accordingly, the Tribunal found that all of the other payments were income of the Applicant.

The Applicant argued that Division 7A and section 109N assisted his case because that section only required a loan agreement to be in place before the lodgement date for the year of income in order to prevent the amount being treated as deemed dividends. However, the Tribunal rejected that argument, holding at [65] that "In this case, the Tribunal is not satisfied the taxpayer has demonstrated, based on verifiable objective evidence that a loan existed at the relevant time. Division 7A of the 1936 Act is of no relevance to that fundamental question."

The Tribunal rejected any argument that the Commissioner, by entering into the Enforceable Voluntary Undertaking with the Applicant, had accepted that the amounts were loans, because otherwise the Enforceable Voluntary Undertaking would not have been necessary.

8.1.2 *Cornell and Commissioner of Taxation* [2015] AATA 852

SM O'Loughlin, 6 November 2015

Outcome: Objection decision affirmed.

This case concerned Mr Cornell who transferred $55,000 and $203,365 from Hong Kong to his Australian bank account in the 2010 and 2011 tax years respectively. In 2010 the amounts were transferred between 28 January 2010 and 22 March 2010 and in the 2011 year the amounts were transferred between 2 July 2010 and 15 June 2011. The Commissioner included these amounts in his income tax assessment whereas Mr Cornell claimed the amounts came from accumulated savings. Division 7A was not raised directly, but the Tribunal accepted that the money came from the bank account of Cornell Sponsorship Group Limited, a company owned by Mr Cornell and his wife.

Mr Cornell lived in Hong Kong for a number of years until September 2009. From 2003 he provided services to the Hong Kong Jockey Club through the Cornell Sponsorship Group Limited. The financial statements for the company for 2008 showed income from consulting of HK $3,375,689 and operating expenses of HK$2,723,368 including directors remuneration of HK$943,937. The accounts showed that the directors owed the company HK$1,482,673 but did not disclose that the company owed Mr Cornell anything.

There was no documentary evidence of the company's sources of money to transfer the amounts to Mr Cornell's Australian bank account. SM O'Loughlin said at [12] while reiterating that the burden of proof lies with the taxpayer: "where the issue in dispute concerns deposits to bank accounts, taxpayers need to prove with evidence that the amounts deposited are not income."

Mr Cornell also claimed that some of the money was transferred before he became a resident of Australia. He said that he returned to Australia in September 2009 but had no intention of staying permanently and that he only became a resident in March 2010 when he began to work for the first time after returning to Australia. However, the evidence was that he returned to Australia in September 2009 with his wife and three children and he did not maintain a residence in Hong Kong after his return to Australia. From late 2009 he tried to enrol his eldest child in school in Australia. From at least late 2009 he was looking for employment in Australia and from 2010 his eldest child commenced schooling in Australia.

Accordingly, the Tribunal found that he was a resident from at least late 2009 and that the amounts transferred to his Australian bank account were income in his hands.

8.2 Rulings

Issue of TD 2015/15 specifying that the benchmark interest rate applicable for the year of income commencing 1 July 2015 for the purposes of Division 7A is 5.45%.

Issue of TD 2016/11 specifying that the benchmark interest rate applicable for the year of income commencing 1 July 2016 for the purposes of Division 7A is 5.40%.

Finalisation of TD 2015/D4 as TD 2015/20 on 25 November 2015 which rules that the release by a private company of a trustee's liabilities in respect of a UPE can constitute a 'payment' within the meaning of Division 7A.

In contrast, TD 2015/D5, which issued on 10 June 2015, has not yet been finalised. This Determination rules that a beneficiary is not entitled to a deduction under s 25-35 of the ITAA 1997 for UPEs written off as bad debts.

9 Administration

9.1 Overview

There were twelve cases in the period under review which have been broadly grouped together under the heading "Administration" in this paper. Four cases raise the issue of whether there was conscious maladministration by the Commissioner, four (two of which concern the Seymours) concern departure prohibition orders or the possibility of the Commissioner issuing such should the taxpayers return to Australia, and two concern director penalty notices. The eleventh case is *Rigoli v Commissioner of Taxation* [2016] FCAFC 38 on appeal to the Full Federal Court for the second time. The final case concerns a s 264 notice. All but two cases were decided in favour of the Commissioner, with the exceptions being *Amies v Commissioner of Taxation* [2015] AATA 777 and *Seymour v Commissioner of Taxation* [2016] AATA 397.

9.2 Cases

Jurisdictional error and conscious maladministration

9.2.1 *FCT v Donoghue* [2015] FCAFC 183

Kenny, Perram and Davies JJ, 17 December 2015

Outcome: appeal allowed, assessments held to be valid.

Mr Donoghue was issued with default notices of assessment for the 2005, 2006 and 2007 tax years, a departure prohibition order, plus administrative penalties. The Commissioner sued Mr Donoghue in the Queensland Supreme Court to recover the debts owing (totalling over $26 million).

In *Donoghue v Commissioner of Taxation* [2015] FCA 235 Logan J granted an application under s 39B of the *Judiciary Act 1903* and declared the assessments invalid because they had been made with the benefit of material supplied to the Commissioner by a third party without Mr Donoghue's permission in the course of the audit. Mr Donoghue claimed the material was subject to legal professional privilege. That was controversial because the material was supplied by Simeon Moore, who Mr Donoghue met while he was a fellow law student of Mr Donoghue's daughter. Simeon Moore supplied the material to the Commissioner after a falling out with Mr Donoghue. Logan J held that the material was privileged and that it had been used by ATO officers in the process of the assessment of Mr Donoghue with reckless indifference for whether it was privileged or not and that amounted to conscious maladministration such that the assessments were subject to jurisdictional error.

On appeal it was held that Logan J had erred in finding that conscious maladministration had occurred. This was due to fact that the documents had been obtained from a third party without the use of compulsory powers, and that legal professional privilege is a common law immunity which prevents a person being required to produce documents or information under compulsion. At [58]

Kenny and Perram JJ said: "It follows that the act of maladministration identified by the trial judge - breach of the common law of legal professional privilege - cannot with respect, be correct. At best the law of privilege afforded Mr Donoghue an immunity against being compulsorily required to disclose communications with his attorneys. Where the Commissioner did not use any such power to obtain the documents in question, whether they were privileged was of no moment."

Kenny and Perram JJ said at [59] that Mr Donoghue's remedy would have been to seek an injunction against Simeon Moore to prevent him disclosing the documents to the ATO or alternatively, to sue the Commissioner for return of the documents before the Commissioner used them. However, these remedies are equitable remedies for breach of confidence and the Court said that Mr Donoghue had abandoned this claim before the trial judge.

Mr Donoghue attempted to resurrect the breach of confidence argument on appeal, however this was rejected by the court. In any event Kenny and Perram JJ commented at [71] and [72] that s 166 permits the Commissioner to use information in his possession which might be the subject of a claim for breach of confidence. Indeed Kenny and Perram JJ went further and said at [74] that *Denlay* indicates that the Commissioner is required to act upon the information which he has in his possession regardless of how he came to have it.

At [93] Kenny and Perram JJ said: "Lest there be any doubt, it is useful to emphasise the consequences of the matter we have discussed above. Where the Commissioner is provided with a taxpayer's privileged documents and uses them in the process of assessing the taxpayer's assessable income in a given income year, this will not involve conscious maladministration under *Futuris* and the notices of assessments will be valid. The common law of privilege has nothing to say in such a circumstance and any claim for a breach of confidence involved in the process of assessment cannot withstand the operation of s 166."

Mr Donoghue argued that the penalty notices were not protected by s 175 of the ITAA 1936 and that s 166 could not make good a breach of confidence with respect to the penalty assessments because they were not notices of assessment within the meaning of that section. Kenny and Perram JJ accepted at [103] that the penalty assessments were not assessments within the meaning of either s 166 or s 175 and therefore that the notice of assessment for penalty may be challenged on the basis of ordinary grounds of judicial review. However, Mr Donoghue had not pleaded any broader grounds of judicial review in relation to the penalty assessments as opposed to the income tax assessments. Further, Kenny and Perram JJ said the penalty assessments were issued because Mr Donoghue had failed to lodge a return and that did not require the Commissioner to have any regard to the documents provided by Simeon Moore.

Davies J agreed with the reasons and conclusions of Kenny and Perram JJ.

9.2.2 *Deputy Commissioner of Taxation v Gould* [2015] FCA 1345

1 December 2015, Pagone J

In *Gould*, the Applicant was seeking an order for standard discovery against the Commissioner as there was a challenge to the validity of assessments made on the ground of conscious maladministration in the use of documents obtained from the Cayman Islands. Pagone J held in favour of the Commissioner.

The Applicant, Mr Vanda Gould, was seeking standard discovery as he was challenging the validity of tax assessments on the basis that the Commissioner's use of documents obtained from a foreign tax authority, the Cayman Islands, constituted conscious maladministration and improper purpose. The judge found that there was no standard discovery necessary for the pleaded case as this was a 'fishing expedition' to find what information the officers of the Commissioner found through requests to Cayman Islands. Pagone J held that an order for particular discovery would be more appropriate in this case.

9.2.3 *Featherby v FCA (No 2)* [2016] FCA 465

Gilmour J, 6 May 2016

In *Featherby* the applicant had brought both s39B of the Judiciary Act 1903 (Cth) proceedings in the Federal Court and Part IVC of the TAA proceedings in the AAT to challenge amended assessments issued to him. In the Federal Court proceedings, Gilmour J was required to consider whether the "*Futuris*" categories of tentative or provisional assessments and conscious maladministration are the only possible jurisdictional errors in the context of an income tax assessment.

Section 175 ITAA 1936 provides that: "The validity of any assessment shall not be affected by reason that any of the provisions of this Act have not been complied with."

In this case the Commissioner issued the applicant with an amended assessment some 9 years after the relevant year of income on the basis that he had formed the opinion that there had been fraud or evasion for the purposes of Item 5 of section 170(1) of the ITAA 1936 and therefore no time limit on amendment. The applicant challenged the formation of that opinion and argued that jurisdictional error was involved.

Gilmour J held that he was bound by *Commissioner of Taxation of Commonwealth of Australia v Futuris Corporation Ltd* [2008] 237 CLR 146. He also listed a further 9 decisions of the Federal Court or Full Federal Court which are either binding on him or persuasive. Accordingly he held that there are only two circumstances in which a jurisdictional error will arise under s175 to enable income tax assessments to be reviewed: where purported assessment is tentative or provisional; or where the purported assessment is the product of conscious maladministration. There was no argument about a tentative or provisional assessment and the court found that the applicant did not put forward a conscious maladministration case, therefore the applicant's case was dismissed.

9.2.4 *Deputy Commissioner of Taxation v Anglo American Investments Pty Ltd* [2016] NSWSC 975

Button J, 14 July 2016

Here there were 6 defendants to debt recovery action brought by the Commissioner. It was agreed that for the purpose of this interlocutory question the parties would focus on Anglo American Investments Pty Ltd and the decision would apply equally to all 6 defendants.

Officers of the ATO conducted an investigation regarding tax affairs of the defendants and in doing so they obtained information from authorities in the Cayman Islands. The defendant contends that those

acts of investigation in the Cayman Islands were done in bad faith and constituted conscious maladministration as well as contempt of court. The defendant argued that officers of the plaintiff knowingly and intentionally obtained material about the defendant in unlawful ways.

The defendants filed an amended defence to the debt recovery proceedings arguing that the assessments upon which the debt recovery proceedings relied were invalid due to conscious maladministration of the ATO officers.

The Commissioner sought an order striking out the amended defence on the basis that it was doomed to fail.

Button J at [49] considered *Futuris* and said that it speaks of "conscious maladministration of the assessment process" and that this suggests that the acts of ATO officers in the process leading up to the issuing of the notice of assessment is relevant.

However, Button J then turned to *Denlay v Federal Cmr of Taxation* [2011] FCAFC 63, which considered unlawfulness in the information gathering process by ATO officers and held that this did not constitute conscious maladministration. It was found that there is only conscious maladministration if bad faith by officers occurred in the making of the assessment. The court found that an alleged breach of commendable principles of good public administration did not provide a defence to the statement of claim. The defence was considered doomed to fail and was thus struck out.

DPOs (Departure Prohibition Orders)

Departure Prohibition Orders are an important tool of the ATO for debt recovery. The courts will not require the Commissioner to provide an undertaking not to issue a DPO against a taxpayer, and are cautious to accept other forms of evidence such as video calls from overseas. The courts, once a DPO is issued consider reasonable conditions to be attached to a departure authorisation certificate to allow for some overseas travel.

9.2.5 *Seymour v Commissioner of Taxation* [2016] FCAFC 18

Siopis, Griffiths and Pagone JJ, 2 March 2016

Outcome: Appeal dismissed (2-1)

This case started as *The Overseas Applicants and Commissioner of Taxation* [2014] AATA 788. Mr Seymour ran a business selling batteries in Australia and to overseas customers. He used off-shore entities to receive income from overseas sales. He did not declare the overseas income, and disputed the residency of the entities that received the income. The Commissioner assessed him on that income because he controlled those entities. He brought proceedings in the AAT to challenge those assessments.

Mr and Mrs Seymour had moved to Mauritius shortly after the Commissioner commenced an audit of their tax affairs. They sought an undertaking from the Commissioner that a departure prohibition order would not be issued if they came to Australia to give evidence. The Commissioner declined to give such an undertaking. Mr and Mrs Seymour then applied for leave to give evidence by video link from a place outside Australia.

In granting the application, the AAT relied on a finding that the taxpayers held fears that they may be prevented from leaving Australia if they came here to give evidence and that those fears were “real and rational” and “well-founded”. The Commissioner’s decision to decline to give an undertaking “lends credence to the fears” of the taxpayers.

The Commissioner filed an application for judicial review with the Federal Court under s39B of the Judiciary Act 1903. The decision of Buchanan J in *Commissioner of Taxation v Seymour* [2015] FCA 320 was reported in last year's paper.

Buchanan J found that the AAT had committed jurisdictional error by taking into account the Commissioner’s decision to decline the undertaking in respect of the departure prohibition order. Secondly, the consequence of the jurisdictional error was to deny the Commissioner procedural fairness (as required by s 39 AAT Act) by denying him the opportunity to cross-examine the taxpayers in person.

On appeal the Full Federal Court dismissed the appeal by majority.

Siopis J was of the view that the making of orders permitting the couple to give evidence from abroad doesn't go so far as to "assist" them to avoid the operation of Australian law but nonetheless has a tendency to undermine the operation of the TAA,[6] and that was a consideration the AAT should have taken into account.

Griffiths J held that the possibility of the issue of a DPO was not relevant in this case, although it might be relevant in other circumstances. He referred to the primary judge's summary of the Applicant's position at [52] as amounting to an ultimatum that the taxpayers would not come to Australia, whatever the consequences for the proceedings they had initiated before the AAT, unless at least two stipulations were satisfied: a binding assurance of no restraint on departure and a binding assurance of no arrest. In those circumstances, the situation with respect to the DPO was not relevant. He also found no error in the primary judge's reasoning with respect to the denial of procedural fairness to the Commissioner.

Pagone J delivered a dissenting judgment where he referred to the House of Lords decision in *Polanski v Condé Nast Publication Ltd* [2005] UKHL 10; [2005] 1 All ER 945 as support for “a general rule” that a witness’s reluctance to come to Australia to give evidence because of a reasonably based fear of arrest or otherwise being prevented from leaving the country after giving that evidence is a relevant matter to be taken into account in determining whether or not to permit the person to give evidence by video link from outside the jurisdiction.

The majority seemed concerned about the prospect of fugitives nonetheless being able to litigate in Australia effectively with the blessing of the court system. Griffiths J said at [72] that he considers "that there is considerable force in the dissenting views in *Polanski*...". However, he went on to say that the decision turned on the particular facts: "... it is unnecessary to state whether the majority view in *Polanski* is correct because the facts are distinguishable."

The High Court refused the Applicants special leave to appeal.

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[6] See [29]

9.2.6 *Seymour v Commissioner of Taxation* [2016] AATA 397

Deputy President SE Frost, 16 June 2016

Having failed in their bid to obtain permission to give evidence by video link the Applicants then applied for orders that their evidence in the proceedings be heard outside Australia, namely in Singapore and accepted that they should cover the Tribunal's expenses of conducting part of the hearing outside Australia. The Commissioner opposed the application unless the Applicants also paid or provided security for their tax liability and met all resulting travel, accommodation and incidental expenses incurred by the Commissioner's legal representatives comprising two counsel, one solicitor from the AGS and two instructing officers from the ATO.

The Tribunal allowed the application subject to the Applicants covering the Tribunal's expenses of an anticipated 5-day hearing in Singapore, plus the Commissioner's expenses. In total, the Applicants were ordered to pay $70,000 on account of all costs, 25,000 for the Tribunal and $45,000 for the Commissioner. The Tribunal declined to impose the condition sought by the Commissioner regarding payment of or the provision of security for the tax liability.

9.2.7 *Amies v Commissioner of Taxation* [2015] AATA 777

Deputy President PE Hack SC, 2 October 2015

Outcome: Commissioner's decision overturned and Applicant granted a departure authorisation certificate for an overseas trip with conditions attached.

The Applicant was assessed to over $3 million in tax, penalties and interest in February 2015 in relation to the 2003 to 2007 tax years. The Commissioner commenced proceedings in the Queensland Supreme Court to recover the debt. On 1 June 2015 he issued a departure prohibition order. The Applicant applied for, but was refused a departure authorisation certificate under s 14U TAA for an overseas trip for a wedding in October 2015.

The Applicant accepted that the Commissioner was not satisfied that she would return to Australia within such period as the Commissioner considers reasonable under s14U(1)(a) TAA and therefore focused on s14U(1)(b)(i), which provides that a departure authorisation certificate is to be granted if the person has given security to the satisfaction of the Commissioner for the person's return to Australia.

The Tribunal noted that the Commissioner had, in his negotiations with the Applicant, required security for the whole amount in dispute. The Tribunal commented at [12] that that was unrealistic as what is required is not security for the debt but security for the Applicant's return to Australia. The Tribunal considered the risk of the Applicant not returning to be very slight because she has considerable family and emotional ties in Brisbane as well as a new business and considerable real property whereas she has no family ties overseas. The Tribunal therefore required security of $200,000 plus the Applicant's consent to the asset freezing orders that were already in place due to the debt recovery proceedings remaining in place until the hearing and determination by the Tribunal under the Part IVC proceedings.

9.2.8 *Oswal & Anor v FC of T* [2015] FCA 1439

Griffiths J, 17 December 2015

Outcome: application dismissed. Commissioner's decision to decline to give an undertaking not to issue a DPO upheld.

One of the Oswal cases was reported on last year (*Oswal v Commissioner of Taxation* [2014] FCA 812) with respect to the CGT treatment of the creation of a trust.

The Oswals' had significant tax liabilities and were parties to several pieces of litigation regarding their tax liabilities. The Commissioner required them to attend at a hearing for cross-examination. The Oswals sought an undertaking from the Commissioner that he would not issue a DPO if they did so. The Commissioner was asked to consider various matters set out in a letter, and to give reasons and identify matters taken into account if not prepared to give an undertaking. The Oswals requested the Commissioner to reconsider his decision and to give reasons if the undertaking was refused again. In answer to both requests the Commissioner refused to give an undertaking and set out brief reasons.

The Applicants sought judicial review under s 39B of the *Judiciary Act 1903* with declaratory relief that the Commissioner's refusal to give an undertaking was unreasonable and constituted jurisdictional error.

Griffths J considered s 3A of the TAA which provides the Commissioner with the general administration of the TAA. Section 14S of TAA allows the Commissioner to issue departure prohibition orders where a person is subject to a tax liability and the Commissioner believes on reasonable grounds that it is desirable to do so.

Griffiths J found that there was no legal obligation for the Commissioner to provide any reasons for his decision. The Applicant's claim that the Commissioner misapprehended the scope of his powers under s3A of the TAA was rejected. Griffths J accepted at [39] that the Commissioner was required to exercise his legal power reasonably and that *Minister for Imigration and Citizenship v Li* [2013] HCA 18 and *Minister for Immigration and Border Protection v Singh* [2014] FCAFC 1 are the leading authorities in that respect. However, he held at [49] that the discretion in s14S is broad and at [51] that there is no express list of matters that must be taken into account. Griffth J at [53] expressed the tentative view that the Commissioner's power to give an undertaking not to issue a DPO "... is non-statutory and in the circumstances of a case like this, is an aspect of the Commissioner's powers and function as a party to litigation, which should be viewed together with the relevant statutory power in s 14S."

Griffith J held at [64] that the Commissioner was entitled to take into account such matters as the significant quantum of the Applicants' taxation liability, the fact that they were not present in Australia and might never return (in which case there would be no issue about a DPO). He held that: "It was not unreasonable for the Commissioner to decline to give an undertaking at the time that he did and by reference to the matters set out in his solicitors' correspondence."

DPN (Director Penalty Notice)

There have been two Director Penalty cases in the past twelve months. Each director failed to establish an adequate defence and there was found to be a penalty owed by the individual to the

Australian Tax Office. Each case had a different defence, one claimed that reasonable steps were taken by the director and the other case claimed that there was an issue with service of the director penalty notice, with delays resulting from the company not being able to be liquidated and repaying the debt in a reasonable time period.

9.2.9 *Deputy Commissioner of Taxation v Holton* [2016] VCC 516

Kennedy J, 17 May 2016

Kennedy J was required to consider whether Mr Holton had a defence to the director penalty notice in the form of whether reasonable steps were taken. There were reasonable steps available which the respondent did not take, therefore Kennedy J found that there was no defence to the notice.

Mr Holton was a company director who withheld, however failed to remit, amounts for purposes of pay as you go withholding provisions of $264,043 becoming liable to penalty through this action. The two issues in the case related to whether Mr Holton took all reasonable steps to ensure his director's duties were fulfilled or there were no reasonable steps able to be taken in the circumstances; or there was a good reason why it was not reasonable to expect Mr Holton to take part in managing the company at the relevant time.

It was found by the Court that Mr Holton did not take reasonable steps to fulfil his director's duties. The reasonable step test is an objective test: what he should have known not what he did know. Mr Holton delegated the financial affairs of the business to another director and relied upon information given by another director, which does not mitigate the responsibility for him to take all steps reasonable to become aware of amounts outstanding or the company's ability to pay debts, which he failed to do. The judge found that reasonable steps Mr Holton could have taken included arranging a meeting of directors; considering placing the company into administration or liquidation; putting systems in place to ensure compliance with directors' duties and taxation duties; or paying the amounts owing by the company.

Accordingly, Kenny J held that the director failed to establish an adequate defence against ATO claim.

9.2.10 *Deputy Commissioner of Taxation v Fitzgerald* [2016] NSWSC 971

Harrison AsJ, 14 July 2016

In *Fitzgerald* the Court considered whether the director penalty notice was served on defendant and whether the defendant lost an opportunity for remission of the penalty. The Court found that the notice had been served.

Mr Fitzgerald was a company director who withheld, however failed to remit, amounts for the purposes of pay as you go withholding provisions of $1,965,485 becoming liable to penalty through this action. The Commissioner served the director penalty notice on the defendant by mail to the defendant's address which appeared on the ASIC records but the defendant failed to pay the director penalty. The Commissioner sought to recover $2,408,511 plus interest and costs in respect of director penalties.

The court found that service of the relevant director penalty notice on the defendant complied with s 269-50 TAA. The court found that the delay between delivery of the director penalty notice and the defendant's actual receipt did not affect the right to achieve remittance by placing company under administration as the time to do so had well and truly passed. The defendant was ordered to pay the Commissioner $1,965,485 and costs on the ordinary basis as agreed or assessed.

9.2.1 *Rigoli v Commissioner of Taxation* [2016] FCAFC 38

Kenny, Davies and Moshinsky JJ , 15 March 2016

In *Rigoli* a bench of three members of the Federal Court considered whether a taxpayer was able to rely on an expert report tendered by the Commissioner to establish that the assessment by the ATO was excessive. The Court found that there was insufficient evidence provided by the taxpayer to discharge the burden of establishing his actual taxable income as the expert report only concerned income from the partnership and did not examine all sources of income. Accordingly, the appeal was dismissed.

Mr Rigoli had not filed income tax returns for a number of years, with the focus being upon 1994 to 2001 years of income. The Commissioner issued default assessments under s 167 ITAA 1936. During the Tribunal hearing, the taxpayer had sought to discharge the onus of showing that the assessments made by the ATO were excessive by relying on a report by a chartered accountant that was put into evidence by the Commissioner. This report, known as the Kompos report, contained calculations of the income of the partnership which the taxpayer was involved with for a number of years. Initially Mr Rigoli was successful before the Tribunal in that the Tribunal held that the assessments were excessive because they failed to allow Mr Rigoli's claims for depreciation deductions on certain capital items. The Commissioner successfully appealed to the Federal Court on the basis that the taxpayer cannot discharge the onus upon him of proving that the assessments are excessive by conceding certain elements and pointing to mistakes in others. Mr Rigoli appealed to the Full Federal Court but the appeal was dismissed and the matter was remitted to the Tribunal for determination.

The Tribunal held a second hearing on 12 November 2014 and in that hearing the taxpayer did not adduce any further evidence but sought to rely on the Kompos report as evidence of his income, subject to the corrections for depreciation that the Tribunal had made in the first hearing. The Tribunal dismissed the matter and upheld the Commissioner's assessments. Mr Rigoli appealed to the Federal Court and Pagone J dismissed that appeal. Mr Rigoli then appealed to the Full Federal Court for the second time.

The main contention by the taxpayer in this case and the case before the primary judge, was that the Tribunal had erred as the consideration of the report was excluded per se as it was not evidence led by the taxpayer. The primary judge held that the Tribunal decision could not be understood this way, and rather the Tribunal had rejected reliance on the report because it did not establish the taxpayer's taxable income.

In considering the appeal, the Court delivered a unanimous judgment in which s14ZZK of the TAA and s167 of ITAA36 were set out. The Court found that the Kompos report was insufficient to discharge the burden on the taxpayer of establishing his actual taxable income as the Commissioner had not agreed to confine the issues for determination before the court to the partnership income; the

Commissioner was putting the taxpayer to proof of his actual income from all sources. The Court rejected the argument that the Tribunal excluded the report per se as it was not evidence led by the taxpayer. The appeal was dismissed.

9.2.2 *LHRC v Deputy Commissioner of Taxation* [2015] FCAFC 184

16 December 2015, Siopis, Pagone and Wigney JJ

Outcome: appeal dismissed - taxpayers required to comply with s 264 notice. Deputy Commissioner was not bound to take into account the “detriment” the taxpayers would be exposed to in deciding to issue a notice under s264 ITAA 1936, requiring the taxpayer to attend an interview with the ATO.

This is a case with multiple appellants. The first appellant was director of an investment bank, and the second to sixth appellants were trustees of discretionary trusts of which the beneficiaries include the first appellant and his family members. The first appellant was also the principal and director of the trustee companies together with his father.

On 10 March 2014 the first appellant was served with a s 264 notice requiring him to attend an interview on 11 April 2014. He had already given evidence in an examination on 24 February 2011 conducted by the Australian Crime Commission as part of Project Wickenby and the ATO had access to his evidence provided during that examination. During that examination he could not rely on the privilege against self-incrimination but he had invoked the protection under the *Australian Crime Commision Act 2002* limiting the uses to which his evidence could be put.

The first appellant brought an application for judicial review of the decision to issue the s 264 notice on the basis that the Commissioner ought to have taken into account the detriment to which he was exposed by the s 264 notice because an interviewee under a s 264 notice has no entitlement to refuse to give evidence on the ground of self-incrimination.

Siopis and Pagone JJ held at [8] that the relevant mandatory consideration in the context of the exercise of the power under s 264 is that the power is being exercised for the purposes of the Act. They found that the power was exercised by the Commissioner for the purpose of gathering evidence concerning the income or assessment of the appellants and related entities identified on the face of the notice. At [17] they held that none of the circumstances relied upon by the appellants justify the conclusion that the decision to issue the s 264 notice was unreasonable in the relevant sense.

Wigney J agreed that the appeal should be dismissed and added some comments of his own. He accepted at [34] that the power to issue a s 264 notice should be exercised reasonably and not arbitrarily or capriciously but held that it does not follow that the Commissioner is bound to consider any detriment to the recipient. At [39] he rejected any notion that the Commissioner was bound to consider whether the information could be obtained by means other than a s 264 notice.

Accordingly, the appeal failed as there was found to be no failure to take into account a relevant consideration and the decision to issue a notice under s264 was not unreasonable.

10 Foreign resident

10.1 Cases

10.1.1 *Macoun v Commissioner of Taxation* [2015] HCA 44

French CJ, Bell, Gageler, Nettle and Gordon JJ

Outcome: appeal dismissed. Commissioner's assessments upheld.

Mr Macoun is a former officer of the International Bank for Reconstruction and Development (IBRD). He argued that he is entitled to an exemption from taxation in respect of monthly pension payments received from IBRD in the 2009 and 2010 years.

Mr Macoun contended that the pension was exempt under sub-section 6-20(1) ITAA 1997 by reason of the *International Organisations (Privileges and Immunities) Act 1963* (**IOPI Act**) and the *Specialized Agencies (Privileges and Immunities) Regulations* (**SAPI Regulations**). This confers upon a person who holds an office in an international organisation to which the IOPI Act applies an exemption from taxation on salaries and emoluments received from the organisation. It was agreed that IBRD was an organisation within the meaning of the Act and thus the Act applied.

The AAT found that the pension payments were exempt from Australian tax. The Commissioner successfully appealed to the Federal Court where it was decided the tax exemption was confined to persons currently holding an office an eligible organisation. It was found that as Mr Macoun did not hold office with the IBRD for the relevant financial years, the exemption did not apply to his pension payments. Mr Macoun appealed to the High Court.

The question for the High Court was whether the monthly pension payments the applicant received from the IBRD was exempt from Australian tax as a “salary or emolument of an official” of the IBRD. The High Court dismissed the case and held unanimously that the taxpayer's monthly pension payments were not exempt from tax because the relevant regulation confined the privilege of tax exemption to persons currently holding an office in an eligible international organisation; the pension payments came from the retirement fund plan rather than from IBRD the organization; and the payments to Mr. Macuon did not fall under the meaning of ‘salaries and emoluments’ as specified under Item 2 of Pt I of the Fourth Schedule of the IOPI Act. Therefore Australia’s international obligations did not require the Commissioner to exempt the monthly payments from taxation.

10.1.2 *Commissioner of Taxation v AP Energy Investments Pty Ltd* [2016] FCA 577

McKerracher J, 25 May 2016

Outcome: appeal by Commissioner from AAT dismissed, taxpayer company (a Chinese company) not liable for CGT on sale of shares it held in an Australian mining company.

The respondent, a non-resident taxpayer, had claimed that the disposal of shares it held in an Australian company Abra Mining Limited (**Abra**) was not subject to capital gains tax, because the shares disposed of were not taxable Australian property (**TAP**) for the purposes of Division 855 ITAA 1997.

The definition of TAP includes:

- taxable Australian real property (**TARP**) and TARP is defined in s 855-20 to be (a) real property in Australia or (b) a mining, quarrying or prospecting right if the minerals, petroleum or quarry materials are situated in Australia.
- an indirect Australian real property interest which is defined in s 855-25(1) to be an interest of 10% or more in an entity where the sum of the market values of that entity's assets that are taxable Australian real property exceeds the sum of the market values of its assets that are not taxable Australian real property.

The case turned on whether the sum of the market value of Abra's TARP assets exceeded the sum of the market values of its non-TARP assets at the relevant date. It was the value of mining information, being non-TARP assets, that was materially in dispute.

The Commissioner contended that the Tribunal followed the first instance decision in *Resource Capital Fund III LP v Commissioner of Taxation* [2013] FCA 363 (**RCF**) as to the method of valuation. RCF was relevantly partly reversed on appeal by the Full Court in *Commissioner of Taxation v Resource Capital Fund II LP* (2014) 225 FCR 290 (**RCF FC**).

McKerracher J referred to the decision of the Full Court (Middleton, Robertson and Davies JJ) in RCF FC and said at [20] that the Full Court had held that the market values of the individual assets should be valued on the basis of an assumed simultaneous sale of the test entity's assets to the same hypothetical purchaser and not as stand alone assets.

McKerracher J held at [73] that what is to be included as comprising the asset mining information for Div 855 purposes will depend on the circumstances of the case, including the activities of the company concerned.

The approach adopted by the taxpayer in regards to mining information valuation was a sunk cost methodology. The taxpayer accepted the Commissioner's estimate of the total value of the company, but disputed the amount of the value attributed to the mining information.

The Commissioner’s appeal was dismissed as the hypothetical purchaser would expect to acquire the mining information and plant and equipment for less than their re-creation costs; and the court found it was open to the AAT to compare the evidence from the experts, and to choose a market value of the mining information on a sunk cost methodology and this did not represent an impermissible application of RCF.

10.1.3 *Hughes v Federal Commissioner of Taxation* [2015] AATA 1007

22 December 2015, SM McCabe

Outcome: taxpayer was a resident of Australia for the 2010, 2011 and 2012 tax years. Commissioner's assessments upheld.

This case concerned the residency of an airline pilot. He was born in Indonesia but moved to Australia with his parents as a young child. It concerned his residency during the 2010, 2011 and 2012 tax years. He used to work for Ansett and when Ansett collapsed in 2001 he was unable to find work in Australia and so began working for foreign airlines. In June 2008 he entered into a 5 year contract with Korean Air, an airline based in Seoul. He worked a roster of 2-3 weeks on and 10-11 days off. During his time on he was often in the air or in foreign ports. During his time off he initially stayed in hotels in Seoul and in January 2009 he reached an arrangement with an American colleague to stay in his apartment as needed. In October 2010 he moved out of that apartment and two months later moved into a 3 bedroom apartment where he had his own room. But he spent a lot of time in Australia during his time off: 136 days in 2010, 158 days in 2011 and 156 days in 2012. His wife and family lived in Australia. He sent significant amounts of money back to Australia. It was held that he was an Australian resident for tax purposes.

11 Liquidation

11.1 Cases

11.1.1 *Commissioner of Taxation v Australian Building Systems Pty Ltd (In Liq)* [2015] HCA 48

French CJ, Kiefel, Gageler, Keane and Gordon JJ, 10 December 2015

The High Court has had the final word on a liquidator's obligations under section 254 of the ITAA 1936 - there is no obligation to retain money on account of tax before a notice of assessment has issued. However, this was a narrow majority of 3-2. In addition, the High Court clarified that a liquidator is not the "trustee of a trust estate" for the purposes of Division 6 of the ITAA 1936 and on that issue the High Court was unanimous.

Section 254(d) of ITAA 1936 provides:

> "With respect to every agent and with respect also to every trustee, the following provisions shall apply:
>
> ...
>
> d) He or she is hereby authorized and required to retain from time to time out of any money which comes to him or her in his or her representative capacity so much as is sufficient to pay tax which is or will become due in respect of the income, profits or gains.

A trustee is defined by s 6 ITAA 1036 to include a liquidator or receiver.

IT 2544 was issued in 1989. IT 2544 stated that the requirement in section 254(1)(d) and 255(1)(b) to retain from money coming to the representative sufficient money to pay "tax that is or will become due" does not require an assessment in order to operate but rather operates of its own force without requiring any notification from the Commissioner.

However, in *Bluebottle UK Ltd & Ors v Deputy Commissioner of Taxation & anor* (2007) 232 CLR 598, [2007] HCA 54 the High Court had to consider the phrase "tax which is or will become due" in section 255(1)(b) and held that it meant tax that had been assessed, even though it might not yet be due for payment. Accordingly, on 23 June 2010 the ATO withdrew IT 2544 but the notice of withdrawal stated that section 254(1)(d) has a radically different context to section 255 and therefore *Bluebottle* did not decide that section 254 only operated when an assessment has been made.

Then in 2012 two draft tax determinations were issued TD 2012/D6 and TD 2012/D7 designed to establish the ATO's priority ranking in respect of tax payable out of funds received by a receiver or liquidator. These rulings were to be finalised in April 2013 but were delayed by the test case *Australian Buildings Systems (in liq) v DCT* [2014] FCA 116.

The test case involved a company to which liquidators had been appointed. The liquidators caused the company to enter into a contract of sale for a property, thus triggering a capital gain in the company's hands. There was a secured creditor in respect of the property and a number of unsecured creditors. The liquidators estimated that there would be a shortfall such that the creditors would not be able to be paid in full in the winding up. Therefore, the company applied for a private ruling to determine whether the capital gains tax on the sale of the property had to be paid to the Commissioner before distributions were made to the creditors of the company. The Commissioner issued a private ruling that the liquidators were bound to retain the monies on crystallisation of the capital gain and pay the capital gains tax to the ATO from those monies before attending to creditors claims. The company objected to the private ruling and the matter came before Logan J in the Federal Court. Logan J overturned the private ruling issued by the ATO in holding that section 254(a)(d) only had application where an assessment had been issued and therefore in the absence of an assessment a liquidator or receiver had no obligation to retain funds and to forward the tax payable to the ATO from those funds.

The company had asked the court to determine whether the monies had to be retained on crystallisation of the gain or on the issue of the assessment but Logan J declined to answer these questions on the basis that there was no obligation to retain in the absence of an assessment. Logan J stated "Given its absence of present application, there can be no question of any need to reconcile s 254 of the ITAA36 with the application of the Corporations Act to the liquidators. The resolution of that question can and should await the issuing of an assessment".

The Commissioner appealed to the Full Federal Court ([2014] FCAFC 133) where Edmonds, Collier and Davies JJ dismissed the appeal. The Commissioner then appealed to the High Court (having been granted special leave to do so by Kiefel and Keane JJ).

French CJ and Kiefel J made reference at [6] to the fact that Edmonds J, with whom Collier J agreed, had applied Division 6 of the ITAA 1936 as part of his reasoning, "... thus equating the liquidators to the position of trustees for the purposes of that Division." Whereas Davies J did not adopt that reasoning as she held that the liquidators would be assessed in their representative capacity rather than the company being assessed. French CJ and Kiefel J held at [7] that a liquidator is not a trustee of a trust estate for the purposes of Division 6 and that the Full Court's reasoning in that respect was erroneous.

French CJ and Kiefel J were not persuaded by the Commissioner's arguments that a different interpretation of the words "to pay tax which is or will become due" should be applied in respect of s 254 and s 255 of the ITAA 1936. They also considered that significant practical difficulties attached to the Commissioner's construction as it imposed personal liability on the liquidators for an uncertain and changing amount.

Gageler J also preferred a construction of s 254 that accorded with the construction of s 255 even though he was less persuaded about the practical difficulties of the Commissioner's construction. He stated at [64] that he agreed in substance with Logan J at first instance and Davies J in the Full Court of the Federal Court. With respect to the reasoning of Edmonds and Collier JJ with respect to the application of Division 6 of the ITAA 1936, he said at [64] that the "uncontested submissions of the Commissioner recorded by Keane J should be accepted for the reasons given by Keane J." Those submissions were firstly, that a liquidator is not a trustee of a trust estate in any ordinary sense and

there was no trust estate as between the liquidators and the company. And secondly, that s 254 is not just a collection mechanism but also imposes a liability on the agent or trustee.

Keane J considered that the appeals should be allowed holding at [134] that "There is no good reason to construe s 254(1)(d) otherwise than on the basis that the phrase "tax which --- will become due" means "tax which ... will be assessed"."

Gordon J held that a liquidator is not a trustee of a trust estate in any ordinary sense and that there was no trust estate as between the liquidators and the company to which Division 6 could apply. Accordingly the word trustee in Division 6 did not apply to a liquidator whereas in s 254 it did. She held at [176] that s 254 both imposes a liability and is a collecting section. Accordingly there is no need to find another specific section in the revenue law rendering the agent or trustee liable for tax in respect of the income profits or gains referred to in s 254(1)(a). Gordon J was persuaded that s 254 should not be interpreted in the same way as s 255 and concluded that the appeal should be allowed.

This doesn't necessarily mean that liquidators will feel comfortable disposing of the proceeds of sale as quickly as possible in reliance on the premise that they are not personally liable until a notice of assessment has issued. The issue of the reconciliation of s 254 of the ITAA36 with the application of the Corporations Act remains at large.

In this respect the curious comment made by Logan J may still have currency given the High Court decision: *"Even though, for the reasons given, s 254 does not require retention upon the mere happening of a CGT event, that does not mean that a liquidator is obliged immediately to distribute the resultant gain or part thereof as a dividend to creditors in the course of the winding up. A prudent liquidator, like a prudent trustee of a trust estate or executor of a will, would be entitled to retain the gain for a time against other expenses which might arise in the course of the administration. Further, in relation to income tax, the liquidator would at the very least be entitled to retain the gain until the income tax position in respect of the tax year in which the CGT event had occurred had become certain by the issuing of an assessment or other advice from the Commissioner that, for example, no tax was payable in respect of that income year. Yet further, in the event of a controversy after the issuing of an assessment as to whether the tax debt that was provable in the winding up, the liquidator would be entitled to retain the gain or some part thereof sufficient to meet the assessed tax until that controversy was resolved."*

11.1.2 *The Bell Group Ltd (In Liq) & Anor v Deputy Commissioner of Taxation & Anor*

Wigney J, 29 September 2015

Outcome: Notices issued by the Commissioner under s 260-5 of Schedule 1 of the TAA were set aside.

The Commissioner issued notices under s 260-5 of the TAA (Garnishee notices) to the NAB on 14 August 2015 in respect of tax liabilities of The Bell Group Limited (TBGL) and Mr Woodings, in his capacity as liquidator of TBGL. The Commissioner contended that the notices are valid because they relate to a post-liquidation tax liability and s 254(1)(h) ITAA 1936 takes priority over s 268(4) of the Corporations Act.

A liquidator was appointed to TBGL on 24 July 1991. In 2000 TBGL and its related entities were successful in proceedings in the Western Australian Supreme court in proceedings against a number of Australian and overseas banks. The banks were ordered to pay TBGL $1.5 billion and on appeal this was increased to over $2 billion. The banks obtained special leave to appeal to the High Court but before the hearing the parties entered a Deed of Settlement, which required the banks to pay $981,865,342.12 to the liquidator to be held on trust for TBGL and its related entities in certain specified proportions. At the time of the proceedings Mr Woodings held $300,000,000 in a NAB term deposit account which was due to mature on 2 October 2015.

The Commissioner issued notices of assessment to TBGL and also to Mr Woodings as liquidator for income of $993,967,829 for the 2014 year as a result of TBGL's proceedings against the banks, leading to a tax liability of $298,190,348.70. 4 days later, on 14 August 2015 the Deputy Commissioner of Taxation issued the garnishee notices to the NAB.

Wigney J noted that there is a regime with respect to pre-liquidation tax liabilities and that for post-liquidation tax liabilities section 254 ITAA 1936 applies. Section 254(1)(h) provides that the Commissioner shall have the same remedies against attachable property of any kind vested in or under the control or management or in the possession of any agent or trustee as the Commissioner would have against the property of any other taxpayer in respect of tax. "Attachable property" is not defined.

Section 260-5 of Schedule 1 TAA enables the Commissioner to issue a garnishee notice to a third party if the third party owes or may later owe money to a person who has a debt payable to the Commonwealth that is a tax-related liability. Subsection 260-5(3) deems a third party to owe money to the debtor if the third party:

a) is an entity by whom the money is due or accruing to the debtor; or
b) holds the money for or on account of the debtor; or
c) holds the money on account of some other entity for payment to the debtor; or
d) has authority from some other entity to pay the money to the debtor.

It also deems the third party to owe money to the debt even if the debt is contingent.

The Commissioner contends that paragraph (a) of subsection 260-5(3) applies to the garnishee notice in respect of the liquidator because NAB is an entity by whom the money in the term deposit account is due or accruing to the liquidator as the relevant debtor. The Commissioner contends that paragraph (c) of subsection 260-5(3) applies to the garnishee notice in respect of TBGL because NAB holds the money on account of "some other entity", being the liquidator, for payment to TBGL as the relevant debtor.

Wigney J considered the High Court decision in In the matter of *Bruton Holdings Pty Ltd (in liquidation) v Commissioner of Taxation* [2009] HCA 32 where it was held that a garnishee notice could not be issued after a company had been placed in voluntary liquidation as that would effectively allow the Commissioner priority of payment of tax debts where third parties owed the company money but no priority where that was not the case. In addition, the Corporations Act provides that any attachment after the passing of the resolution for voluntary winding up is void and a garnishee notice is such an attachment.

TBGL and the liquidator submitted that the reasoning in Bruton Holdings applies equally to a post-liquidation tax debt where the liquidation is not voluntary but has been court-ordered. The Commissioner argued that s 254(1)(h) ITAA 1936 specifically provides for or preserves the availability of the Commissioner's remedy of a garnishee notice under s 260-5.

However, Wigney J held at [69] that the word "attachable" in s 254(1)(h) meant that it did not apply to property in the control or possession of a liquidator and thus it does not "confer any remedy on the Commissioner against the property of a company after the commencement of the winding up of the company" and that this construction meant that there was no conflict with ss 468(4) and 500(1) of the Corporations Act, which prevent the attachment of property of a company in liquidation. Wigney J also rejected at [70] the Commissioner's argument that ss 468(4) and 500(1) of the Corporations At only operate to render void an attachment if the effect of the attachment is to secure priority in respect of the payment of a debt that is not otherwise a priority debt and that the Commissioner has priority in respect of post-liquidation tax-related liabilities. Wigney J held that neither proposition is correct.

Wigney J concluded at [81] that the Commissioner had no power to issue the garnishee notices.

11.1.3 Commissioner of Taxation v Warner (No 2) [2015] FCA 1281

Perry J, 20 November 2015

Outcome: In *Commissioner of Taxation v Warner* [2015] FCA 659 the Federal Court made a declaration that the liquidators had to comply with the notice to produce documents issued by the Commissioner under s 264 of the ITAA 1936 and s 353-10 of Sch 1 to the TAA and that the obligation was not subject to s 486 of the Corporations Act. In this matter Perry J ordered the liquidators to personally pay the Commissioner's costs and the costs incurred by the Commissioner in arranging for counsel to appear as *amicus curiae*.

The Commissioner issued a notice to produce documents under s 264 of the ITAA 1936 and s 353-10 of Sch 1 to the TAA to liquidators appointed in creditors' voluntary liquidations. The liquidators refused to produce the documents without a court order because they argued that s 264 of the ITAA 1936 is subject to s 486 of the Corporations Act which requires a creditor to obtain a court order before it can inspect the companies' records. The Commissioner commenced proceedings in the Federal Court to obtain such a court order and the liquidators refused to participate and made a submitting appearance only, save as to costs. The Commissioner arranged for an amicus curiae to appear as a contradictor.

On 1 July 2015 the Court made the declaration sought by the Commissioner that s 264 of the ITAA 1936 and s 353-10 of Sch 1 to the TAA are not subject to s 486 of the Corporations Act. Perry J considered the discretion regarding costs but having considered all the circumstances determined that the liquidators should personally bear the Commissioner's costs and, at [42]: "It will then be for the liquidators to establish the reasonableness of their conduct in all of the circumstances in due course, should they ultimately seek indemnity against these costs out of the companies' assets.

11.1.4 *Bell Group N.V. (In Liq) & Anor v The State of Western Australia* [2016] HCA 21

French CJ, Kiefel, Bell, Gageler, Keane, Nettle and Gordon JJ, 16 May 2016

This was a special case stated to the High Court where French CJ, Kiefel, Bell, Keane, Nettle and Gordon delivered a joint judgment that the *Bell Group Companies (Finalisation of Matters and Distribution of Proceeds Act 2015* (WA) enacted by the Western Australian Parliament in November 2015 (the **Bell Act**) was invalid under s 109 of the Constitution because it was inconsistent with the ITAA 1936 and the TAA, the Corporations Act and s 39(2) of the Judiciary Act 1903. Gageler J delivered a separate judgment agreeing with the conclusion that the Bell Act was invalid in its entirety but on a narrower basis than the other members of the Court.

The Bell Act was designed to govern the distribution of the assets in the liquidation of The Bell Group Ltd (in liquidation) and certain of its subsidiaries before any of the windings up had concluded. The High Court held it invalid in its entirety.

11.2 Rulings

Draft Tax Determinations TD 2012/D6 and D7 issued on 19 September 2012, which were put on hold pending the outcome of the *Australian Building Systems Pty Ltd (in liquidation)* test case, can now be finalised. Given that the High Court decision is contrary to these draft tax determinations it will be interesting to see whether the Commissioner withdraws them or re-issues them in an altered form.

Draft Tax Determination TD 2012/D6 indicates the Commissioner's opinion that section 254(1)(d) has application even if no tax assessment has been issued. That is, the obligation to retain funds on account of tax arises on crystallisation of a gain and liquidators and receivers are personally liable for the tax even in the absence of a tax assessment.

Draft Tax Determination TD 2012/D7 specifically considers the circumstances where a receiver is appointed by a secured creditor and disposes of a CGT asset of the debtor company. The ATO view set out in the draft determination is that, in the normal course of events where the receiver is appointed as agent of the company, the receiver derives the gross proceeds of sale as agent of the company and is obliged by section 254(a)(d) to retain sufficient of those gross proceeds to satisfy any capital gains tax before accounting to the secured creditor for the balance. This is even if the funds are paid directly to the secured creditor at settlement. The ATO considers that 'comes to' the receiver because the total sale proceeds from the disposal are money of the debtor. The obligation also attaches to the entire gain regardless of whether some part of the gain accrued before the receiver was appointed.

12 Legislative Developments

12.1 National Innovation and Science Agenda

On 7 December 2015 the Government announced the National Innovation and Science Agenda (NISA). Under this heading the Government introduced the following measures:

- Intangible Asset Depreciation - to remove the rules that limit depreciation deductions for some intangible assets (like patents) to a statutory life and enable taxpayers to choose to self-assess the effective life of such assets. An exposure draft "*Tax and Superannuation Laws Amendment (2016 National Innovation and Science Agenda) Bill 2016: Intangible asset depreciation*" was released on 1 April 2016 with an intended start date of 1 July 2016.
- New tax incentives for early stage investors - to provide concessional tax treatment for investments made in a range of innovative start-up companies with high growth potential. The tax incentives will provide investors with a 20% non-refundable carry-forward tax offset for qualifying investments, capped at $200,000 for each investor and their affiliate (combined) per year and an exemption from capital gains tax for qualifying investments held between one and ten years (capital losses on investments held for less than ten years must be disregarded). This scheme is based on the successful Seed Enterprise Investment Scheme in the United Kingdom, which has resulted in over $500 million in funding to almost 2,900 companies in its first two years. The *Tax Laws Amendment (Tax Incentives for Innovation) Act 2016* received Royal Asset on 5 May 2016 and the key measures apply from 1 July 2016.
- Expansion of same business test to a "predominantly similar business test" to enable companies to access past year losses even if they have entered into new transactions or business activities. This is stated to be to allow a startup to bring in an equity partner and secure new business opportunities without worrying about tax penalties. Legislation is expected to be introduced in the first half of 2016. The “predominantly similar business test" will apply to losses made in the current and future income years. An exposure draft of the Tax and Superannuation Laws Amendment (2016 National Innovation and Science Agenda) Bill 2016: Access to Losses was released in April 2016.

12.2 Foreign Resident CGT Withholding

The *Tax and Superannuation Laws Amendment (2015 Measures No. 6) Act 2016* was enacted on 25 February 2016 to introduce a 10% non-final withholding on payments made to foreign residents under contracts entered into on or after 1 July 2016 to dispose of certain taxable Australian property. These rules are a collection mechanism where taxable Australian property is disposed of and apply to sales of such property with a market value of $2 million or more. Sellers can avoid or reduce the withholding if a clearance or variation certificate is obtained from the ATO prior to settlement. Australian residents can obtain a clearance certificate and foreign residents may be able to obtain a variation certificate. In any event, the vendors can claim a credit for the withholding amount when their tax return is lodged.

The taxable Australian property subject to withholding include real property in Australia – land, buildings, residential and commercial property; lease premiums paid for the grant of a lease over real property in Australia; mining, quarrying or prospecting rights; interests in Australian entities whose majority assets consist of the above such property or interests – this is called an indirect interest; and options or rights to acquire the above property or interest.

Three Law Companion Guidelines have issued with respect to this new regime:

1. LCG 2016/5: the Commissioner's variation power
2. LCG2016/6: amount payable to the Commissioner
3. LCG 2016/7: options

12.3 Changed CGT treatment for earnout rights

The *Tax and Superannuation Laws Amendment (2015 Measures No 6) Bill 2015* received Royal Assent on 1 March 2016 and amends the ITAA 1997 to provide for a "look-through" CGT treatment for the sale and purchase of businesses involving earnout rights.

12.4 Small business CGT rollover

The *Tax Laws Amendment (Small Business Restructure Roll-over) Bill 2016* received Royal Assent on 8 March 2016. It provides a new CGT roll-over from 1 July 2016 to make it easier for small business owners to restructure. Key concepts to access the rollover are "genuine restructure" and "small business entity" - taken from the small business CGT concessions.

Two Law Companion Guidelines have been issued with respect to this new rollover, including:

1. LCG 2016/2: consequences of a roll-over
2. LCG 2016/3: meaning of genuine restructure

13 Table of Cases

Case name	Date	Court/Tribunal	Successful party	Page
BAI v Federal Commissioner of Taxation [2015] FCA 973	3.9.2016	Federal Court Rares J	Taxpayer	36
The Bell Group Ltd (in liq) & Anor v Deputy Commissioner of Taxation & Anor [2015] FCA 1056	29.9.2015	Federal Court Wigney J	Liquidator	58
Sunraysia Harvesting Contractors Pty Ltd and Others v Commissioner of Taxation [2015] AATA 764	30.9.2015	AAT Deputy President P E Hack SC	Cmmr	35
Amies v Commissioner of Taxation [2015] AATA 777	2.10.2016	AAT PE Hack SC	Taxpayer	48
Alderton v FC of T [2015] AATA 807	16.10.2015	AAT PE Hack SC	Cmmr	27
Blank v Commissioner of Taxation [2015] FCAFC 154	29.10.2015	Full Federal Court Kenny, Robertson and Pagone JJ	Cmmr	22
Cornell and Commissioner of Taxation [2015] AATA 852	6.11.2015	AAT SM O'Loughlin	Cmmr	40
Rosgoe Pty Ltd v Commissioner of Taxation [2015] FCA 1231	13.11.2015	Federal Court Logan J	Taxpayer	21
Commissioner of Taxation v Warner (No 2) [2015] FCA 1281	20.11.2015	Federal Court Perry J	Cmmr	60
Trustee of the WT & A Norman Superannuation Fund & the Trustee of Mary A Norman Superannuation fund v Commissioner of Taxation [2015] AATA 914	27.11.2015	AAT SM O'Loughlin	Cmmr	31
Devuba Pty Ltd v. Commissioner of Taxation [2015] FCAFC 168	30.11.2015	Full Federal Court Greenwood, Jagot, Pagone JJ	Taxpayer	13
Ward v FC of T (No 2) [2015] AATA 919	30.11.2015	AAT Deputy President Humphries	Cmmr	30
Deputy Commissioner of Taxation v Gould [2015] FCA 1345	1.12.2015	Federal Court Pagone J	Cmmr	44
Macoun v Commissioner of Taxation [2015] HCA 44	2.12.2015	High Court French CJ, Bell, Gageler, Nettle and Gordon JJ	Cmmr	53

Case name	Date	Court/Tribunal	Successful party	Page
Commissioner of Taxation v Australian Building Systems Pty Ltd (In Liquidation) [2015] HCA 148	10.12.2015	High Court French CJ, Kiefel, Gageler, Keane and Gordon JJ	Liquidator	56
Bywater Investments Limited v Commissioner of Taxation [2015] FCAFC 176	11.12.2015	Full Federal Court Robertson, Pagone and Davies JJ	Cmmr	21
FCT v Elecnet (Aust) Pty Ltd (Trustee) [2015] FCAFA 178	14.12.2015	Full Federal Court Jessup, Pagone and Edelman JJ	Cmmr	17
LHRC v Deputy Commissioner of Taxation [2015] FCAFC 184	16.12.2015	Full Federal Court Siopis, Pagone and Wigney JJ	Cmmr	52
PFGG v Federal Commissioner of Taxation [2015] AATA 972	16.12.2015	AAT Siopis J and SM Walsh	Cmmr	14
Oswal & Anor v FC of T [2015] FCA 1439	17.12.2015	Federal Court Griffiths J	Cmmr	49
FCT v Donoghue [2015] FCAFC 183	17.12.2015	Full Federal Court Kenny, Perram & Davies JJ	Cmmr	43
Normandy Finance Pty Ltd v Commissioner of Taxation [2015] FCA 1420	17.12.2015	Federal Court Edmonds J	Taxpayer	37
Breakwell v Federal Commissioner of Taxation [2015] FCA 1471	22.12.2015	Federal Court White J	Cmmr	10
Hughes v Federal Commissioner of Taxation [2015] AATA 1007	22.12.2015	AAT SM McCabe	Cmmr	54
Cable & Wireless Australia & Pacific Holding BV (In Liq) v Federal Commissioner of Taxation [2016] FCA 78	11.2.2016	Federal Court Pagone J	Cmmr	18
Miley v Commissioner of Taxation [2016] AATA 73	15.2.2016	AAT S.E. Frost	Taxpayer	12
Brady v Commissioner of Taxation [2016] AATA 97	23.2.2016	AAT (SM Lazanas)	Taxpayer	29
Seymour v Commissioner of Taxation [2016] FCAFC 18	2.3.2016	Full Federal Court Siopis, Griffiths and Pagone JJ	Cmmr	46
Rigoli v Commissioner of Taxation [2016] FCAFC 38	15.3.2016	Full Federal Court Kenny, Davies and Moshinsky JJ	Cmmr	51

Case name	Date	Court/Tribunal	Successful party	Page
Fischer v Nemeske Pty Ltd [2015] HCA 11	6.4.2016	High Court Frech CJ, Kiefel, Bell, Gageler and Gordon JJ	NA	25
Schreuders v Grandiflora Nominees Pty Ltd *[2016] VSCA 93*	6.5.2016	Victorian Court of Appeal Kyrou, Ferguson and McLeish JJA	NA	26
Featherby v FCT (No 2) [2016] FCA 465 (pending appeal to Full Federal Court)	6.5.2016	Federal Court Gilmour J	Cmmr	*45*
Bell Group N.V. (In Liq) & Anor v The State of Western Australia [2016] HCA 21	16.5.2016	High Court French CJ, Kiefel, Bell, Gageler, Keane, Nettle and Gordon JJ	NA	60
Deputy Commissioner of Taxation v Holton [2016] VCC 516	17.5.2016	County Court Kennedy J	Cmmr	50
Commissioner of Taxation v AP Energy Investments Pty Ltd [2016] FCA 577	25.5.2016	Federal Court McKerracher J	Taxpayer	53
Case 3/2016 [2016] AATA 348	27.5.2016	AAT SE Frost DP	Cmmr	20
Seymour v Commissioner of Taxation [2016] AATA 397	16.6.2016	AAT Deputy President Se Frost	Taxpayer	48
The Executors of the Estate of the Late Peter Fowler v FC of T [2016] AATA 416	22.6.2016	AAT SE Frost DP	Cmmr	15
Rowntree and Commissioner of Taxation [2016] AATA 420	24.6.2016	AAT Professor R Deutsch	Cmmr	39
Commissioner of Taxation v Ludekens (No 2) [2016] FCA 755	28.6.2016	Federal Court Pagone J	Cmmr	36
Azer v FC of T [2016] AATA 472	1.7.2016	AAT SM O'Loughlin	Cmmr	30
Millar v Commissioner of Taxation [2016] FCAFC 94	4.7.2016	Full Federal Court Logan, Pagone and Davies JJ	Cmmr	34
Deputy Commissioner of Taxation v Fitzgerald [2016] NSWSC 971	14.7.2016	Supreme Court of NSW Harrison AsJ	Cmmr	50

Case name	Date	Court/Tribunal	Successful party	Page
Deputy Commissioner of Taxation v Anglo American Investments Pty Ltd [2016] NSWSC 975	14.7.2016	Supreme Court of NSW Button J	Cmmr	45
Deputy Commissioner of Taxation v Rodriguez [2016] FCA 860	29.7.2016	Federal Court McKerracher J	Cmmr	32