Partial deduction

If a trust cannot deduct a tax loss because of a change in ownership in the loss year or because of abnormal trading in its units, it can generally deduct that part of the loss that is properly attributable to that part of the loss year occurring after the change in ownership or abnormal trading, as appropriate, providing it satisfies the relevant conditions (see above) for that part of the year (s 266-50; 266-95; 266-130; 266-170; 267-50).

[FTR ¶799-450ff]

¶6-263 Fixed trusts

A fixed trust is a trust where *all* of the income and capital of the trust is the subject of fixed entitlements (whether held by a natural person, company, trustee or partners in a partnership) (Sch 2F s 272-65). Thus, a discretionary trust is not a fixed trust.

A beneficiary has a fixed entitlement to either income or capital of a trust where, under the trust instrument, the beneficiary has a vested and indefeasible interest in a share of the income or capital of the trust (s 272-5). The interest of a unitholder in a unit trust will not be taken to be defeasible only because units in a unit trust can be issued or redeemed (at full value). The Commissioner has a discretion to determine that an interest of a beneficiary to income or capital that is not vested and indefeasible can be treated as being vested and indefeasible. This discretion should be exercised only in the special kinds of circumstances with which it was intended to deal (PS LA 2002/11). In one case the interests of beneficiaries in a unit trust that was a managed investment scheme were defeasible because of the power of the members (under the *Corporations Act 2001*) to alter the constitution of the trust by special resolution (*Colonial First State Investments*). Note that it was announced by the former government that a review was to be undertaken with a view to achieving a more workable definition of a fixed trust. The present government has not indicated its position on this proposal.

Interposed entities

A person will be taken to have a fixed entitlement to the income or capital of a company, partnership or trust if the person is indirectly entitled to the income or capital through fixed entitlements in a chain of one or more interposed entities (s 272-20; 272-30). A person's entitlement to the income or capital is determined by multiplying the entitlements of the person in each successive entity.

▶ Example

Perkins Panes Pty Ltd has a 40% fixed entitlement to both the income and capital of a trust. Elizabeth holds 60% of the shares in Perkins Panes Pty Ltd, all of which are of the same class. Her fixed entitlement to the income of the trust is 60% × 40% = 24%. Elizabeth's fixed entitlement to the capital of the trust is worked out in the same way (ie also 24%), except that it is traced through her fixed entitlement to the capital of Perkins Panes Pty Ltd.

Special tracing rules apply in relation to certain interposed entities, including mutual companies, complying superannuation funds, complying ADFs, foreign superannuation funds, government bodies, credit unions, non-profit sporting clubs and trade unions (s 272-25).

Types of fixed trust

There are five types of fixed trust for the purpose of the trust loss measures:

(1) a fixed trust other than a widely held trust (an ''ordinary fixed trust'')

(2) an unlisted widely held trust — a widely held unit trust where the units are not listed on an approved stock exchange (s 272-110)

(3) a listed widely held trust — a widely held unit trust where the units are listed on an approved stock exchange (s 272-115)

(4) an unlisted very widely held trust — an unlisted widely held trust with at least 1,000 unitholders where the units carry the same rights (s 272-120), and

(5) a wholesale widely held trust — an unlisted widely held trust where at least 75% of the units in the trust are held by certain bodies (a listed widely held trust, an unlisted very widely held trust, a life assurance company, a registered organisation, a complying superannuation fund, a complying ADF or a PST), the initial amount subscribed for units by each particular unitholder was at least $500,000 and all the units carry the same rights (s 272-125).

An unlisted very widely held trust and a wholesale widely held trust must engage only in investment or business activities that are conducted at arm's length in accordance with the trust instrument or deed and any prospectus of the trust.

A fixed trust is a ''widely held unit trust'' if it is a unit trust and is not closely held (s 272-105). A trust is ''closely held'' if 20 or less individuals between them beneficially hold, directly or indirectly, 75% or more of the fixed entitlements to income or capital of the trust (the ''20/75 rule''). For these purposes, an individual and their relatives and nominees are treated as being one individual. A trust is also a closely held trust where no individual beneficially holds (or no individuals between them hold) entitlements to 75% or more of the income or capital of the trust. Thus, a unit trust owned by a non-fixed trust can qualify as a closely held trust.

If the fixed entitlements to income and capital of a fixed trust (other than an ordinary fixed trust or a listed widely held trust) are all held, directly or indirectly, by one or more trusts of a higher level, the subsidiary trust will be classified as a trust of the same kind as the highest level superimposed trust (s 272-127). The level of a trust is determined by the following order (lowest to highest): (a) unlisted widely held trust; (b) unlisted very widely held trust; (c) wholesale widely held trust; and (d) listed widely held trust.

A subsidiary that was collectively owned by two ''listed widely held trusts'' could not obtain the benefit of the higher status as it was not wholly owned by each of the trusts (*ConnectEast*, special leave to appeal to High Court refused).

[FTR ¶799-475]

¶6-264 Tests to be satisfied

The various tests that must be satisfied before a trust (other than an excepted trust) can deduct a current year or prior year loss or a debt deduction (see the table at ¶6-262) are summarised below. Those tests are set out in Sch 2F Div 269 (s 269-5 to 269-100).

50% stake test

A trust satisfies the 50% stake test if, at all relevant times during the test period (s 269-50 to 269-55):

- the same individuals have fixed entitlements, directly or indirectly, to more than 50% of the income of the trust, and
- the same individuals have fixed entitlements, directly or indirectly, to more than 50% of the capital of the trust (these individuals need not be the same as those who hold the fixed entitlements to income).

In the case of a widely held unit trust, the 50% stake test will be satisfied where it is reasonable to assume that the requirements of the test are met.

▶ Example 1

The Murray Trust is an ordinary fixed trust that has a loss from Year 1. The trust seeks to deduct that loss in Year 2. Throughout Year 1 and part of Year 2: (a) Ian and Valerie each have a 50% fixed entitlement to income and a 30% fixed entitlement to capital on a winding-up; and (b) Robyn and Rune each have a 20% fixed entitlement to capital on a winding-up.

During Year 2, both Ian and Valerie sell 60% of their fixed entitlements in the Murray Trust to Luc. As a result, from the time of the sale, Ian and Valerie's fixed entitlements to income and capital are each reduced to 20% and 12% respectively, while Luc has a 60% fixed entitlement to income and a 36% fixed entitlement to capital. Before the sale, Ian, Valerie, Robyn and Rune have, between them, 100% of the fixed entitlements to income and capital. After the sale, they have, between them, a fixed entitlement to income of 40% and a fixed entitlement to capital of 64%.

As the original owners of more than 50% of the fixed entitlements have not held more than 50% of the fixed entitlements to income of the Murray Trust throughout the test period, the trust fails the 50% stake test and the loss is not deductible.

Same business test

The same business test is satisfied in respect of a listed widely held trust if (s 269-100):

- at all times in the period being considered (the ''same business test period''), the trust carries on the same business it carried on immediately before the start of that period (the ''test time'')
- at any time in the same business test period, the trust does not derive assessable income from a business of a kind it did not carry on before the test time or from a business transaction of a kind it had not entered into before the test time
- before the test time, the trust does not start to carry on a business it had not previously carried on or enter into a business transaction of a kind it had not previously entered into, for the purpose (whether or not there are other purposes) of satisfying the same business test, and
- where the trust is seeking to deduct a current year loss, it does not, at any time in the same business test period, incur expenditure in carrying on a business of a kind that it did not carry on before the test time or incur expenditure as a result of a business transaction of a kind it had not entered into before the test time (this condition does not apply in relation to prior year losses and debt deductions).

Pattern of distributions test

The pattern of distributions test (which applies to non-fixed trusts only) is satisfied if, within two months of the end of the income year (s 269-60 to 269-85):

- the trust has distributed, directly or indirectly, more than 50% of every ''test year distribution'' of income to the same individuals for their own benefit (ie otherwise than in the capacity of a trustee), and
- the trust has distributed, directly or indirectly, more than 50% of every ''test year distribution'' of capital to the same individuals for their own benefit (those individuals need not be the same as those to whom income is distributed).

The test is not relevant if the trust has not made relevant distributions.

The various ways income or capital may be ''distributed'' are covered in Sch 2F Subdiv 272-B (s 272-45 to 272-63). ''Distribution'' includes paying or crediting money (including loans), reinvesting money, transferring property, allowing the use of property, dealing with money or property on behalf of a person or as the person directs, applying money or property for the benefit of a person and extinguishing, releasing or waiving a debt or other liability (but only to the extent that the amount or value exceeds any consideration given in return for the loan, payment, etc) (s 272-60). The ''distribution'' must be to a person in the capacity of a beneficiary of the trust (ID 2012/12).

▶ Example 2

A trustee provides a beneficiary with a $1,000 interest-free loan repayable in five years. A comparable loan from a financial institution would attract a 10% interest rate and would be repayable in equal instalments. If the annual interest rate is 10%, the present value of $1,000 repayable in five years is $620. The benefit provided to the beneficiary is $1,000 – $620 = $380. That amount will be taken to be a distribution of income.

A distribution will also be taken to have been made to an individual where the distribution is made to a chain of interposed entities and one of the interposed entities distributes an amount to the individual (s 272-63). The amount indirectly distributed by a trust to an individual is determined by reference to what is fair and reasonable, having regard to the actual distributions by each entity in the chain.

A ''test year distribution'' of income or capital is the total of all distributions of income or capital in a relevant period (generally an income year) made by the trust, but excluding income years beginning more than six years before the start of the income year in which the trust seeks to deduct the prior year loss or debt deduction (s 269-65). A ''relevant period'' is:

- the end year, ie the income year being examined and the two months after the end of the year
- the start year, ie the earliest of: (a) the income year in which the trust distributed income that is before the loss year but closest to the loss year; (b) the loss year if the trust distributed income in that year; and (c) the income year in which the trust distributed income that is not before the loss year but is closest to the loss year, and
- each intervening year between the start year and the end year.

There are anti-avoidance arrangements designed to ensure that persons do not enter into arrangements that ensure the pattern of distributions test is satisfied.

Control test

The control test requires that no group (ie a person and their associates, whether alone or together) begin to control the non-fixed trust, whether directly or indirectly, in the test period (¶6-262). A group is taken to control a non-fixed trust if (s 269-95):

- the group has the power to obtain, or is capable under a scheme of obtaining, the benefit of the income or capital of the trust (eg by ensuring the exercise of a trustee discretion in their favour)
- the group is able to control, directly or indirectly, or is capable under a scheme of obtaining control of, the application of the income or capital of the trust
- the trustee is accustomed, is under an obligation or might reasonably be expected, to act in accordance with the directions or wishes of the group
- the group is able to remove or appoint the trustee or any of the trustees, or
- the group gains fixed entitlements to more than 50% of the income or capital of the trust.

Control of the trust is deemed not to change where a member of the controlling group dies, separates from their spouse (including a de facto spouse) or becomes incapacitated (ie mentally or physically disabled to an extent that the person can no longer control the trust), provided the other members of the controlling group remain the same (apart from any relatives of the deceased, separated or incapacitated person) and there are no changes in the beneficiaries of the trust (apart from any relatives of the deceased, separated or incapacitated person). See, for example, ID 2007/59.

The Commissioner is given the discretion to treat a group as not beginning to control a trust where, having regard to all the circumstances, it is reasonable to do so (eg where a trustee retires but the beneficiaries do not change).

[FTR ¶799-695 – ¶799-710]

¶6-265 Current year net income/loss

If a fixed or non-fixed trust (other than an excepted trust) does not pass the current year loss tests (see the table at ¶6-262), it must work out its net income and tax loss in a special way (Sch 2F Div 268: s 268-10 to 268-85).

(1) The trust's income year is divided into periods on the basis of when a specified event (eg a change in ownership or control) occurs. The events that result in the end of a period are summarised in the table below.

Current year losses: division of income year into periods

Type of trust	Events that result in the end of a period
Fixed trust other than widely held unit trust	Failure of 50% stake test Failure of alternate test
Unlisted widely held trust	Failure of 50% stake test (50% stake tested on abnormal trading)
Listed widely held trust	Failure of 50% stake test (unless the same business test is satisfied) (50% stake tested on abnormal trading)
Unlisted very widely held trust	Failure of 50% stake test (50% stake tested on abnormal trading)
Wholesale widely held trust	Failure of 50% stake test (50% stake tested on abnormal trading)
Non-fixed trust	Failure of 50% stake test Failure of continuity of control test

(2) Assessable income and deductions are allocated, where possible, to particular periods and a notional net income or notional loss is calculated for each period as if it were an income year. If there is no notional loss in any of the periods, the net income of the trust is calculated in the normal way. A notional loss incurred in the last period of an income year may be carried forward to a later year.

(3) The net income (if any) and tax loss is calculated, taking into account the notional net income and notional loss for each period and any income or deductions that cannot be allocated to particular periods.

There are special rules for calculating the trust's general domestic losses and film losses.

▶ Example

The Helm Trust's income year is divided into two periods with notional net income and notional losses as follows:

Period 1	notional net income	$30,000
Period 2	notional loss	$25,000

(1) Calculation of net income

	$30,000	total notional net income
+	1,000	full year amount (share of net income of trust estate)
	31,000	
–	1,200	full year deductions (bad debts)
	29,800	
–	100	other full year deductions (gifts)
–	1,200	(tax losses of earlier income years)
	$28,500	net income

The amount remaining ($28,500) is the trust's net income for the year. It is assessable under Pt III Div 6 (¶6-060).

(2) Calculation of tax loss

	$25,000	notional loss
–	3,200	net exempt income
	$21,800	tax loss

The amount remaining ($21,800) is the trust's tax loss for the year. It can be carried forward for deduction in a later year.

Abnormal trading

There are two methods to determine whether there is abnormal trading (Sch 2F Subdiv 269-B: s 269-10 to 269-49). "Trading" means an issue, redemption or transfer of, or other dealing in, the trust's units.

(1) A number of factors are weighed to determine whether the trading is, on balance, abnormal. The factors include:

(a) the timing of the trading when compared with the normal timing for trading in units of the trust

(b) the number of units traded by comparison with the normal number of units traded

(c) any connection between the trading and any other trading in units in the trust, and

(d) any connection between the trading and a tax loss or other deduction of the trust.

(2) Abnormal trading (other than in the case of a wholesale widely held trust) will automatically be taken to have occurred where:

(a) the trading is part of an acquisition of the trust or a merger with another trust (but only if the trustee knows or reasonably suspects this to be the case)

(b) 5% or more of the units in the trust are traded in one transaction

(c) a person and/or associates of the person have acquired and/or redeemed 5% or more of the units in the trust in two or more transactions (but only if the trustee knows or reasonably suspects that the acquisitions or redemptions have occurred and that they would not have been made if the trust did not have a tax loss or other deductions), or

(d) more than 20% of the units in the trust on issue at the end of any 60-day period are traded during that period (eg if ownership of more than 20% of the units changes in a 60-day period or if units are issued to new unitholders and, at the end of a 60-day period, they have more than 20% of the issued units).

In the case of a *wholesale widely held trust*, abnormal trading occurs where: (a) there is abnormal trading on balance (ie (1) above); (b) there is a merger or acquisition, or suspected merger or acquisition, of the trust (ie (2)(a) above); or (c) the trustee knows or reasonably suspects that the persons that held more than 50% of the units in the trust at the beginning of the period did not hold more than 50% of the units at the end of that period.

There are also special abnormal trading rules for a unit trust that is a *subsidiary* of another unit trust.

[FTR ¶799-545, ¶799-645 – ¶799-680, ¶799-702]

¶6-266 Family trusts

The trust loss measures, other than the income injection test (¶6-267), do not prevent a family trust from deducting current year or prior year losses or debt deductions, provided the trust is a family trust at all times in the relevant test period (Sch 2F Subdiv 272-D: s 272-75 to 272-95).

Family trust election

A trust is a family trust where the trustee has made a family trust election. A trust cannot make a family trust election unless it passes the family control test (see below). The election must be in writing and in the approved form (s 272-80(2)).

A trustee can make a family trust election at any time in relation to an earlier income year, rather than having to include it in the tax return for the year in which the election is made. This option is only available if at all times from the beginning of the specified income year until 30 June of the income year before the one in which the election is made:

- the trust passes the family control test (see below), and
- any conferral of present entitlement or any actual distributions of income or capital of the trust made by the trustee during that period have been made to the individual specified in the election or to members of that individual's family group.

The election must specify an individual as the individual whose "family group" (see below) is the subject of the election. It should also include other information required by the Commissioner, such as the name and address of the trust and the beneficiaries (s 272-80(3)). The Commissioner's view is that the individual who is specified must be alive at the time the election is made (ID 2014/3). The specified individual does not, however, need to be alive when an interposed entity election (see below) is made.

A family trust election generally cannot be revoked or varied, except in limited circumstances (s 272-80(5)).

Revocation of election

A fixed trust may revoke an election if some or all of the interests in the trust are disposed of to non-family members or if any of the persons holding the fixed entitlements cease to be family members (s 272-80(6)). However, where an election was revoked under this provision, the Commissioner determined that the trustee could not make a further election as s 272-80(11) provides that no more than one election can be made in relation to a trust (ID 2008/73).

In addition, for the 2007/08 and later income years, the rules were relaxed to allow an election to be revoked unless:

- tax losses have been recouped by the trust or another entity during a specified period where the losses could not have been recouped if the election had not been in force, or

- bad debt deductions or franking credits have been claimed during that period where the claim could not have been made if the election had not been in force (s 272-80(6A)).

Variation of test individual

In 2007, amendments were made to allow the test individual specified in the family trust election to be varied, once only, where:

- the new test individual was a member of the original test individual's family at the election commencement time, and
- no conferrals of present entitlement to, or distributions of income or capital of, the trust (or an entity for which an interposed entity election has been made) have been made outside the new test individual's group during the period in which the election has been in force (s 272-80(5A)).

In addition, the test individual may be varied if, as a result of an obligation arising from a marriage breakdown, control of the trust passes to the new test individual or a group comprising the new individual and the members of that individual's family (s 272-80(5C)).

Family group

The family group of the individual specified in a family trust election consists of (s 272-90):

- members of the individual's family, ie the individual's spouse (¶15-030), a child, grandchild, parent, grandparent, brother, sister, nephew or niece of the individual or of the individual's spouse, and the spouse of such a child, grandchild, parent, grandparent, brother, sister, nephew or niece. In 2007, the definition of "family" was broadened to include lineal descendants of a nephew, niece or child of the individual or the individual's spouse. A person does not cease to be a family member merely because of the death of another family member (s 272-95)
- a person who was a spouse of the individual or of a member of his or her family (see above) before a breakdown in the marriage or relationship (including where the person is now the spouse of a person who is not within the individual's family)
- a person who was the spouse of the individual or a member of his or her family immediately before the death of the individual or the family member and who is now the spouse of a person who is not a member of the individual's family
- a person who was a child of a spouse of the individual or a member of his or her family before a breakdown of the marriage or relationship of the individual or family member
- the trust covered by the family trust election
- a trust with the same primary individual specified in its family trust election
- companies, trusts and partnerships covered by an interposed entity election (see below)
- companies, partnerships and trusts where family members and/or family trusts of those individuals have fixed entitlements to all of the income and capital of the company, partnership and trust
- certain funds, authorities or institutions in Australia to whom tax-deductible gifts may be made
- certain tax exempt bodies

hands of the plaintiff and parliament did not intend to impose CGT on transactions in such cases, ie where the compensation merely put the plaintiff back in the position he was in before the defendant intervened. The Federal Court also declined to adjust (for potential CGT liability) a damages award relating to breach of copyright (*Namol*).

Where damages are awarded for non-performance of obligations under a contract for the sale of property, a capital gain normally arises, either on the disposal of the right to sue (CGT event A1: ¶11-250) or because CGT event H2 (¶11-320) happens (TR 94/29). In *Rabelais v Cameron*, the court suggested that the cost base of the asset disposed of is normally no less than the capital component of the damages. In *Provan v HCL Real Estate*, a plaintiff was held to be entitled to an indemnity from a defendant against any CGT which might subsequently be found to be payable on damages from an aborted property sale. The right of indemnity in such a case would itself be a CGT asset with potential CGT implications (¶11-380).

Where the compensation is closely connected to the disposal of a main residence, the compensation may be exempt from CGT under the main residence exemption (¶11-730; *Guy*).

[FITR ¶154-560 – ¶154-572]

¶11-660 Other receipts disregarded for CGT purposes

Any gains or losses arising from receipt of the following are disregarded for CGT purposes (s 118-37):

- compensation received under the firearms surrender arrangements
- a re-establishment grant or a dairy exit payment under the *Farm Household Support Act 1992*
- winnings or losses from gambling, a game or a competition with prizes. This exempts winnings from, for example, race bets, Tattslotto, Lotto, raffles and quiz shows. An asset won is taken to be acquired at its market value and a subsequent CGT event may give rise to a capital gain or loss (IT 2584)
- a tobacco industry exit grant received under the Tobacco Growers Adjustment Assistance Programme 2006. This exemption only applies if, as a condition of receiving the grant, the recipient agreed not to become the owner or operator of any agricultural enterprise within five years after receiving the grant
- a right or entitlement to a tax offset, deduction, or other similar benefit
- payments or property received in connection with persecution or property lost during the Second World War
- payments received as reimbursement or payment of expenses under a scheme established by an Australian government agency, a local governing body or a foreign government agency under an enactment or an instrument of a legislative character
- payments received as reimbursement or payment of expenses under the General Practice Rural Incentives Program, the Rural and Remote General Practice Program, the Sydney Aircraft Noise Insulation Project, the M4/M5 Cashback Scheme, the Unlawful Termination Assistance Scheme or the Alternative Dispute Resolution Assistance Scheme
- a water entitlement, to the extent that the CGT event happens because an entity derives a Sustainable Rural Water Use and Infrastructure Program payment that is non-assessable, non-exempt under s 59-65

- a Sustainable Rural Water Use and Infrastructure Program payment derived that is non-assessable, non-exempt under s 59-65.

[FITR ¶154-560]

¶11-670 Exempt or loss-denying transactions

Leases not used for income-producing purposes

A capital loss a lessee makes from the expiry, surrender, forfeiture or assignment of a lease (except one granted for 99 years or more) is disregarded if the lessee did not use the lease solely or mainly for income-producing purposes (s 118-40).

Strata title conversions

If a taxpayer owns land on which there is a building, the building is subdivided into stratum units and each unit is transferred to the entity having the right to occupy it just before the subdivision, a capital gain or loss made by the taxpayer from transferring the units is disregarded (s 118-42).

In such situations, a roll-over is also available for the occupiers of the building in relation to the change in the nature of their rights of occupation (¶12-320).

Mining rights of genuine prospectors

A capital gain or loss from the sale, transfer or assignment of rights to mine in certain areas of Australia is disregarded if the income from the sale, transfer or assignment is exempt because of former s 330-60 (about genuine prospectors) (s 118-45).

Foreign currency hedging contracts

A capital gain or loss from a hedging contract entered into solely to reduce the risk of financial loss from currency exchange rate fluctuations is disregarded (s 118-55).

Gifts of property

A capital gain or loss from a testamentary gift of property is disregarded (s 118-60) if it arises from a testamentary gift that would have been deductible under s 30-15 (¶16-942) if it had not been a testamentary gift. As an anti-avoidance measure, if a testamentary gift is reacquired for less than market value by either the estate of the deceased person or an associate of the deceased person's estate, the rules relating to the effect of death on CGT assets will apply (¶12-580).

Relationship breakdown settlements

Capital gains and losses arising from relationship breakdown settlements are generally disregarded.

A capital gain or loss that is made as a result of CGT event C2 happening to a right (¶11-270) is disregarded if:

- that gain or loss is made in relation to a right that directly relates to the breakdown of a relationship between spouses, and
- at the time of the trigger event, the spouses involved are separated and there is no reasonable likelihood of cohabitation being resumed (s 118-75).

See ¶14-270 for the definition of a ''spouse'', which includes same-sex couples.

Native title and rights to native title benefits

A capital gain or loss made by a taxpayer that is either an indigenous person or an indigenous holding entity is disregarded where the gain or loss happens in relation to a CGT asset that is either a native title or the right to be provided with a native title benefit, and the gain or loss happens because of one of the following:

- the taxpayer transfers the CGT asset to one or more entities that are either indigenous persons or indigenous holding entities
- the taxpayer creates a trust that is an indigenous holding entity, over the CGT asset

- the taxpayer's ownership of the CGT asset ends (eg by cancellation or surrender), resulting in CGT event C2 happening in relation to the CGT asset (s 118-77).

Other exemptions

An exemption may also apply in relation to foreign branch gains and losses of companies (¶21-098), external territories (¶10-640), securities lending arrangements (¶12-430), ETPs (¶14-000), life insurance companies (¶3-480), demutualisation of insurance companies (¶12-650), offshore banking units (¶21-080), cancellation and buy-back of shares (¶3-160, ¶3-170), superannuation and related businesses (¶13-130), calculating the attributable income of a CFC (¶21-200), assets transferred for no consideration to a special disability trust or a trust that becomes a special disability trust as soon as practicable after transfer (s 118-85) and a capital gain or loss made from a registered emissions unit or a right to receive an Australian carbon credit unit (s 118-15).

[FITR ¶154-575 – ¶154-614/20]

¶11-675 Earnout arrangements

The CGT consequences arising from an earnout arrangement are in the process of change. Changes to the law were first announced on 12 May 2010 in the 2010/11 Federal Budget to provide for look-through CGT treatment. While look-through treatment is still proposed, the implementation method has changed with effect from 24 April 2015. The current law, the proposed look-through treatment and the protection available for arrangements entered into prior to 24 April 2015 are outlined below.

Current law

Under an earnout arrangement, the capital proceeds from the sale of a CGT asset include a right to an amount calculated by reference to the earnings generated by the asset for a defined period following the sale. Pursuant to the existing law such an earnout right is treated as a separate CGT asset received in terms of s 116-20.

Under a standard earnout arrangement, the seller's capital proceeds include the market value of the earnout right worked out at the time of the CGT event. Upon the subsequent expiry or satisfaction of the right, CGT event C2 (¶11-270) happens when the right ends. Under a reverse earnout arrangement, the earnout right is the buyer's right to a post-sale payment. In that case, the *seller's* capital proceeds from the CGT event exclude so much of the payment as is reasonably attributable to the granting of the right. If an amount becomes payable in respect of the right, CGT event C2 happens and the *buyer's* capital proceeds from the CGT event will generally be the amount payable by the seller under the arrangement (*Draft* TR 2007/D10).

Proposed law

With effect from 24 April 2015 (¶41-300), it is proposed that look-through CGT treatment will apply to a ''look-through earnout right'' by:

- disregarding any capital gain or loss relating to the creation of the right
- for the buyer — treating financial benefits provided (or received) under the right as forming part of (or reducing) the cost base of the business asset acquired (¶11-570)
- for the seller — treating financial benefits received (or provided) under the right as increasing (or decreasing) the capital proceeds of the business asset sold (¶11-510).

For these purposes, a ''financial benefit'' means anything of economic value and includes property and services (s 974-160).

A taxpayer disregards the capital gain or loss relating to the creation of the right arising from:

- CGT event C2 (¶11-270) in relation to a right received, or
- CGT event D1 (¶11-280) for a right created in another entity (proposed s 118-575).

A right will be a ''look-through earnout right'' where the following conditions are satisfied:

(a) the right is a right to future financial benefits that are not reasonably ascertainable at the time the right is created

(b) the right is created under an arrangement that involves the disposal of a CGT asset

(c) the disposal causes CGT event A1 to happen

(d) just before the CGT event, the CGT asset was an ''active asset'' of the seller

(e) all of the financial benefits that can be provided under the right must be provided no later than five years after the end of the income year of the CGT event

(f) the financial benefits are contingent on the performance of the CGT asset or a business that the CGT asset is expected to be an active asset for the period of the right

(g) the value of the financial benefits reasonably relate to the economic performance, and

(h) the parties to the arrangement are dealing at arm's length (proposed s 118-565(1)).

The five-year requirement in (e) will be treated as having never been satisfied where the arrangement includes an option to extend or renew that arrangement, the parties vary the arrangement or the parties enter into another arrangement over the CGT asset so that a party could receive financial benefits over a period ending later than five years after the end of the income year in which the CGT event happens (proposed s 118-565(2)).

A CGT asset owned by an entity will be an active asset for the purposes of requirement (d) where it meets the definition in s 152-40 (¶7-145) or it satisfies all of the following:

- is a share in an Australian company or an interest in a resident trust
- the holder of the share or interest is either (i) an individual that is a CGT concession stakeholder (¶7-156) of the company or trust or (ii) not an individual but has a small business participation percentage (¶7-156) in the company or trust of at least 20%
- the company or trust is carrying on a business and has carried it on since the start of the prior income year
- in the prior income year the assessable income of the company or trust was more than nil and at least 80% of it was from the carrying on of a business or businesses and was not from an asset used to derive interest, annuities, rent, royalties or foreign exchange gains (proposed s 118-570).

A look-through right also includes a right to receive future financial benefits that are for ending such a defined look-through right, provided the arrangement does not result in a breach of the five-year limitation (proposed s 118-565(3)).

Temporarily disregard capital loss

Where a taxpayer makes a capital loss from disposing of a CGT asset which may be reduced as a result of the receiving financial benefits under a look-through earnout right, a portion of the capital loss must be temporarily disregarded. The portion of the capital loss that is temporarily disregarded is:

- where the maximum financial benefits cannot exceed a certain maximum amount — so much of the capital loss that equals that maximum amount
- otherwise — the whole capital loss.

The capital loss is only disregarded until and to the extent that the loss becomes reasonably certain (proposed s 118-580).

CGT small business concessions

The CGT small business concessions are proposed to be amended to ensure that they effectively apply to the sale of assets involving a look-through earnout right. Amendments will extend the time to choose to apply the concessions, where necessary, including extending the replacement asset period. The CGT small business concessions are detailed from ¶7-145. The provisions will also extend the time to make superannuation contributions pursuant to the CGT cap (¶13-780).

Transitional Rules

Prior to 23 April 2015, the proposed changes to earnout arrangements were different (see the 2014 *Australian Master Tax Guide* (55th Edition)). While the law was proposed to apply from the date of assent, transitional rules were announced that would allow taxpayers to apply the proposed rules from 12 May 2010 for sellers and from 17 October 2007 for buyers. As the originally proposed measures will not proceed, taxpayers will receive protection from the Commissioner amending their assessments where the relevant CGT event occurred prior to 23 April 2015 and it included the taxpayer's reasonable anticipation of the changes.

¶11-680 Taxpayers exempt from CGT

If the income of a taxpayer for an income year is exempt, any capital gains are also exempt. A capital loss made by an entity is disregarded if it was an exempt entity *at the time* that it made the loss despite not being an exempt entity at all times during the year (s 118-70). Exempt entities are detailed in ¶10-604, which include entities exempt from taxation pursuant to Div 50 such as charitable, educational, scientific or religious institutions.

All income of constitutionally protected funds is exempt (¶13-300).

[FITR ¶154-513]

¶11-690 General relief from double taxation

A capital gain is reduced if, because of the CGT event giving rise to it, a tax provision (other than a CGT provision) includes an amount in the taxpayer's assessable income (including an ETP) or exempt income or, if the taxpayer is a partner in a partnership, in the assessable or exempt income of the partnership (s 118-20). This reduction will also apply where there is a discharge of a debt that arose from the provision of services and the income from those services was previously included in the taxpayer's assessable or exempt income (ID 2008/110). Any capital gain that a non-participating shareholder makes from the receipt of a retail premium is reduced to the extent that the amount is otherwise included in assessable income or is non-assessable non-exempt income (TR 2012/1). A capital gain is also reduced if an amount is specifically treated as being neither assessable nor exempt, eg ITAA36 s 121EG, which deals with offshore banking units (¶21-080). The capital gain is reduced to zero if it is not more than the assessable amount included in the taxpayer's income because of the non-CGT provision. However, a capital gain cannot be reduced below nil so as to create a capital loss. If the capital gain is more than that assessable amount, it is reduced by that assessable amount.

However, a capital gain is not reduced if an amount is included in assessable income because of a balancing adjustment. The capital gain is also not reduced in some circumstances where an amount is included in non-assessable non-exempt income under ITAA36 s former 23AJ; ITAA97 s 768-5 (about exempting certain non-portfolio dividends paid by foreign residents: ¶21-095).

This rule against double taxation does not apply to an amount under a share buy-back that is taken to be a dividend (¶3-170) nor to an assessable imputation gross-up amount attached to a franked distribution (¶4-800).

Special rules also apply to a superannuation fund that becomes a resident (¶13-270) or becomes non-complying (¶13-200) if the asset's market value was taken into account in working out the net previous income of the fund.

These rules ensure that an amount which is taxed under another provision of ITAA97 or ITAA36, or which is specifically granted concessional tax treatment under another provision, is not inappropriately taxed under the CGT provisions.

▶ Example

MiaCo bought a vacant block of land with the intention of building a factory on it and then selling it at a profit. MiaCo is not carrying on a business of dealing in land and the land is not trading stock. Any profit arising from the venture is assessable as ordinary income.

Section 6-5		
Proceeds of sale		$600,000
Less: Cost of land	$150,000	
Cost of construction, etc	200,000	
Holding and financing costs	80,000	
Incidental costs	10,000	440,000
Assessable profit		$160,000
Unreduced capital gain		
Capital proceeds		$600,000
Cost base (indexed)		480,000
		$120,000

The capital gain of $120,000 is reduced by the amount assessable as ordinary income. As the amount assessable as ordinary income is $160,000, the capital gain is reduced to nil.

[FITR ¶154-530 – ¶154-538]

¶11-700 Other CGT anti-overlap provisions

In addition to general relief from double taxation, a number of other specific exemptions ensure that there is no overlap of taxation in relation to CGT and specific provisions dealing with a particular area.

Carried interests

A venture capital manager's entitlement to receive payment of a carried interest that is CGT event K9 (¶11-350) is taxed as a capital gain. The carried interest is not ordinary income of the venture capital manager and a deduction is not allowable to the limited partnership for the payment (s 118-21).

Depreciating asset exemptions

A capital gain or loss may be disregarded if it arises from a CGT event (that is also a balancing adjustment event) that happens to a depreciating asset (s 118-24). There are exceptions to this rule where the capital gain or loss arises under CGT events J2 (¶11-340) and K7 (¶11-350), or where the CGT event is not equivalent to a balancing adjustment event, eg where rights are created over a depreciating asset. Exceptions also apply to various primary production assets for which amounts are deductible under Subdiv 40-F (water facilities, horticultural plants and grapevines) or 40-G (landcare operations, electricity connections and telephone lines). For further details, see ¶17-670.

Trading stock exemption

A capital gain or loss from trading stock is disregarded (s 118-25) (¶9-150). A capital gain or loss is also disregarded if the taxpayer starts holding as trading stock a CGT asset it already owns but did not previously hold as trading stock, provided the

taxpayer elects for the asset to be treated as having been sold for its cost. If, in such circumstances, the taxpayer elects to treat the asset as being sold for market value, CGT event K4 (¶11-350) happens.

To ensure that CGT is the primary taxing code for complying superannuation funds, "eligible assets" acquired by a complying superannuation on or after 10 May 2011 are excluded from being trading stock (s 70-10(2); ¶13-130). Eligible assets are primarily shares, units in a trust and land (s 275-105; ¶12-660).

Taxation of financial arrangements

Generally, a capital gain or loss a taxpayer makes from a CGT asset, in creating a CGT asset or from the discharge of a liability will be disregarded if it was part of a Div 230 financial arrangement (¶23-020) and there is an assessable gain or deductible loss pursuant to Div 230 (s 118-27). The capital gain or loss will not be disregarded where:

- the financial arrangement is a hedging financial arrangement and the gain/loss arising on the arrangement is treated as a capital gain/loss
- a loss of a capital nature arises on ceasing to have a financial arrangement
- the capital gain or loss is not assessable/deductible under Div 230 (s 118-27(2), (3)).

Film copyright exemption

A capital gain or loss from a CGT event relating to an interest in the copyright of a film is disregarded if an amount is assessable under ITAA36 s 26AG because of the CGT event (s 118-30).

R&D exemption

A capital gain or loss from a CGT event is disregarded purposes if an amount is assessable under specified R&D provisions because of that CGT event (s 118-35).

[FITR ¶154-539 – ¶154-555]

Main Residence Exemption

¶11-730 Basic concepts of main residence exemption

A capital gain or loss from a dwelling is disregarded if the taxpayer is an individual, the dwelling was the taxpayer's main residence throughout the ownership period and the interest did not pass to the taxpayer as a beneficiary in, or as the trustee of, the estate of a deceased person (s 118-110).

If those conditions are satisfied, a taxpayer cannot choose not to apply the main residence exemption, eg where a capital loss was made (ID 2003/257). However, a capital gain or loss may still arise if the dwelling was also used for income-producing purposes (¶11-760). A separate rule applies for beneficiaries and trustees of deceased estates (¶11-770).

The main residence exemption also applies to a residence that is owned by a special disability trust (¶6-230) and used by the relevant beneficiary as their main residence (s 118-218).

Scope of exemption

For the purpose of the main residence exemption, a dwelling includes a unit of accommodation that is a building, or is contained in a building, and consists wholly or mainly of residential accommodation, a unit of accommodation that is a caravan, houseboat or other mobile home, and any land immediately under the unit of accommodation (s 118-115). A dwelling can include more than one unit of accommodation, provided those units are used together as one place of residence or abode (TD 1999/69).

Factors that are taken into account in deciding if a dwelling is a taxpayer's main residence include:

(i) the length of time the taxpayer has lived in the dwelling
(ii) the place of residence of the taxpayer's family
(iii) whether the taxpayer's personal belongings have been moved into the dwelling
(iv) the address to which the taxpayer's mail is delivered
(v) the taxpayer's address on the electoral roll
(vi) the connection of services such as telephone, gas and electricity, and
(vii) the taxpayer's intention in occupying the dwelling.

In addition, it is relevant whether the taxpayer freely chooses or is obliged to spend time at one residence or another (*Case 26/93*).

A dwelling can only be the main residence of the taxpayer if the taxpayer actually occupies the dwelling. The mere intention of a taxpayer to occupy the dwelling as a main residence is insufficient to obtain the exemption (*Couch*). A taxpayer who did not reside on the property is not able to claim the main residence exemption even if the property was the co-owner's main residence (*Gerbic*).

An improvement to a main residence which is a separate CGT asset (¶11-410) can qualify for the exemption (TD 96/21).

The main residence exemption can apply to moneys received from a forfeited deposit if a contract for its disposal falls through where the deposit is forfeited as part of a continuum of events for selling the dwelling, ie the dwelling must be put straight back onto the market and be subsequently resold (s 118-110(2); *Guy*; TR 1999/19). The exemption also applies to damages received from a defaulting purchaser to compensate for any loss from reselling the dwelling in a falling market, provided the necessary continuum of events exists.

The main residence exemption does not apply to moneys received from the grant of an easement or profit à prendre over adjacent land (TD 93/236).

The main residence exemption is available for CGT purposes only. If the sale of a dwelling gives rise to ordinary income, eg because the sale is part of a business or a profit-making transaction, the income is assessable under s 6-5. For example, if a builder builds a "spec" home for the purpose of resale, but resides in it while building a second "spec" home, the profit from the sale of the first home is assessable even if it is exempt from CGT (TD 92/135).

Adjacent land

The main residence exemption is available for a dwelling's adjacent land. A dwelling's adjacent land is land adjacent to a dwelling to the extent that the land was used primarily for private or domestic purposes in association with the dwelling (s 118-120). The maximum area of adjacent land for the exemption is generally two hectares less the area of land immediately under the dwelling. The taxpayer can choose which two hectares the main residence exemption is to apply to (TD 1999/67). The cost base of land exceeding two hectares can be apportioned on a pro rata basis (ID 2002/691). If the taxpayer's dwelling is built on pre-CGT land, the taxpayer can choose to apply the main residence exemption to adjacent post-CGT land, up to a maximum of two hectares (ID 2001/325). Land does not have to touch or connect with the main residence dwelling to be adjacent for these purposes. It only has to be close to the dwelling so that it can be used in association with the dwelling (TD 1999/68).

In the event that the taxpayer has previously claimed the main residence exemption in relation to a compulsory acquisition of part of a dwelling's adjacent land, or ownership in it, separate from the dwelling, the exemption will only apply to the dwelling's adjacent

land in relation to the maximum exempt area (s 118-120(4)). The maximum exempt area for the CGT event and the dwelling is two hectares less any area previously claimed as exempt pursuant to a compulsory acquisition (s 118-255).

The main residence exemption applies to an adjacent structure of a flat or home unit (if the same CGT event happens to that structure or the taxpayer's ownership interest in it) as if it were a dwelling (s 118-120(5)). For a flat or home unit, a dwelling also includes a garage, storeroom or other structure that is associated with it (s 118-120(6)).

It does not matter if the adjacent land was acquired after the dwelling (TD 92/171). Adjacent land used for agistment during most of the relevant period is not eligible for exemption. If the adjacent land is used primarily for private or domestic purposes in association with the dwelling for some of the period, a part exemption (¶11-760) is available to that extent (TD 2000/15).

Generally, if any part of a dwelling's adjacent land or an associated garage, storeroom or other structure is disposed of separately from the rest of the dwelling, the main residence exemption does not apply to that disposal (¶11-750). However, the CGT main residence exemption applies to compulsory acquisitions (and certain other involuntary events) of adjacent land or buildings to a dwelling that are used as the taxpayer's main residence (s 118-245; 118-250; ¶11-740).

Ownership period

For the purpose of the main residence exemption, the taxpayer's ownership period for a dwelling is the period on or after 20 September 1985 when the taxpayer had an ownership interest in the dwelling or in land (acquired on or after 20 September 1985) on which the dwelling is later built (s 118-125). Where land or a dwelling is acquired or disposed of under a contract and legal ownership passes at a later date, eg upon settlement, the ownership period is worked out on the basis of legal ownership. However, if the purchaser has a contractual right to occupy before legal ownership passes, the ownership period commences when the right begins.

A taxpayer has an ownership interest in land or a dwelling if:

- for land, the taxpayer has a legal or equitable interest in the land or a right to occupy it
- for a dwelling that is not a flat or home unit, the taxpayer has a legal or equitable interest in the land on which the dwelling is erected, or a licence or right to occupy the land; eg a leasehold interest is an ownership interest, as is a licence arrangement in relation to, say, a retirement village, or
- for a flat or home unit, the taxpayer has a legal or equitable interest in a stratum unit in it, a licence or right to occupy it, or a share in a company that owns a legal or equitable interest in the land on which the flat or home unit is erected that gives the taxpayer a right to occupy it (s 118-130).

A dwelling owned by the trustee of a deceased estate or a special disability trust may qualify for exemption (¶11-770). The only other circumstance in which a dwelling owned by a trustee may qualify for exemption is if the beneficiary is absolutely entitled to the dwelling as against the trustee (¶11-210). A dwelling owned by a family company is not eligible for the exemption (s 118-110(1)), nor is one owned by an individual in a trustee capacity (ID 2003/467).

For a checklist of the tax aspects of a family home, see ¶44-108.

[FITR ¶154-630 – ¶154-670]

¶11-740 Rules extending main residence exemption

Moving into a main residence

If a dwelling becomes a taxpayer's main residence by the time it was first practicable for the taxpayer to move into it after it was acquired, the dwelling is treated as the taxpayer's main residence from when it was acquired until it actually became the taxpayer's main residence (s 118-135).

A taxpayer who rents out a property for a period prior to moving in is only eligible for a partial exemption as the taxpayer does not move in as soon as practicable (*Chapman*; *Caller*).

This extension of the main residence exemption will not apply in the situation where a taxpayer purchases a property with the intention of occupying it as their main residence but never actually occupies the property (*Couch*).

Changing main residences

If a taxpayer acquires a dwelling that is to become the taxpayer's main residence and the taxpayer still owns an existing main residence, both dwellings are treated as the taxpayer's main residence for up to six months (s 118-140). However, this rule only applies if the taxpayer's existing main residence was the taxpayer's main residence for a continuous period of at least three months in the 12 months before it was disposed of and it was not used for income-producing purposes in any part of that 12-month period when it was not the taxpayer's main residence.

This concession applies even if the taxpayer has made a choice under s 118-145 or 118-150 that only one of the dwellings is to be treated as a main residence (TD 1999/43).

Where a taxpayer subdivides land on which a main residence is built and constructs a new main residence on the vacant part of the land, the main residence exemption is not available for both dwellings for the full period of ownership. However, both dwellings may be exempt for up to six months (TD 2000/13; TD 2000/14).

Dwelling stops being main residence

If a dwelling that was a taxpayer's main residence stops being the taxpayer's main residence, the taxpayer may choose to continue to treat it as a main residence (s 118-145). If the dwelling is not used for income producing purposes during the taxpayer's absence this choice can apply indefinitely. However, if the property is used for income producing purposes, the maximum period the dwelling can be treated as the taxpayer's main residence is six years.

▶ Example

Sharon lives in her own house for two years. She is posted overseas for four years, during which period she rents the house. On her return, she lives in the house for two years and is then again posted overseas for five years (again renting out her house). On her return she sells the house. Sharon can choose to treat her house as her main residence during both absences because each absence is less than six years (in this case, no other house can be treated as her main residence, unless s 118-140 applies). She can do this by not including any capital gain or loss in her income tax return for the year in which the house is sold.

For examples of the interaction between the six-year extended exemption and the special rule where the first use of a main residence to produce income occurs after 20 August 1996, see ¶11-760.

The absence exemption can apply to a main residence that the taxpayer owned overseas before becoming a resident of Australia (TD 95/7). For these purposes, the ownership period includes the time prior to the taxpayer becoming a tax resident of Australia (ID 2010/101). However, the exemption did not apply where a taxpayer, immediately after ceasing to occupy a dwelling as a main residence, commenced to convert it into commercial premises (ID 2005/19).

The power has also been used to acquire the names of a lawyer's clients who had entered into certain arrangements (*Coombes (No 2)*; *Hart*). Further, the power was validly used to obtain information from a bank, stored on its Australian database, about customers who held accounts with any of its subsidiaries in Vanuatu; the court rejected arguments that the power infringed on foreign sovereignty or Vanuatu confidentiality laws (*ANZ v Konza*).

The Commissioner may exercise these powers for the purpose of conducting an audit of a taxpayer's affairs, including where the taxpayer is selected for audit at random, provided the audit is related to the ascertainment of the taxpayer's taxable income or tax liability (*Industrial Equity* (1990)). The powers can still be exercised after an assessment or amended assessment has been made (*Industrial Equity* (1990)). TAA Sch 1 s 353-10 notices can be issued seeking information about employee share plans and employee benefits trusts prepared by a firm of solicitors but never offered to or used by clients (*May*).

Attend and give evidence . . .

TAA Sch 1 s 353-10(1)(b), a person may be requested to attend before the Commissioner *or* before any officer authorised by him. A person may, however, be requested to attend before both the Commissioner *and* one or more officers (*Industrial Equity* (2000)).

Both the person being examined and the ATO officer conducting the examination are entitled to have legal counsel present at the examination to advise on legal issues such as legal professional privilege (*Dunkel*). To facilitate the investigatory process, counsel retained by the Commissioner are also permitted to ask questions during the examination (*Grant*).

A spouse cannot refuse to answer questions about their partner. The High Court has held that the common law does not recognise a privilege against spousal incrimination (*ACCC v Stoddart*).

Produce all documents . . .

A TAA Sch 1 s 353-10 notice served on a solicitors' firm will override the firm's clients' contractual right of confidentiality. However, this power cannot be used to compel the production of documents covered by legal professional privilege (¶25-220) (*Baker v Campbell*). A TAA Sch 1 s 353-10 notice is not invalid simply because it requires production of a document that is prima facie privileged (*Perron Investments*). The spirit of the Commissioner's guidelines on access to documents held on lawyers' premises in circumstances where a claim of legal professional privilege is made (¶25-220) is intended to apply where a lawyer receives a TAA Sch 1 s 353-10 notice.

The Commissioner can require a person to produce documents only where these documents are in the custody of or under the control of that person. This covers persons who have the physical ability to produce the documents. So, for example, a bank has custody or control of the contents of a safe deposit box kept on its premises and can, therefore, be compelled to produce its contents (*ANZ Banking Group*; *Smorgon*).

The only documents that can be required to be produced are those that relate to the income or assessment of a particular person and that person must be named or otherwise indicated in the notice (*ANZ Banking Group*). On this basis, a notice requiring a solicitor to produce *all* his firm's trust account cash books, not just the cash books relating to the two clients named in the notice, was held to be too wide (*Clarke*). Note that the Commissioner's guidelines on access to accountants' papers (¶25-230) also apply in relation to requests to external accountants to furnish information and produce papers.

The Commissioner's powers to require production of documents do not extend to authorising him to require persons to make *copies* of documents (*Perron Investments*).

Give the information . . .

Where a TAA Sch 1 s 353-10 notice requires a person to both produce documents and attend and give evidence, the one requirement is severable from the other (*Elliott*).

[FTR ¶785-680]

Amended Assessments

¶25-300 Amendment powers

The Commissioner's powers to amend an assessment, or further amend an amended assessment, are set out in ITAA36 s 170 and in s 170A.

The standard period in which the Commissioner can amend an assessment for most individuals and small business entities (¶7-050) is two years from the day on which the Commissioner gives notice of the assessment (¶25-310). A four-year period of review applies for taxpayers with more complex affairs (¶25-320).

A taxpayer wishing to challenge an amended assessment must lodge an objection within the prescribed time or such further time as allowed by the Commissioner (¶28-010 – ¶28-030). If the objection is disallowed, the taxpayer may seek a review by the AAT or appeal to the Federal Court (¶28-080 and following).

The Commissioner is required to amend an assessment where this is necessary to give effect to an AAT or court decision, but only when any appeals from the decision have been finalised (¶28-160). Such an amendment must be made within 60 days of the decision becoming final. The normal specified time limits do not apply for this purpose. The Commissioner may amend an assessment to give effect to a private ruling even though the normal specified time limit for making amendments has expired.

Although the Commissioner cannot be compelled to amend an assessment if he does not think it necessary, it is arguable that he must make all alterations and additions to make the assessment correct (including allowing deductions previously unclaimed).

A taxpayer may apply to the Commissioner for an amendment to an assessment. Any information necessary to decide the application must be supplied to the Commissioner within that time. If these conditions are satisfied, the Commissioner may amend the assessment at any time and for any reason. For example, a taxpayer may want to apply for an amendment of an assessment to reflect a changed interpretation of the law in his/her favour. Where an application is made electronically it must contain the taxpayer's electronic signature (¶24-010) or, if given to the Commissioner by a tax agent on behalf of the taxpayer, the tax agent's electronic signature (TAA Sch 1 s 388-75).

In considering an application to amend an assessment, the Commissioner is authorised to accept a statement made by or on behalf of the taxpayer. Accordingly, the Commissioner can amend an assessment without, at that time, checking any claims made by or on behalf of the taxpayer in connection with the application for an amendment. This effectively allows a taxpayer to "self-amend" an assessment.

The Commissioner's power to amend an assessment to reduce liability, and particularly his power to amend on the taxpayer's application, is discretionary, not mandatory. It is, therefore, imperative that taxpayers preserve their rights to dispute an incorrect or invalid assessment by lodging an objection (¶28-010).

The Commissioner's power to amend an assessment to reduce liability extends to any error in the return, whether it is an error of law, an error in calculation or a mistake of fact.

Further amendment rectifying excessive reduction

The Commissioner may amend an assessment (including a deemed assessment in the case of companies and funds) so as to *reduce* the taxpayer's liability on the basis of an amendment request by the taxpayer. In such a case, the Commissioner can, within the relevant timeframe for amending assessments, further amend the assessment in respect of the particular that was earlier amended, to *increase* the taxpayer's liability (ITAA36 s 170(3)). This could happen where an audit of the taxpayer's affairs reveals that the reduction in liability was excessive. In these circumstances, the taxpayer will not be entitled to a further amendment (to reduce liability) of an assessment that has already been amended twice.

Extensions of the amendment period

The Commissioner may amend an assessment even if the limited period of amendment has ended where:

- the taxpayer applies for an amendment in the approved form before the end of the amendment period (s 170(5))
- the taxpayer applies for a private ruling before the end of the amendment period and the Commissioner makes a ruling in response to the application (s 170(6)), and
- the Commissioner has started to examine a taxpayer's affairs but has not completed that examination by the end of the amendment period. In that case, the period can be extended by:
  - a Federal Court order where it is satisfied that the failure to complete the examination was due to the taxpayer's behaviour (eg instigating such proceedings) or the taxpayer's failure to take action (eg failing to comply with a TAA Sch 1 s 353-10 notice to provide information), or
  - written consent of the taxpayer (s 170(7)).

Similar to s 170(5), where a taxpayer has applied for an amendment or a private ruling within the limited amendment period allowed under particular legislation (ie outside of s 170), the Commissioner is allowed to amend an assessment to give effect to his decision or ruling after that period has expired. Further, where the Commissioner has started to examine the affairs of a taxpayer in relation to that particular legislation but has not completed the examination by the limited amendment period, he may apply to the Federal Court or seek the taxpayer's consent to extending the limited amendment period for a specified period (s 170A).

Profit or loss from extended operations

The Commissioner also has the power to amend an assessment to ensure its completeness and accuracy where the assessment contains an estimated amount of income or capital gain from a series of incomplete operations extending over more than one year. The amended assessment may be made within four years after the Commissioner ascertains the actual profit or loss (s 170(9)).

Protection for anticipating certain announcements

The Commissioner cannot amend an assessment in a less favourable manner to the taxpayer where the taxpayer has reasonably and in good faith anticipated in a statement in a tax return or otherwise a government-announced legislative amendment but which the government subsequently decided on 14 December 2013 not to proceed with (ITAA36 s 170B). To obtain the benefit of the "protection provision", the government

announcement must be one of those specifically listed in s 170B(8), the taxpayer's anticipation of the amendment must be reasonably within the terms of the announcement and timing requirements in s 170B(3) must be met.

However, the protection provision does not prevent the Commissioner from amending an assessment, in the relevant circumstances, where the taxpayer applies for the amendment or where the amendment is to give effect to an objection decision or a decision on review or appeal (s 170B(6)). Further, the protection provision does not apply where the taxpayer makes a statement for a later income year, in a tax return or otherwise, that is inconsistent with the taxpayer's previous position (s 170(10), item 27A; 170B(7)).

¶25-310 Standard two-year amendment period

The period during which the Commissioner may amend an assessment for most individuals or very small business taxpayers is two years. The amendment period applies from the day on which the Commissioner gives notice of the assessment to the taxpayer (s 170(1)).

Taxpayers with more complex tax affairs are subject to a four-year amendment period. These include businesses that are not small business entities (¶7-050). The period for review and amendment of assessments involving arrangements with a dominant tax avoidance purpose is also four years. For details of the exclusions from the standard two-year period see ¶25-320.

Eligibility for the standard two-year amendment period depends on the actual tax affairs of the taxpayer for that year, and not the taxpayer's or the Commissioner's understanding of the status of the affairs at the time of the assessment.

▶ Example 1

George includes in his 2014/15 tax return his salary and a share of his interest in the net income of a partnership that he wrongly believes to be a small business entity for that year. In December 2015, the Commissioner issues a notice of assessment to George based on his return as lodged. Subsequently, in August 2018, the Commissioner adjusts the net partnership income and issues an amended assessment to George reflecting that adjustment. The amended assessment was issued more than two years after George received his original assessment. He is not eligible for the standard amendment period for the 2014/15 year because he is a partner in a partnership that was not a small business entity.

▶ Example 2

In her 2014/15, Rachel declares as part of her assessable income her salary and a distribution from a trust. It appears that the trust is not a small business entity so she is not eligible for the standard amendment period. Three years after she receives her notice of assessment for 2014/15, she discovers that the trust was a small business entity and, therefore, Rachel was subject to the standard amendment period for the 2014/15 year.

¶25-320 Four-year amendment period

Certain taxpayers are not eligible for the standard two-year amendment period, but are subject to a four-year amendment period (s 170(1)). Exclusions from the standard two-year amendment period apply to:

- a taxpayer that carries on a business (or is a partner in a business) unless the taxpayer is a small business entity (¶7-050)
- a taxpayer in the capacity of a trustee of a trust
- a taxpayer who is a beneficiary of a trust unless the trust is a small business entity or the trustee of the trust (in that capacity) is a full self-assessment taxpayer. For these purposes, a taxpayer who is an object of a discretionary trust is considered to be a beneficiary (*Yazbek*)

- a taxpayer who (either alone or with others) entered into or carried out a scheme for the sole or dominant purpose of obtaining a scheme benefit, and
- a taxpayer in a high risk category or special case to be prescribed by regulation (see below).

Avoidance schemes

The avoidance exclusion is not limited to cases where ITAA36 Pt IVA applies. The exclusion can also apply where the benefit sought is unavailable because of any provision of the law, if the relevant purpose is present. In that case, the four-year amendment period will apply regardless of whether the taxpayer is actually entitled to the benefit.

The four-year amendment period for taxpayers involved in tax avoidance arrangements only applies for the 2004/05 and later income years. The former six-year amendment period continues to apply to assessments for earlier years.

Other exclusions

The following "high risk" categories are excluded from the standard two-year amendment period (ITR15 reg 14).

- **Non-arm's length transactions between associates where there is a mismatch in the review periods of the parties involved.** This exclusion applies, for example, where a private company has a four-year amendment period and a shareholder in the company with a majority voting interest has a two-year amendment period. The exclusion would not apply to transactions that do not have income tax consequences, eg gifts between parties in a personal relationship.
- **Distributions to entities connected with a private company.** This excludes taxpayers involved in transactions to which Div 7A applies, where there is a mismatch between the company's amendment period of at least four years and the related entity's amendment period. The exclusion applies to related entities that are shareholders, former shareholders and their associates.
- **Unpaid present entitlements.** This excludes taxpayers involved in transactions where, as a result of Subdiv EA of Div 7A applying, certain amounts are included in assessable income as if they were dividends.
- **Employee share scheme anti-avoidance rule.** An anti-avoidance rule operates in respect of employee shares and rights offered by a company whose predominant business is the acquisition, sale or holding of shares, securities or other investments. Employee shareholders who are subject to this rule are excluded from the two-year amendment period unless the company is a small business entity that itself has a two-year amendment period.
- **Omitted income from foreign transactions.** This exclusion applies to individual taxpayers who omit income from foreign transactions from their tax returns. However, this does not mean that taxpayers have to correctly identify income from foreign transactions at a correct label on the tax return (*Elliott*).
- **Transfer of property and services and tainted services income.** Exclusions apply where information is required from overseas in relation to two specific anti-avoidance provisions, namely deemed transfers of property and services and tainted services income.
- **Other specific anti-avoidance provisions.** This excludes taxpayers whose affairs fall under various specific anti-avoidance provisions not covered by the general avoidance exclusion (see above). The provisions relate to distributions of preferentially taxed capital, excluded income of minors, stripping of company

profits, franking debit creation and franking credit cancellation schemes, schemes to take advantage of deductions, expenses for a leisure facility or boat, the use of a company's losses and the cancellation of gross up or tax offset where the imputation system has been manipulated.

¶25-330 No time limits for certain amendments

If an under-assessment of tax was due to fraud or evasion, the Commissioner can amend the assessment at any time. There are also other specific provisions that give rise to unlimited review periods.

Fraud or evasion

The essence of "fraud" is the absence of a genuine belief in the truth of a statement or representation, or a reckless carelessness as to its truth or falsity. "Evasion" is something less than fraud but something more than avoidance or mere withholding of information. There must be some blameworthy act or omission on the taxpayer's part, eg deliberately withholding information so that the Commissioner does not consider that the taxpayer has a larger taxable income than the taxpayer is prepared to concede.

Failure to keep proper records of a business due to carelessness and indifference has been held to amount to evasion. There was also evasion where a taxpayer, who had doubts about the tax treatment of share transactions, failed to seek advice from the Commissioner and also failed to give full particulars to a broker, accountant and solicitor consulted (10 TBRD *Case* K88). Wilful overstatement of expenditure or understatement of receipts is, of course, evasion at the very least.

The Commissioner was not precluded from issuing amended assessments on the basis of fraud or evasion even though the AAT had made orders to set aside an objection decision by consent (*Case 18/2006*).

As to the respective powers of the AAT and courts to review the Commissioner's opinion that the avoidance of tax is due to fraud or evasion, see ¶28-080. The question of whether there has been an avoidance of tax is a matter of fact (to be disproved by the taxpayer) and is not a matter that depends on the Commissioner's opinion. Guidelines for ATO officers on how to deal with suspected cases of fraud or evasion are set out in PS LA 2008/6.

Other unlimited amendment periods

There are no time limits restricting the Commissioner's power to amend an assessment to reflect the fact that a contract that is found to be void *ab initio* has no CGT consequences (ITAA36 s 170(9D)).

The Commissioner may also amend an assessment at any time to give effect to specified provisions (ITAA36 s 170(10); 170(10AA)) although some of these unlimited review periods are being pared back.

The Commissioner had thought that he could amend an assessment at any time to include the amount of a capital gain taken to have been made in an income year because of the timing rule in ITAA97 s 104-10(3)(a) (¶11-250). Under that rule, the disposal of an asset is deemed to occur at the time when the contract is made rather than when the change of ownership occurs, ie at settlement. However, the Full Federal Court held in *Metlife Insurance* that where settlement has already occurred at the time of lodgment/deemed assessment of the taxpayer company's return, s 170(10AA) could not operate.

Payment

¶25-400 Time for payment

In the case of individuals or trustees, income tax is due for payment 21 days after the due date for lodgment of the taxpayer's return or 21 days after a notice of assessment is given to the taxpayer, whichever is the later (ITAA36 former s 204(1); ITAA97 s 5-5(5), (6)) (see ¶25-110 as to when a notice of assessment is served). This rule also applies to the payment of administrative penalties imposed under TAA Sch 1 Pt 4-25 (¶29-000) and to GIC (¶29-510). It does *not* apply to late lodgment penalties payable by a company or fund.

The 21-day period is a minimum period and the Commissioner may, and often does, specify a date for payment which is more than 21 days after the service of the notice of assessment. The period of 21 days is calculated by excluding the date of service or deemed service and including the 21st day. Thus, for example, the earliest due date for payment of tax where the notice of assessment is posted on 29 September to an address in the same town or city as the branch office of the ATO issuing the notice would be 21 October (the notice of assessment would be deemed to be served on 30 September). If an amended assessment *increases* liability (¶25-300), a new 21-day due date period calculated from the date of service applies to the excess amount. If an amended assessment *decreases* liability, no new period may be calculated for the reduced amount.

The tax liability of a full self-assessment taxpayer (with a 30 June balance date) is due and payable on 1 December of the following year of income or such later date as notified by the Commissioner. For full self-assessment taxpayers with substituted accounting periods, tax is due and payable on the first day of the sixth month of the following year of income or such later date as notified by the Commissioner (ITAA36 former s 204(1A); ITAA97 s 5-5(4)).

Liability to pay the assessed tax is not suspended pending the Commissioner's consideration of the taxpayer's objections against the assessment, nor while a review or an appeal is pending (¶25-510). The Commissioner has the power to defer the time for payment of tax (¶25-410). In certain circumstances, interest is payable by the Commissioner on early payments and overpayments of tax (¶25-440, ¶28-170).

If the Commissioner has reason to believe that a person is about to leave the country before the due date for payment of tax assessed to that person, the tax is due and payable on such (earlier) date (if any) as the Commissioner notifies to the taxpayer (TAA Sch 1 s 255-20). This notice can operate as a notice of assessment in its own right and its validity is not dependent upon the Commissioner having previously issued a notice of assessment specifying a later date for payment as otherwise required (*Thai*). The Commissioner also has the power to prevent a person with undischarged tax liabilities from leaving Australia (¶25-550).

[FITR ¶16-110]

¶25-410 Deferring of time for payment

The Commissioner may defer the time for payment of tax for particular taxpayers and may permit the tax to be paid by instalments (TAA Sch 1 s 255-10(1); 255-15(1)). The Commissioner may also defer the time for payment for a class of taxpayers by publishing a notice on the ATO website (TAA Sch 1 s 255-10(2A) to (2C)).

Taxpayers seeking an individual deferment of time to pay should apply to the ATO. The application should ideally be made before the due date for payment and include details of the assessment number, TFN, due date for payment and a brief statement of the taxpayer's financial position and the reasons for seeking an extension. It should also

contain a definite offer to pay by a specific date, or by instalments beginning and ending on specified dates, otherwise the application may be refused (*Lawrence*). If the deferment sought is for more than six months, a statement of assets and liabilities and other information should be supplied.

If the Commissioner defers the time at which tax is due and payable, then GIC (¶29-510) only becomes payable, in the event of non-payment, from the extended date.

If the taxpayer intends to lodge an objection, the proposed grounds of objection should be indicated in the application (*Lawrence*). However, an application for a deferment of time for payment should not be incorporated in the same letter as an objection against the assessment, as the objection and the application are dealt with in separate sections of the ATO. The inclusion of both in the one letter could result in delay.

A taxpayer does not have any right under the income tax legislation to challenge a decision of the Commissioner refusing a deferment of time for payment. However, the taxpayer may apply for judicial review of such a decision (¶28-180).

Commissioner's guidelines on deferment

Guidelines on the circumstances in which the Commissioner will exercise the power to defer the time for payment of a tax-related liability are set out in PS LA 2011/14. The validity of the guidelines was upheld in *Elias*.

The guidelines stipulate that the time for payment will not normally be deferred unless the taxpayer can demonstrate that:

- payment cannot be, or has not been, made by the original time for payment because of circumstances beyond their control, and the taxpayer has taken reasonable steps to mitigate the effects of those circumstances
- payment in full can be made at a later time (when the circumstances that led to non-payment have been alleviated)
- once the circumstances are under control, continuing tax-related liabilities will be paid as and when they fall due.

Each request will be considered on its merits and the deferred payment time will be determined having regard to the particular circumstances of the taxpayer and the circumstances that led to the inability to pay on time. Examples of circumstances where deferment will normally be granted include natural disasters, serious illness or a legal impediment.

Disputed assessment cases

In considering an application for an extension of time to pay the whole of the tax in dispute, the Commissioner should take into account the fact that an objection has been lodged against the assessment in question or that an appeal is pending (*Ahern*; *ARM Constructions*). Where there is a genuine dispute, the Commissioner is bound to take into account a claim that immediate payment of the tax would cause total or partial liquidation of the taxpayer's business (*ARM Constructions*). In one case, a relevant factor in the court's decision to set aside the Commissioner's refusal to grant an extension of time was that assessments covering an 11-year period were issued suddenly after a long investigation into the taxpayer's affairs and the taxpayer was required to pay $20m in tax within one month (*Nestle Australia*).

Where the Commissioner lodges an appeal against an AAT or court decision in favour of a taxpayer on a matter which directly affects other taxpayers, the ATO does not apply that decision in making assessments pending the determination of the appeal. In such a case, any extension of time to pay the disputed tax will be on terms requiring GIC

to be paid on any amount ultimately found to be payable. However, GIC will not be imposed for the period during which a decision in the taxpayer's favour still subsists (IT 2250).

[FTR ¶977-615]

¶25-420 Security for payment

The Commissioner may require a taxpayer to give security for the payment of an existing or future tax-related liability where the Commissioner: (1) has reason to believe that a taxpayer establishing or carrying on a business in Australia intends to carry it on only for a limited period (including "phoenix arrangements" where a company with significant unpaid debts is wound up but the same business is conducted through a new company with the same directors/management); or (2) reasonably believes that the requirement is otherwise appropriate having regard to all the circumstances (TAA Sch 1 s 255-100(1)). In *Keris*, it was held that the Commissioner could require a taxpayer to provide security for estimated GST liability even before the proposed transaction had taken place.

The Commissioner may require security to be given by way of a bond, deposit or by any other means that the Commissioner believes is appropriate, eg a mortgage over property (real or personal), floating charges, liens and guarantees (TAA Sch 1 s 255-100(2)).

The Commissioner is required to give written notice to a taxpayer required to give security (TAA Sch 1 s 255-105(1)). The notice must explain why the Commissioner has asked for security, describe the means by which security can be provided; set out by when security must be provided and advise of the procedures available to have the Commissioner's decision reviewed (TAA Sch 1 s 255-105(2)).

In making the decision to require security and how much security, the Commissioner must consider all relevant matters and act reasonably (TAA Sch 1 s 255-100(3)) — since the decisions are administrative in nature, they are subject to judicial review by the Federal Court. However, to avoid taxpayers challenging or defeating the notice on purely technical grounds, a failure to comply with specific technicalities of the notice requirements does not invalidate the notice (TAA Sch 1 s 255-105(5)).

Failing to provide a security as required by the Commissioner is a criminal offence which carries with it a maximum penalty of 100 penalty units (¶29-000) for individuals and 500 penalty units for bodies corporate (TAA Sch 1 s 255-110; *Crimes Act 1914*, s 4B). It follows that the Criminal Code defences apply to the criminal offence of refusing to provide security, eg the defence of involuntariness may apply to a taxpayer who is incapable of providing the security required.

The collection of security deposits is not subject to the general collection and recovery rules that apply to tax-related liabilities (¶25-500). Accordingly, security deposits cannot be allocated to a running balance account, and the general interest charge is not applicable for failing to provide a security within the required timeframe.

[FTR ¶977-670, ¶977-674]

¶25-430 Means of payment

Payment of a tax-related liability (¶25-500) must be in Australian dollars. Payment may be effected by: (i) posting or delivering the amount to an address that is approved by the Commissioner; (ii) delivering the amount to the Australian High Commissioner in the United Kingdom; (iii) depositing the amount at a branch of the Reserve Bank of Australia or a deposit-taking institution in accordance with arrangements made by the Commissioner (this allows for payment using electronic funds transfer (EFT)); or (iv) paying the amount in accordance with other arrangements made by the Commissioner (eg

by using the Australia Post BillPay service). Where a tax debt is paid by cheque, it will not be paid until the cheque is cleared (Taxation Administration Regulations 1976 (TAR), reg 18).

Taxpayers (other than companies and funds that only lodge paper returns) can have their tax liabilities directly debited from their bank, building society or credit union account. Only accounts under the direct control of the taxpayer and which contain the taxpayer's name in the account title can be used. A taxpayer wishing to use the direct debit facility has to lodge the required form with the financial institution (a copy of the form is in the *Individual tax return instructions*). The ATO (as well as the taxpayer) can cancel a direct debit in certain circumstances.

Tax refunds can also be directly credited to the taxpayer's bank, building society or credit union account. EFT refunds can also be made to any one specified account that need not be the taxpayer's account, eg it could be the account of the tax agent or another third party (TAA s 8AAZLH). The refund is credited on the day the notice of assessment is issued.

A tax-related liability must be paid in full, unless the Commissioner gives written permission for part payment (reg 18(3)). The Commissioner is not required to give a receipt unless one is requested (TAR reg 19).

If a tax-related liability is paid by post, but the Commissioner has to contribute to the postage because the envelope was unstamped or insufficiently stamped, he may deduct the amount contributed from the payment (or from any other payment made by the taxpayer) (TAR reg 21). If so, the equivalent amount of the relevant tax-related liability would effectively not be paid.

[FTR ¶976-150]

¶25-440 Interest on early payments

The Commissioner is required to pay interest where income tax or certain other amounts are paid by the taxpayer more than 14 days before the day on which the relevant amount becomes due and payable (the "appropriate due day") (*Taxation (Interest on Overpayments and Early Payments) Act 1983*, s 8A to 8D).

The amounts in respect of which early payment interest may be payable include payments of, or on account of, income tax, a HELP or FS assessment debt (¶2-380, ¶2-385), administrative penalties under TAA Sch 1 Pt 4-25 (¶29-000), interest on accumulated non-resident trust income (¶21-350), shortfall interest charge and GIC for liabilities arising from amended assessments (¶29-550) and GIC for late lodgment of returns by non-instalment taxpayers (¶29-510).

Interest is *not* payable on:

- any part of a payment that exceeds the amount of income tax that is due
- amounts deducted from payments under arrangements for the advance collection of tax (eg amounts withheld from an employee's salary under the PAYG system), and
- amounts credited in payment of a tax liability but which are not directly paid by the taxpayer (eg overpayments of income tax liabilities for an earlier year), or other tax liabilities such as FBT or GST.

The period for which early payment interest is calculated is:

- for companies, superannuation funds, ADFs and PSTs — from the day the early payment is made until the appropriate due day, and
- for other taxpayers — from the later of the day of payment or the day the relevant notice (eg of assessment) is issued until the appropriate due day.

If an amount that is paid early is refunded before the day it becomes due and payable, early payment interest is not payable in respect of any period after the day it is refunded.

The rates at which early payment interest is payable are set out at ¶28-170.

A taxpayer can ask the ATO for payment of the interest or can claim the interest as a credit in the return for the income year in which the entitlement to the interest arises. The Commissioner can offset interest on early payments against income tax and other tax liabilities (TAA Pt IIB Div 3).

Early payment interest is assessable in the year in which it is received or applied against another tax liability (¶10-470). If the interest is claimed as a credit in one year, it should be included as income in the return for the following year.

The Commissioner is also required to pay interest on overpayments of tax in certain circumstances (¶28-170). Note that early payment interest is not payable for any period where interest is also payable as a result of a credit, refund or remission.

[FTR ¶910-200]

¶25-450 Release from payment

Taxpayers may apply to the Department of Finance and Deregulation for a waiver of their tax debts, ie the right to pursue and recover the debt is irrevocably abandoned. Under the *Financial Management and Accountability Act 1997*, the minister has the general power to waive a debt due to the Commonwealth, and the decision-maker has a very broad discretion to consider each request on a case-by-case basis. Waivers are most common where there is a moral obligation on the Commonwealth to extinguish the debt, due to equity or financial hardship considerations. *Finance Circular* 2009/09 outlines the three broad categories of applications that are commonly considered:

(1) where the ATO's actions or omissions in administering the tax laws have caused the taxpayer to incur unintended tax debts

(2) where the operation of the tax laws has caused the taxpayer to incur an unintended tax debt, the recovery of which would produce an anomalous or inequitable result

(3) where paying a tax debt would cause genuine and significant financial hardship.

While not delegated with the general power to waive tax debts, the Commissioner may approve release from the payment of some tax debts, in whole or part, on the grounds of serious hardship. TAA Sch 1 Div 340 provides for an individual or the trustee of the estate of a deceased person to be released from paying certain liabilities if payment of the liability will cause serious hardship. An application for release should be made before the due date for payment. The taxpayer's application should be made on the approved form and should furnish sufficient details to satisfy the ATO that payment of the tax debts would cause serious hardship and that release would be appropriate (PS LA 2011/17).

Liabilities from which release may be granted are income tax (including Medicare levy, Medicare levy surcharge and withholding tax), together with administrative penalties (¶29-000), shortfall interest charge (¶29-550), GIC and other penalties associated with those liabilities. Applications may also include instalments of PAYG and FBT. However, where release is granted from a PAYG or an FBT instalment, a taxpayer is not entitled to a credit for the instalment to the extent of that release. If the taxpayer's circumstances have not improved by the time of the final assessment, the taxpayer could apply for release from the overall liability at that time. The Commissioner does not have the power to grant release from a debt arising from an administrative overpayment (*Anderson*).

A taxpayer who is dissatisfied with the Commissioner's decision has a right of objection under TAA Pt IVC (¶28-010). A taxpayer who is dissatisfied with the objection decision may request the AAT to review the merits of that decision. Decisions on whether to grant release continue to be subject to judicial review (¶28-180).

If the Commissioner refuses an application or only grants partial release, a taxpayer may make a further application in relation to the same liability, even if the taxpayer has unsuccessfully objected against the decision. However, a taxpayer cannot apply for the return of taxes previously paid.

The estates of deceased Australian Defence Force personnel and deceased civilians who have served in a prescribed UN peacekeeping force are also eligible for release under ITAA36 s 265A (¶10-750, ¶10-780).

What is serious hardship?

The decision to grant relief is based on whether payment of the liability would cause the taxpayer (or the dependants of a deceased taxpayer) to suffer serious hardship.

Guidelines on determining whether there is serious hardship can also be found in PS LA 2011/17. According to that policy, serious hardship would exist where a taxpayer is left without the means to achieve reasonable acquisitions of food, medical supplies, accommodation, education for children and other basic requirements.

A decision not to grant relief was upheld in *Ferguson*, the AAT noting that the ATO's policy provided appropriate guidance for decision-makers. Serious hardship, while less severe than extreme financial hardship, was nevertheless hardship of a significant kind in terms of normal community standards. In this case, although the taxpayers were in straitened circumstances in terms of everyday living, they were not in serious hardship. In *Van Grieken v Veilands*, the taxpayer's financial affairs, including financial relations with other members of his household or with any family company, were held to be relevant matters to consider.

Release will not normally be granted if it would *not* relieve hardship, eg where the existence of other creditors make bankruptcy inevitable (Explanatory Memorandum to the Taxation Laws Amendment Bill (No 6) 2003). In *Rollo v Morrow*, an application by a tax consultant was refused because of his knowledge of the tax laws and his obligations under them, his ability to earn large sums of money and the fact that money was owing to him.

A solicitor in receipt of a very substantial income was granted release from his tax debt on the basis of serious hardship. The Federal Court found that, while the AAT's decision to grant relief was initially surprising, it was based on a consideration of the taxpayer's particular circumstances. These included whether he could achieve acquisitions of food, clothing, accommodation, medical supplies, education and other basic requirements that were not excessive or unreasonable in the circumstances. The court accepted that the taxpayer's income was highly vulnerable should he be made bankrupt (*Taxpayer*). Similarly, in *Milne*, because of the taxpayer's age and serious

health problems, the few remaining years of his working life, the dependency of his two children and the likely loss of his practicing certificate in the event of bankruptcy, his circumstances constituted serious hardship.

In *Rollason*, however, a solicitor failed to obtain relief. Although the taxpayer established that serious hardship arose from misfortune for which he was not responsible his compliance record was very bad and the hardship was attributable to his own conduct. The AAT considered that the relief provisions were not designed to allow a taxpayer to escape an obligation that he did not discharge through his own fault. Similarly, in *Rasmussen*, the AAT found that the taxpayer would suffer serious hardship but that did not arise merely because of his tax liability but rather his other liabilities. Accordingly, he did not satisfy the condition that he would suffer serious hardship if required to satisfy the tax liability (s 340-5(3), item 1).

[FTR ¶978-415]

Collection and Recovery

¶25-500 Collection and recovery regime

The collection and recovery of unpaid tax-related liabilities (including penalties) is covered by a common set of rules in TAA Sch 1 Pt 4-15.

The collection and recovery regime allows the Commissioner to collect and recover amounts of taxes and other liabilities that remain unpaid after they have become due and payable. The rules also allow multiple taxation liabilities to be recovered under one legislative provision, rather than a number of separate provisions.

Specific rules about the collection and recovery of tax-related liabilities from third parties, eg liquidators, receivers, agents, trustees of the estate of a deceased person, and people who owe money to a person with a tax-related liability, are discussed at ¶25-520 and following.

What is a tax-related liability?

The collection and recovery regime applies to all tax-related liabilities, including PAYG instalment and PAYG withholding amounts. A tax-related liability is defined as a pecuniary liability to the Commonwealth arising under a taxation law (TAA Sch 1 s 255-1). A ''taxation law'' is defined in TAA s 2.

A full list of the different types of tax-related liabilities that arise throughout the various taxation laws is contained in two tables in TAA Sch 1 s 250-10. The tables also set out the various provisions that specify when those liabilities become due and payable.

Commissioner's policies

Guidelines on the Commissioner's policy in relation to the collection and recovery of tax-related liabilities are set out in PS LA 2011/14. Guidelines on the recovery of tax liabilities from trustees is set out in PS LA 2012/2.

[FTR ¶977-550 – ¶977-890]

¶25-510 Recovery of tax

Income tax (and other tax-related liabilities), when it becomes due and payable (¶25-400), is a debt due to the Commonwealth of Australia (TAA Sch 1 s 255-5(1)). Liability to pay tax is a civil one and failure to pay exposes the taxpayer to civil but not criminal remedies. However, a criminal offence may be committed where arrangements are entered into with the purpose of rendering a company or trustee unable, or likely not to be able, to pay tax (¶30-000).

Unpaid tax may be sued for and recovered as a civil debt by the Commissioner or Deputy Commissioner in any court of competent jurisdiction, ie in every court which by enactment is made competent to entertain a claim for recovery of unpaid tax (TAA Sch 1 s 255-5(2)). For these purposes, tax includes penalty tax under ITAA36 former Pt VII (¶29-000) and GIC (¶29-510).

If a taxpayer cannot be found after reasonable inquiry, or has left Australia and has no agent or attorney in Australia, service of any process in proceedings for the recovery of tax (eg a Supreme Court writ) may be effected by posting it to the taxpayer's last known place of business or abode in Australia (TAA Sch 1 s 255-40). This does not apply to service of a bankruptcy notice and creditors' petition by the Commissioner (they must be served personally in accordance with the *Bankruptcy Rules*) (*Re Kassab*).

An application may also be made to the Federal Court for service outside Australia. Rule 10.43 of the Federal Court Rules 2011 allows this if it is permitted under Australia's double tax agreements (¶22-160), the Hague Convention or the law of the foreign country. Some of the DTAs provide for mutual assistance on the collection of taxes (TAA Sch 1 Div 263) and these are effective (*Ben Nevis*).

In recovery proceedings, a certificate signed by the Commissioner (or duly authorised officer) setting out certain facts relating to the assessment (the name of the taxpayer, the particulars of the assessment and the amount of tax owed) is sufficient evidence of those facts, unless there is evidence to the contrary (TAA Sch 1 s 255-45; ITAA36 s 175; TAA Sch 1 s 350-10).

Where a husband and wife resided in and spent substantial amounts rebuilding a property that was orally gifted to them by the husband's parents (who remained the registered owners), a constructive trust existed in favour of the taxpayers. Consequently, in the event of proceedings to recover a tax debt, the taxpayers could not contend that they did not have an interest in the property (*Sarkis*; *Karas*).

Liability not suspended pending review

Liability to pay assessed tax, additional tax or any other amount is *not* suspended pending the outcome of an application for review or appeal (TAA s 14ZZM; 14ZZR). Thus, once assessed tax or any other amount (eg penalties and GIC) becomes due and payable, the Commissioner is entitled to take whatever steps necessary and appropriate to recover the tax or other amount. This rule applies even if any objection, review or appeal under TAA Pt IVC, or any further appeal, is still outstanding (*Broadbeach Properties*). Further, the AAT is specifically prevented from granting a stay of execution of the judgment debt pending determination of the review proceedings before it (TAA s 14ZZB; *Coshott*).

If the taxpayer is a company, the Commissioner can serve a statutory demand under s 459E of the *Corporations Act 2001* which may ultimately lead to the company being wound up: *Kalis Nominees*. A company may seek to have a statutory demand set aside on the ground that there is a ''genuine dispute'' about the existence or amount of the debt (*Corporations Act 2001*, s 459H). In *Hoare Bros*, the Full Federal Court held that challenging an assessment under the provisions of Pt IVC was not a genuine dispute to justify setting aside a demand as, in the meantime, the tax had to be paid. In *Broadbeach Properties*, the High Court upheld the correctness of *Hoare Bros*.

- A distribution should not be paid unless the franking account(s) have been reconciled (¶4-700).
- The resolution declaring a distribution must be dated at least one day before the payment date, even where payment is by crediting a loan account.
- An entity other than a private company must provide a distribution statement in an approved format to the recipient no later than the time the distribution is made.

The state of the company's franking account should always be kept in mind. For example, if the account has a nil balance and it is expected that a franking credit will soon arise, such as by the payment of a PAYG tax instalment (¶4-700) or the receipt of franked dividends, there may be a window of opportunity to declare an unfranked dividend. Alternatively, if franked dividends are declared in anticipation of franking credits arising but those credits do not arise, over-franking may occur (this can be rectified later in the year by generating franking credits, otherwise franking deficit tax will be payable: ¶4-780). Under-franking may create more problems than over-franking because a full franking debit arises but the shareholders get only a partial credit.

The rules for distinguishing debt from equity (¶23-100) may also need to be considered to determine whether a distribution is to be treated as a frankable distribution or an interest payment.

Other factors

It would seem that some tax "incentives" may be effectively lost where a business is conducted by, or property is held in, a company. For example, where a company is entitled to some incentive deduction that reduces its taxable income below the amount of its accounting profit, distributions out of the excess of the accounting profit over the taxable income will ultimately be fully taxable in the hands of the shareholder as no franking credits will be generated to cover the excess.

If a person is both a shareholder in and an employee of a private company, an employment-related benefit provided to that person will generally be deductible and subject to FBT (¶35-120).

A private company loan to a shareholder and/or director may be a loan fringe benefit (¶35-270) and thus give rise to an FBT liability, or may be deemed to be a dividend (¶4-210). The deemed dividend rule is likely to apply if there is no intention to repay the "loan". However, it should not apply if the loan is properly documented and complies with the rules concerning minimum interest rate and maximum term. Minimum annual repayments must be made while the loan is outstanding. Reference should also be made to the anti-avoidance rules applying where capital is returned to shareholders (¶4-682) and the rules governing the tax consequences of off-market share buy-backs (¶3-170).

CGT issues

In some cases it may be desirable to inject additional funds into the company as capital. However, if the shares in the company are pre-CGT shares great care must be taken to ensure that the CGT provisions are not triggered — a substantial change in the underlying interests may deem a pre-CGT asset to have been acquired after 19 September 1985 (¶12-870). Additionally, attention should be given to the value shifting provisions (¶12-800). Alternatively, it may be desirable that the assets of the business be sold rather than the shares in the company.

If the business of the company commenced before 20 September 1985 but substantial share capital was issued on or after that date, it may be advantageous to sell the assets rather than the shares, as the assets may include a substantial amount of goodwill that could attract concessional CGT treatment. If the sale consideration includes a share of future profits, the rules governing "earnout" arrangements will need to be

considered (¶11-675). Roll-over relief may be available where active assets of a small business are sold and the proceeds are reinvested in other active assets within two years (¶7-195).

Companies should generally not be used to hold capital appreciating assets. Companies are not eligible for capital gains discounts, whereas a gain realised directly by an eligible investor (eg individual or superannuation fund) may be eligible to be discounted before tax is calculated (¶11-033).

Further, to the extent that dividends distributed to shareholders represent the tax-free indexed component of a capital gain (now effectively restricted to assets acquired before 1 July 1999), those dividends will not be franked. Accordingly, a resident individual shareholder may pay tax on what would otherwise be a tax-free amount. Alternatively, a lack of franking credits may erode the value of the company's shares.

¶31-540 Diversion through family trusts

The most significant features of a typical family trust are as follows.

- The trustee — which is usually a shelf company controlled by the client (eg the parent who contributed the bulk of the trust estate), but may be a trusted friend or family member of the client — is given wide discretionary powers in relation to the distribution of income and the appointment of capital among members of the client's family (ie a discretionary trust). In particular, the trustee should have the discretion to distribute different categories of income to different beneficiaries and to treat, as trust income, capital gains or receipts deemed to be income for tax purposes — otherwise the tax advantages of a family trust are greatly reduced.
- A clause in the trust deed gives the client the power to remove any trustee and to appoint a new trustee or trustees, thereby giving the client indirect control.
- The trustee is given wide power to acquire or dispose of property, to carry on business and to borrow money.

Discretionary family trusts

Discretionary family trusts provide flexibility in relation to distributions of income and assets among members of the client's family, while at the same time permitting the client to maintain either direct or indirect control over funds or other assets that have become the property of the family members. "Streaming" a category of trust income to a particular beneficiary provides tax planning opportunities. For example, foreign tax offsets can be best utilised by resident individual beneficiaries with high marginal tax rates and net capital gains can be best utilised by beneficiaries with carry-forward capital losses, low income beneficiaries with carry-forward revenue losses and minors able to receive excepted trust income (¶2-210). With effect from 2010/11, the streaming of net capital gains and franked distributions are governed by specific statutory rules (¶4-860, ¶11-060). For articles discussing the streaming of interest income, see CCH *Tax Week* ¶677 (2011) and ¶771 (2011).

Note also the provisions directed at disclosure of ultimate beneficiaries in closely held trusts (¶6-275).

For an article analysing the use of a family discretionary trust to hold a negatively-geared investment property, see CCH *Tax Week* ¶1059 (2013).

Loss trusts

The trust loss measures, which limit the circumstances in which trusts can deduct prior year and current year losses and certain debt deductions (¶6-262), generally do not apply to family trusts (¶6-266).

Other potential pitfalls are:

- whether transactions have been entered into that are void or voidable pursuant to the *Bankruptcy Act 1966* or *Corporations Act 2001*
- the risks of undisclosed liabilities, etc — in this regard, any warranties given by vendors may be of more doubtful value than would be the case where, for example, a profitable company is acquired, and
- the problems of diverting income to the loss trust to absorb available losses — in particular, ITAA36 s 100A may apply where the diversion is effected by means of a distribution from another trust (¶6-270).

Loans

As noted at ¶31-530, the ATO may review loans by family trusts to beneficiaries and by trustee companies to shareholders and/or directors, to determine whether they may be loan fringe benefits (¶35-270) giving rise to an FBT liability, or whether, in the case of loans by private companies, the loans should be deemed to be dividends (¶4-210).

Diversion to children

The diversion of income to children who are too young to have independent incomes is affected by ITAA36 Div 6AA, as a result of which most of this income is taxed at higher than normal rates (¶2-160). Division 6AA does not apply to certain children (eg children in full-time occupations, double orphans and many disabled children), nor to certain types of income (eg business income, employment income, death benefits and damages for personal injury or loss of parental support). With effect from 2011/12 onwards, minors covered by Div 6AA also cannot claim the benefit of the low income earner's rebate (¶15-330).

Distributions to superannuation funds

Discretionary trust distributions to superannuation funds are generally taxed at 45% (¶6-170). Distributions to superannuation funds by a unit trust are taxed at 15%, except to the extent that the distribution exceeds an arm's length amount (the excess is taxed at 45%).

Distributions to tax-exempt beneficiaries

For rules that may expose tax-exempt beneficiaries to tax on trust distributions, see ¶6-274.

Corporate trustees

If the trustee of a trust is a company, then the trust can be provided with most of the advantages of company status including perpetual succession and limited liability as far as the trustee is concerned. The use of a company trustee also facilitates control over the trust by the client, ie by giving the client some means of controlling the company that acts as trustee. Generally speaking, it is unnecessary for customers to know that they are dealing with a trustee, although the accounts of a trustee company (which would disclose that the company did not own the trust assets beneficially) would make this plain to anyone who had access to them. This latter circumstance sometimes causes difficulties with lending institutions but they are not insuperable. Where a company acts as trustee, the requirements of the *Corporations Act 2001* must, of course, be complied with.

Drafting trust deeds

An inadequately drafted trust deed can give rise to serious problems, sometimes long after the establishment of the trust. Forward planning is particularly important, eg by identifying a class of beneficiaries that is appropriate not only for the settlor(s) but also for their successors, and by including in the trust deed mechanisms to minimise or

resolve any disputes that may occur. Resettling the trust or amending the trust deed may have undesirable stamp duty consequences (although rectification of the trust deed is possible to give effect to the true intention of the parties, eg *Carlenka*).

One issue to be considered is that, in some circumstances, there may be a difference between the amount of net income for trust law purposes and the amount of net income for income tax purposes (¶6-200), particularly where there is a net capital gain. If this situation is not covered in the trust deed, circumstances may arise where there is no beneficiary presently entitled to part of the net income as calculated for income tax purposes and the maximum rate applicable to "accumulated" income will apply.

Another issue is that a beneficiary, on turning 18, will be entitled to demand payment or delivery of the balance of their allocated fund, or at least so much as remains after payment of tax and deduction of amounts applied for their benefit (eg living and education expenses). The amounts to which minor beneficiaries remain entitled may be substantial and thus considerable skill in drafting (as well as understanding legal principles) is necessary to avert the difficulties that might flow from demands for payment made by beneficiaries on turning 18.

Other potential pitfalls include:

- losing (in whole or in part) an entitlement to a deduction where trust property is let at less than market rent (eg *Madigan*: ¶16-650)
- the application of the thin capitalisation rules (¶22-700)
- the application of the continuity of ownership test to determine whether a company can carry forward losses where the company is owned by a family discretionary trust (¶3-110)
- the difficulty for a discretionary trust to take advantage of the CGT roll-over relief or exemption where the proceeds of sale of active assets of a small business are either reinvested in active assets of another business or used for retirement purposes (see above), and
- the "prudent person principle" in most states' legislation regulating trusts — in the absence of a provision in the trust deed specifying otherwise, this principle requires trustees to make investments in light of the beneficiaries' tax requirements (including whether they can use imputation credits, the effect of selling pre-CGT assets and the CGT consequences of changing investments).

It is important for beneficiaries, particularly non-residents, to keep written evidence that they received (actually or constructively) trust distributions. In the absence of such evidence, it may be more difficult to establish that the trust distributions were not shams (*Hasmid Investments*).

¶31-545 Comparison of family trusts and family companies

Whether a family company or a discretionary family trust is the appropriate vehicle will depend on the circumstances of each case. Considerations other than tax (eg the costs of establishing and maintaining a particular structure) must also be taken into account. Of course, as much flexibility as possible should be maintained in any set-up. In some cases, this may be obtained by having a discretionary family trust with both individual and company beneficiaries — the shareholders of the company being the persons whom it is intended should eventually benefit.

¶31-550 Diversion through loss companies

There are two kinds of loss companies that may be considered as possible income recipients — "current year loss companies" and "past year loss companies".

Broadly speaking, losses incurred by a company in previous years will not be deductible unless the company meets either a continuity of ownership test (¶3-105) or a ''same business'' test (¶3-120). Great care must be taken when seeking to utilise losses of past years where the losses are to be recouped from the profits of a different business from that in which the losses were incurred. Where a family trust directly or indirectly holds the relevant interests in a company, the trustee will be taken to beneficially own the interests as an individual for the purposes of the continuity of ownership test (¶3-110).

The inter-entity loss multiplication rules (¶3-135) should also be noted.

''Current year loss companies'' are companies that have incurred losses in the current income year. The tests used to determine the deductibility of carry-forward losses are applicable in determining the availability of deductions in one income year against profits for the same year. There is very little opportunity to take advantage of current year losses except in similar situations to those where it may still be possible to obtain a deduction for carry-forward losses. Even where other entities in the same ''stable'' seek to take advantage of losses incurred by a current year loss company, great care must be taken to ensure that the various requirements of the legislation are satisfied (¶3-065).

¶31-560 Diversion through unit trusts

A unit trust is a trust in which the beneficial ownership of the trust property is divided into a number of units. Although discretionary unit trusts do exist (see below), the property of a unit trust is normally held on trust absolutely for the persons who for the time being are the holders of units in the unit trust (although the unitholders may themselves be the trustees of discretionary trusts). There is normally no discretion to redistribute the beneficial interests in capital or income among the unitholders. Thus, like a company, a unit trust permits the association of a number of unrelated parties in a venture. A unit trust is governed by the same principles as other trusts and there must be property vested in the trustee for the benefit of beneficiaries. Like any other trust, a unit trust imposes obligations with respect to the trust property; and the trustee of a unit trust has, and in general is subject to, the same duties, obligations and liabilities as the trustee of any other trust. Corporate unit trusts (¶6-280) and public trading trusts (¶6-310) are taxed as companies.

In recent years, unit trusts have been used less for tax planning purposes since various disadvantages associated with companies have been removed, eg the reduction in the company tax rate. The trust loss measures also affect unit trusts (¶6-262) as well as CGT event E4 (¶11-290). However, the recipients of income who may benefit from a unit trust structure include low income individuals, individuals with carry-forward losses (subject to the trust loss measures), tax-exempt organisations and trustees of child support or maintenance trusts.

A CGT roll-over is available where a fixed trust transfers all its assets to a shelf company having the same ownership (¶12-395).

Character of unit trusts

The character of each unit trust will be determined by the provisions of the relevant unit trust deed. There are a number of different kinds of unit trusts and unit trust deeds. Generally speaking, units in a unit trust are negotiable, ie capable of being transferred, although often the most convenient method of effecting transfers of units is to have the units of a retiring unitholder redeemed and fresh units issued to an incoming unitholder. Normally a unit trust deed will confer on the trustee a wide discretion in relation to the management of the trust and the day-to-day running of the business; otherwise the risk of unitholders incurring personal liability for the activities of the trustee, never completely absent, would be significantly increased. On the other hand, the trustee would normally have no discretion in relation to distributions of income or capital among the unitholders, although discretionary unit trusts do exist (these give the trustee the discretion to

''distribute'' income by way of superannuation contributions and to differentiate between unitholders as to the types of income distributed). It is thought to be desirable in almost all cases that the trustee of a unit trust should be a company. Obviously it is necessary to exercise great care in determining the shareholding composition and in drafting the constitution of such a company.

Relevant matters in setting up a unit trust

Some of the issues to be considered when setting up a unit trust are:

- the composition and control of the trustee company, the method of arriving at decisions (eg whether unanimity should be required in certain cases) and the method of removing the trustee and appointing a new trustee (the fact that two or more unrelated parties may be associated in the operation of a unit trust and the fact that the unit trust, unlike a discretionary trust, will normally be under the control of more than one person, increases the risk of disputes as to the management of the trust assets and the construction of the relevant documents)
- the powers of the trustee to determine whether receipts, receivables, outgoings and other charges are on income or capital account with particular regard to the effect of special tax concessions
- the extent of control that should be exercised by unitholders over the activities of the trustee
- the means of transferring units or permitting unitholders to have their units transferred or redeemed
- whether units should, in any circumstances, be subject to compulsory redemption and how this should be achieved
- the means of introducing new unitholders
- the extent of the indemnity that should be provided to the trustee for breaches of trust and the effect of these provisions on potential lenders to the trustee
- the means of excluding a unitholder (eg the trustee of a deceased individual's family trust) from a continued interest in a closely held unit trust, in a manner that is fair to the deceased person's family and yet not onerous for continuing unitholders that are involved in the ongoing business activities of the trust, and
- the protection of unitholders from personal liability to the extent that this is possible.

The assessability of distributions to unitholders in a unit trust is discussed at ¶10-460. The CGT implications for unit trusts are discussed at ¶11-290 and following.

¶31-570 Diversion through administration companies/service entities

Self-employed professional persons, whether sole practitioners or in partnership, can set up administration companies to provide themselves with access to employer-sponsored superannuation.

This is generally achieved by the administration company employing the practitioner to carry out the administrative duties of the practice for a proportion of that practitioner's total working time. However, the Commissioner requires that the company be established only for the purpose, so far as income tax is concerned, of providing employer-sponsored superannuation benefits for professional practitioners (IT 2494; IT 2503). The Commissioner accepts that the benefits will arise to the professional person in their capacity as a partner, and not as an employee, and therefore there are no FBT consequences (TD 95/57). An administration company can also provide fringe benefits as part of an employee's remuneration package, provided no material taxation advantage is gained, other than access to greater superannuation benefits: see below (TD 95/34). It is

accepted that there is no material taxation advantage simply because the amount of FBT payable is less than the amount of income tax that would have been payable if the benefit had been provided in the form of salary or wages. An administration company should not provide exempt benefits unless required to do so by legislation (eg workers compensation).

In the case of professional partnerships, it is also common to establish a service entity to provide various services to the business, including premises, plant, equipment and the services of support staff. The partnership will pay the service entity for those services, effectively splitting income to the extent that the service entity makes a profit on the services and is owned by family members of the partnership on lower marginal tax rates than the partners. The Commissioner may apply the general anti-avoidance provisions (¶30-120) if it is considered that obtaining a tax benefit is the dominant purpose for establishing the service entity. To avoid problems, partnerships using a service entity should: (i) enter into a written agreement setting out the nature of the services and the fees to be charged; (ii) ensure that those fees are at commercial rates; (iii) ensure that the service entity invoices the business regularly for the services performed; (iv) separate the administration of the service entity from the rest of the business; (v) ensure that employees know who their employer is (ie the service entity or the partnership); and (vi) review the operation of the service entity from time to time, including the fees charged.

An arrangement involving a service trust was upheld in *Phillips' case* (¶16-070), where the court emphasised that the charges in question were reasonable. However, the Commissioner's view is that the decision in *Phillips' case* does not mean that service fees calculated using the particular mark-ups adopted in that case will always be deductible. Where the benefits passing to the taxpayer under the service trust arrangement are not obviously connected to the conduct of the taxpayer's income-earning activities or business, or where the service fees are not commercially realistic, a broader examination of the circumstances surrounding the expenditure may be necessary. If it is determined that the expenditure was in fact incurred in pursuit of an independent advantage then, to that extent, based on a fair and reasonable apportionment, it will not be deductible (TR 2006/2; ATO guide entitled "Your service entity arrangements").

The ATO's approach to service entities is discussed in CCH *Tax Week* ¶674 (2005). For a discussion of alternatives to service entities that are available to professional practices, see CCH *Tax Week* ¶1 (2006). As a result of the increasing complexity of recent restructures of professional practice entities, the ATO has also issued guidelines in *Taxpayer Alert* TA 2013/3, identifying its concerns about (1) whether CGT and other tax outcomes are being correctly identified when practices restructure, and (2) whether the business is actually being operated by the purported practice structure or by the individual principals (see also ¶5-160). The ATO is also considering whether Pt IVA may apply to choices made on restructuring or annual distributions. For an article discussing some of the implications, see CCH *Tax Week* ¶788 (2014).

Some Common Planning Situations

¶31-610 Tax planning in business sales

Parties to a business sale should consider the income tax and CGT consequences for each asset (tangible or intangible) being sold, and also any associated matters such as the provision of services or the grant of a restrictive covenant. As taxpayers will be required to prove that an adverse assessment is excessive, it would not generally be desirable to leave any of the sale consideration unallocated. If the consideration is not allocated, the Commissioner may so allocate (generally using market values). Allocations of consideration by taxpayers should, of course, be commercially justifiable. From the vendor's point of view, as much of the consideration as possible should be allocated to

pre-CGT assets. Where assets are subject to CGT, the vendor may wish to consider other alternatives. In the case of small businesses, an important factor will be the various CGT concessions that apply (¶7-110). The GST implications of buying or selling a business are discussed at ¶34-240.

The purchaser should seek to maximise any tax benefits of the assets being acquired. For example, where the cost of purchased assets may be subject to depreciation or amortisation for tax purposes (eg a unit of industrial property or fixtures in a building), consideration should be specifically allocated to those assets. The purchaser should also request the original construction cost details where a building is eligible for amortisation under ITAA97 Div 43. Where a business may later be sold by the purchaser, it may be desirable to maximise the payment for goodwill (particularly for a pre-CGT business of the vendor) so as to maximise the purchaser's cost base of the goodwill. See also ¶31-300.

Where it is intended to sell a business conducted by a company or unit trust, it may in some cases be advantageous to sell the shares in the company or units in the trust, rather than the business itself, so as to avoid balancing adjustments in respect of depreciating assets that have a higher value than their written down value or to avoid the application of the rules on the sale of trading stock, etc (¶9-290). However, the usefulness of this will also depend on the implications of the CGT provisions. Relevant points include whether any of the shares or units were acquired on or after 20 September 1985 and whether acquisitions of assets by the company or trust on or after 20 September 1985 are such that the CGT anti-avoidance measures would be activated (CGT event K6: ¶30). For other CGT issues see ¶31-530. In considering a sale of shares, it should also be kept in mind that there may be other factors in addition to taxation. For example, an acquisition of shares may be commercially undesirable where the purchaser is not being protected against the potential liabilities of the company.

The sale of business assets for variable consideration is a particularly difficult area, for example where there is an "earnout" arrangement which relates the sale proceeds to the earnings generated for a period after the sale. In April 2015, the government released exposure draft legislation to provide look-through CGT treatment for earnout arrangements. Under the draft, a subsequent payment received by the seller will be treated as part of the capital proceeds of sale of the business with interest and penalties suspended. For details of the proposal, and the current status, see ¶11-675.

If a taxpayer sells business assets and goodwill in return for a percentage of future profits for life, those receipts will generally be income in the taxpayer's hands; but they are not the proceeds of the business which, when carried on by the purchaser, will constitute the *purchaser's* income.

Where the business sale involves land, timing of settlement may be important for land tax purposes. Depending upon the state jurisdiction, the owner at 30 June, 1 July or 31 December will generally be responsible for a full year's land tax (¶38-010 – ¶38-070).

Business sales are also an area where unintended stamp duty consequences may arise. For example, if documents need to be stamped in more than one jurisdiction, there is a potential for double stamp duty if the consideration is not properly allocated between jurisdictions and the authorities in those jurisdictions disagree on the value of tangible assets within their control. The availability of stamp duty exemptions for transfers, consequent on the sale of a business, that do not themselves transfer the beneficial ownership of property also needs to be considered.

Treatment of debtors

Consideration must also be given to the manner in which the debtors of the former proprietor are dealt with. If a proprietor on a cash basis assigns debtors for value, the amount received from the assignee will be assessable income to the proprietor and the payment will not be deductible to the assignee. If the business is conducted on an

accruals basis (as most are), care must be taken in the treatment of prospective or actual bad debts. A debt assigned and subsequently found to be bad may not be claimed as a deduction by the assignor, who has realised it, nor by the assignee, who has not returned it as income (¶16-580). However, a capital loss for the purposes of the CGT provisions may be incurred in some cases. A ''traditional security'' deduction is not available under ITAA36 s 70B in this situation (¶23-340). For a deduction to be obtained for a debt written off before the transfer of the business, the debt must be bad at the time it is written off. Writing off a debt may have adverse consequences for the debtor under the commercial debt forgiveness measures: ¶16-910.

The above difficulties may often be avoided if the vendor of the business retains the debtors, but the purchaser collects the debts in return for commission. This may also be advantageous from a stamp duty perspective. A mechanism for consequential adjustments to the sale price of the business may be required depending on how the arrangements were structured. If such arrangements can be justified as part of an ordinary business transaction, it is most unlikely that the general anti-avoidance provisions of ITAA36 Pt IVA would apply.

For an article on CGT planning for business sales, see CCH *Tax Week* ¶996 (2014).

For work in progress, see ¶31-300. For other commercial considerations, see ¶31-040.

¶31-620 Tax planning for CGT

In considering the application of CGT, particular attention should be paid to the following:

- ascertaining which, if any, CGT event has occurred (as this affects the calculation and timing of any assessable gain)
- the importance of maintaining the status of pre-CGT assets
- the possible loss of an asset's pre-CGT status where the underlying beneficial interests change
- the diminution of the value of pre-CGT assets
- non-assessable amounts which give rise to CGT consequences (such as CGT event E4 (¶11-290))
- value shifts that give rise to a deemed capital gain or reduce the cost base of the relevant asset (¶12-800)
- the immediate assessability of the consideration, even where paid by instalments (¶11-500)
- the taxpayer incurring non-deductible expenditure in relation to an asset where the expenditure does not form part of the cost base of the asset
- disposals involving multiple taxpayers (eg there may be ordinary income to one taxpayer and a capital gain to another)
- a taxable CGT event (¶11-240) arising in relation to a pre-CGT asset, and
- the requirements (including residence) for obtaining the CGT discount (¶11-036).

Care should be taken to ensure that an asset-rich individual preparing a will is aware of the likely CGT consequences of creating interests such as life estates where final distribution of the assets is effectively postponed (¶11-000).

For an outline of basic CGT planning points, see CCH *Tax Week* ¶603 (2005). For an article on CGT planning for business sales, see CCH *Tax Week* ¶996 (2014). For other CGT planning aspects, see ¶31-125 and ¶31-130.

Year End Tax Strategies

¶31-700 Year end tax strategies checklist

The following is a checklist of some of the income tax planning strategies outlined in this chapter or elsewhere in the Guide that may be particularly relevant as the tax year draws to a close. Note that, as in all tax planning situations, other considerations must also be taken into account — for example, personal factors, commercial considerations, common sense, the general economic climate and the potential impact of other taxes. For simplicity, a tax year ending on 30 June is assumed.

As a general planning consideration, you should also be aware of upcoming tax changes. These are summarised in the Checklist of tax changes at ¶2.

Personal tax

- To ensure eligibility for tax offsets that are based on expenses being incurred, ensure that those expenses are actually paid by the end of the tax year (¶15-320).
- Be aware of the annual income levels at which certain dependant tax offsets cut out (¶15-025).
- Be aware of the income cut-off for the low income tax offset (¶15-300).
- Consider making deductible gifts before year's end, particularly if you expect that your average tax rate (and therefore the value of your deduction) will fall in the next year. However, the effects on liquidity, and the possible loss of interest on the accelerated payment, must be kept in mind. Note, too, that the gifts deduction is limited to the taxable income for the year, and cannot create a carry forward loss, so deferment of ''excess'' gifts may be appropriate in some cases (¶16-942).
- Where spouses are on different marginal rates, consider ensuring that all deductible gifts are made by the spouse in the higher tax bracket so as to maximise the benefit of the deduction (¶16-942).
- A minor will be able to avoid being taxed at the penal rates applicable to minors' income if they are in a full-time occupation as at 30 June. A minor who is intending to take up a post in July may therefore be better off if they are able to take it up in June (¶2-170).
- To qualify for the government superannuation co-contribution, a contribution must have been made by 30 June and various other tests must be satisfied (¶13-760).
- A taxpayer who is considering retiring near year end may find it worthwhile to defer discretionary income until after 30 June. In that subsequent year, their income will normally be smaller and the marginal rate may therefore be less (¶31-210).
- When considering the timing of retirement, keep in mind the restrictions on the concessional treatment of employment termination payments that apply (¶14-620).

Income

- Subject to cash flow considerations and anti-avoidance rules, consider deferring income to the following year, particularly if: (1) income for that year is likely to be lower; or (2) tax rates for that year are expected to be lower (¶31-210). High income earners, however, will also have to factor in the effect of the 2% ''deficit levy'' applying in 2015/16.
- Consider the availability of statutory roll-overs to defer liability arising in the current year, eg partnerships' trading stock (¶9-290), depreciation (¶17-710) and capital gains (¶12-035).
- In general, under the *Arthur Murray* rule, income is not derived until it has been earned by the provision of the relevant services. Service contracts should be reviewed accordingly (¶9-090).

- Interest income credited on the maturity of a fixed term deposit in June may be fully assessable in the current year, but may not be assessable until the following year if the term deposit matures in July (¶9-080, ¶10-470).
- An accruals based professional person is normally not assessable on work in progress unless there is a recoverable debt, eg when the client is invoiced (¶9-050).
- Where feasible, and subject to anti-avoidance rules, consider acquiring income-producing assets in the hands of a low income taxpayer rather than a high income taxpayer (¶31-500).
- If seeking to avoid having a private company loan treated as a dividend, the loan must comply with the requirements relating to minimum interest and maximum term of the loan (¶4-200).
- The special averaging rules for authors, inventors, performing artists, production associates and sportspersons can provide relief in years in which their professional income fluctuates above their average income (¶2-140).
- Primary producers may consider permanently withdrawing from their special averaging system where their income is consistently lower than their average income (¶31-240).
- Long-term visitors to Australia should consider their resident status — in particular, the rule that a person may be classed as a resident if they have been in Australia continuously or intermittently for more than one half of the year of income (¶21-020).

Capital gains and losses

- Consider realising a capital gain in a low income year rather than a high income year. However, as a capital gain accrues on disposal, simply deferring the derivation of the sale proceeds to a later year may not be effective (¶31-270).
- Where appropriate, consider realising capital losses by year's end so that they may be offset against realised capital gains of that year (¶11-030).
- Where appropriate, consider realising capital gains by year's end so that they may be reduced by current year capital losses (or unused capital losses from previous years) (¶11-030).
- Where it is intended to stream a capital gain to a particular beneficiary, take care to ensure that "specific entitlement" requirements are satisfied (¶11-060).

Deductions, offsets and losses

- In general, deductions are not allowed where there is merely an accounting provision or reserve set up for estimated costs — the actual expense must be incurred (¶9-120).
- Ensure that documentary records of deductible expenses are in order, especially where specific substantiation requirements apply (eg in relation to cars (¶16-320)).
- Ensure that deductible wages to spouses are actually incurred by year's end and that this is documented. Be aware that deductions are limited where the payment is considered unreasonable (¶31-380).
- Small business entities may be able to take advantage of special prepayment rules (¶16-045).
- Subject to cash flow considerations and prepayment rules, consider making deductible purchases by year's end in order to accelerate deductions. This applies particularly if tax rates for the following year — and therefore the tax benefit of the deduction — are expected to be lower than in the current year (¶16-040). High income earners, however, will also have to factor in the effect of the 2% "deficit levy" applying in 2015/16.

- Consider year-end tax shelter investments with caution (¶31-045).
- For PAYG individuals, significant deductions in the current year may justify lower PAYG withholding rates in the following year (¶26-500).
- For taxpayers wishing to claim deductions for concessional superannuation contributions, or to qualify for the government's co-contribution, ensure that the payment is made (and received by the fund) by year's end. Bear in mind the annual caps that apply and consider whether any excess contribution over the cap should be deferred (¶13-760, ¶13-775).
- For taxpayers on higher incomes, consider the use of negatively-geared investments to generate excess deductions that can be offset against current year income (¶16-742).
- To be deductible, a bad debt may need to be actually written off by year's end (¶16-582).
- To claim a current year deduction for directors' fees, the company should have definitively committed itself to the payment, eg by passing a properly authorised resolution (¶16-040).
- To claim a current year deduction for annual or long service leave, it is not sufficient for the employer merely to have made a provision in its accounts to cover the employees' entitlements (¶16-040).
- Be aware that capital allowances are not available for a year unless the asset has been used or installed ready for use, and the taxpayer's income-producing operations have commenced (¶17-480).
- If claiming a deduction for a retiring allowance under s 25-50 (as distinct from the business deduction provisions), be aware that these deductions cannot produce a tax loss. If this would be the effect of paying the full amount of the allowance during the current year, consideration may need to be given to deferring the payment (or the appropriate apart of it) to the next year (¶16-540).
- If claiming a concession for R&D expenditure, be aware of the various thresholds and time limits that may apply (¶20-150).
- Subject to transitional rules, if the foreign tax paid exceeds the amount claimable as a foreign tax offset, the tax benefit of the excess is lost. It cannot be taken into account in determining the offset in subsequent income years, nor can it be transferred (¶21-760).
- Consider whether a family trust election needs to be made where the trust has made losses (¶6-266).
- Consider whether a loss claim may be affected by the non-commercial loss rules (¶16-020).
- Where a company is seeking to carry forward a prior year loss, pay attention to the requirements for the continuity of ownership test to be satisfied up to the end of the claim year (¶3-105).
- By accelerating income and deferring deductible expenditure, it may be possible to increase the taxable income of a loss company in the period before consolidation, thus utilising or reducing some if its pre-consolidation losses (¶8-110).
- Tax agent fees are not deductible until they have been incurred, irrespective of the year of the tax return to which they may relate (¶16-850).