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The Tax Institute

Taxation in Australia

Division 7A: some things you may not know
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Residency status: CGT implications for assets
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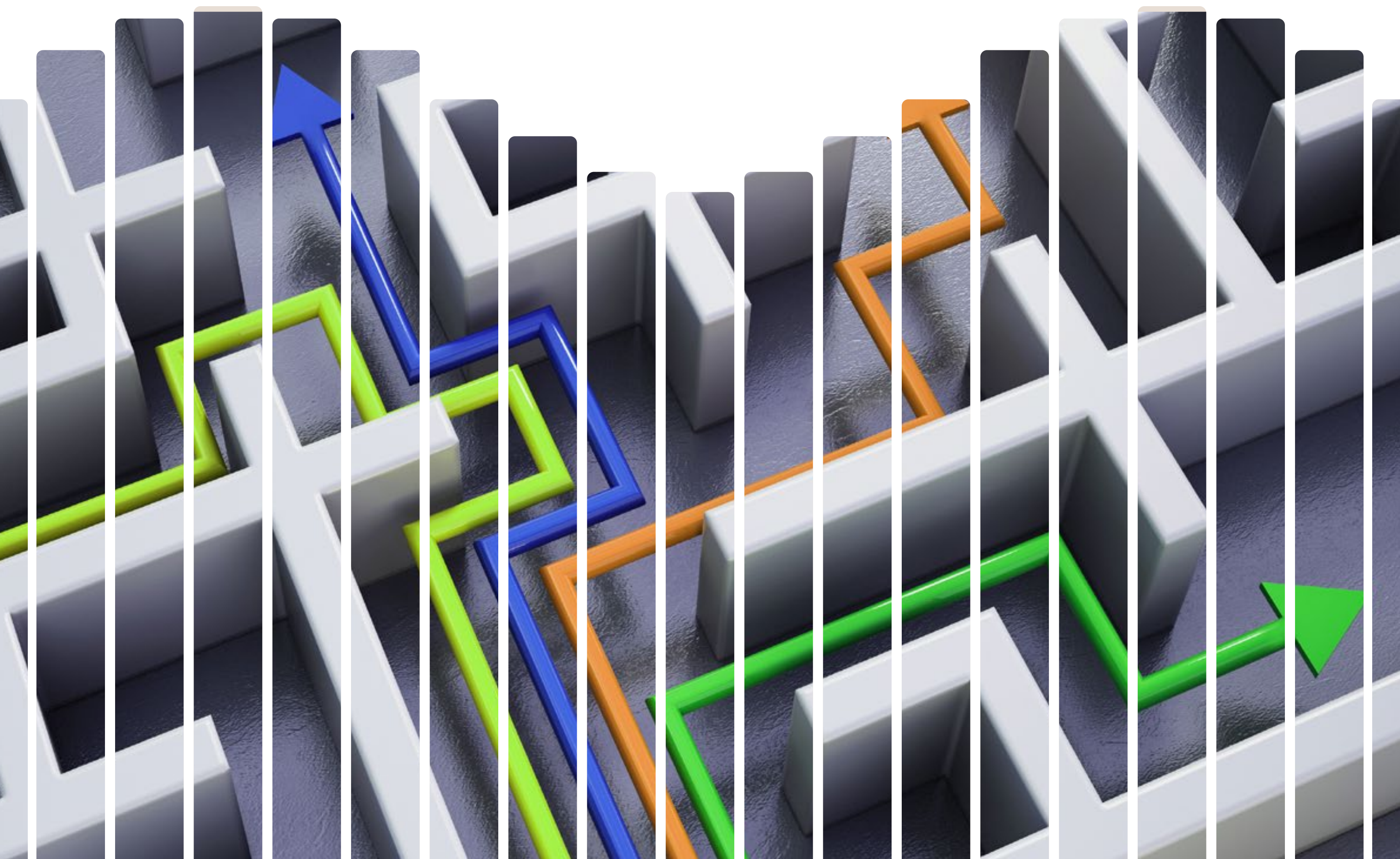

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Invitation to write

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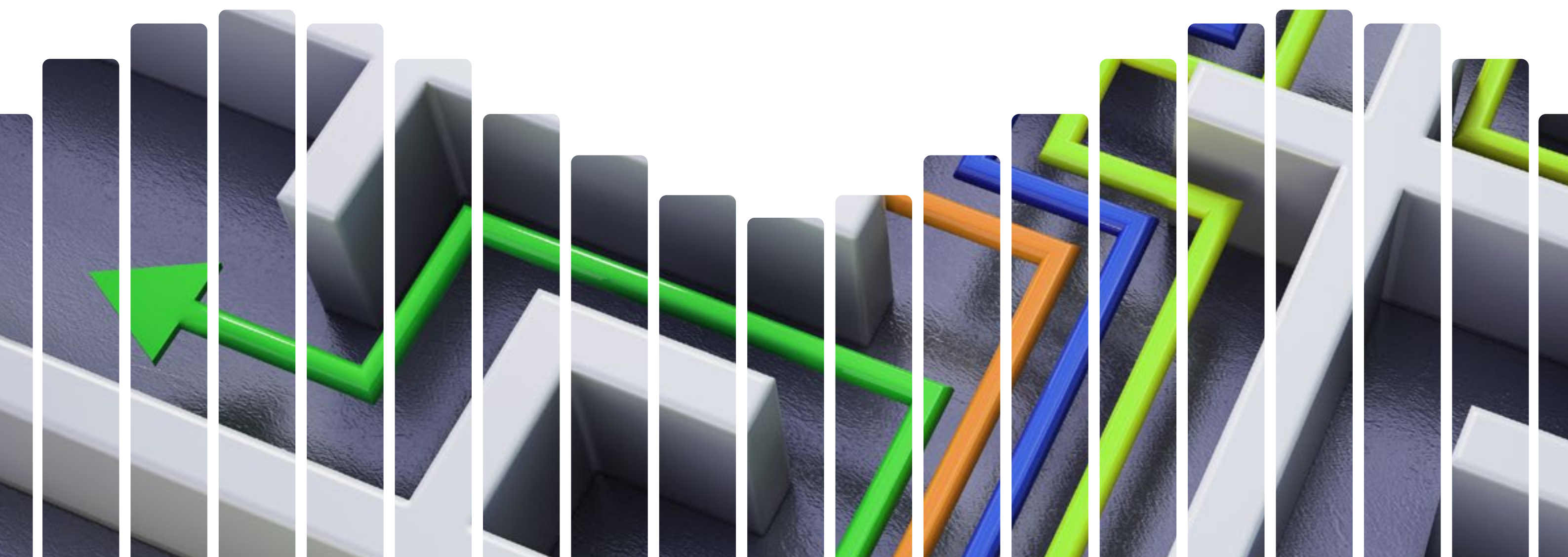

Tax News – at a glance

by TaxCounsel Pty Ltd

February – what happened in tax?

The following points highlight important federal tax developments that occurred during February 2025. A selection of the developments is considered in more detail in the "Tax News – the details" column on page 341 (at the item number indicated).

Amending legislation

An amending Bill (the Treasury Laws Amendment (Tax Incentives and Integrity) Bill 2024) that is currently before parliament contains amendments that are to give effect to several previously announced measures. **See item 1.**

Areas of focus 2024–25

The ATO has released the key risk areas that it intends to focus on for private wealth in 2024–25. **See item 2.**

Default assessments upheld

The Administrative Review Tribunal (ART) has rejected an individual taxpayer's challenge to default assessments (and penalty assessments) that were made by the Commissioner for the five income years 2016 to 2020 on the basis that unexplained deposits into a joint bank account that the taxpayer held with his wife were ordinary income assessable to the taxpayer (*Smith and FCT* [2024] ARTA 49). **See item 3.**

TPB decision: stay order refused

The ART has refused to make a stay order in respect of a decision of the Tax Practitioners Board which terminated the registration of a tax agent and imposed a four-year ban on the agent from applying for re-registration (*Kambourakis and Tax Practitioners Board* [2025] ARTA 1). **See item 4.**

Rectification of trust deed

The Tasmanian Supreme Court (Blow CJ) has recently made orders for the rectification of a family trust deed that failed to carry out the real intention of a settlor which was that a proposed transfer to the trustees of the trust would qualify for an intergenerational rural transfer stamp duty exemption (*Holloway v Commissioner of State Revenue* [2024] TASSC 45). **See item 5.**

Division 7A: what is a loan?

In a very recent unanimous and important decision, the Full Federal Court (Logan, Hespe and Neskovcin JJ) has unanimously held that, where a company becomes presently entitled to income of a discretionary trust and the present entitlement is not paid, this does not give rise to a loan by the company to the trust for the purposes of Div 7A of the *Income Tax Assessment Act 1936* (Cth) (ITAA36) (*FCT v Bendel* [2025] FCAFC 15).

What was particularly in issue was whether the reference to "a provision of credit or any other form of financial accommodation" in para (b) of the Div 7A ITAA36 definition of "loan" was satisfied in the circumstances.

In a joint judgment, the Full Court said that, having regard to its context, para (b) was to be construed as referring to a provision of credit or any other form of financial accommodation which involves an obligation to repay an identifiable principal sum, rather than simply an obligation to pay. The creation of an obligation to pay an amount to a private company that does not result from a transfer of an amount from or at the direction of the private company is not a loan within the statutory definition of "loan" that applies for the purposes of Div 7A.

The effect of the Full Court's decision (which dismissed an appeal by the Commissioner from a decision of the AAT (*Bendel and FCT* [2024] AATA 3074)) is that the Commissioner's longstanding views and practice in relation to unpaid present entitlements in the context of Div 7A that has been expressed in public rulings (most recently in TD 2022/11) is not correct.

It is not as yet known whether the Commissioner will seek special leave to appeal to the High Court from the decision of the Full Federal Court.

The Full Federal Court's decision will be further considered in the April issue of the journal.

Foreign purchasers of land

In a joint media release on 16 February 2025, the Treasurer and the Minister for Housing announced that the government will ban foreign investors (including temporary residents and foreign-owned companies) from buying established homes for at least two years (1 April 2025 until 31 March 2027) and will crack down on land banking by foreign investors.

President's Report

by Tim Sandow, CTA

Supporting you in a changing environment

President Tim Sandow discusses the impact of an election year and how the Institute supports its members through change.

With an election approaching this year, it's important that we consider The Tax Institute's position and impact as our tax and political landscape shifts. This includes our advocacy work, and how we support our members through this time. While previous years' Federal Budgets have seen a lack of substantial policy change in the tax space, this year, with an election imminent as well, there may well be pressure for more change.

The Tax Institute has been vocal about the lack of tax reform and the vital need for change. Tax initiatives during the COVID-19 pandemic were perhaps some of the most substantial in recent memory, although they were highly targeted and don't constitute tax reform in any sense. Other measures in recent years are more akin to "tinkering" than to true reform.

Now, the question is what the upcoming election and the following Federal Budget – no matter who delivers it – could mean for the tax system. What sort of changes should we anticipate and how will they affect the work we do here at The Tax Institute and what our members do out in the world?

What an election may mean for the tax profession

Regardless of the outcome, an election year often gives rise to new thinking and new appetite for change. That may include adjustments to tax policy, big or small (although we aren't holding our breath for true reform).

The focus of our advocacy this election year is promoting the need for certainty for our members working within the tax system, and support for vulnerable parties susceptible to being impacted by potential changes to tax laws. As I outlined in my last report to you, there are a number of key areas where we will be advocating for better certainty in the tax system. The upcoming election makes this even more pertinent.

The importance of tax consultancy in a changing environment

Potential changes to tax policy mean that the role of tax advisers is more important than ever. Clients look to tax professionals to help them navigate changes to their individual and business tax obligations, and it is our responsibility to advise them with accuracy.

Our tax system remains more complex than it should be. So, while changes may not necessarily introduce further complexity, they must fit in with a system already covered in band-aids. This can make understanding their impact quickly and effectively a challenge.

As we head towards an election and the Federal Budget, the Institute has its eye on what changes to tax policy may occur and what they might mean for you and your clients. Our resources and the expertise of our Tax Policy & Advocacy team are dedicated to supporting you through change.

The changing role of technology

The increase in AI technology and digital innovation is no longer "new" and seems to be here to stay. We may see a push for technology that optimises operations in the industry, with the potential to introduce technology and systems that alleviate the workload of tax professionals, ultimately increasing efficiency and accuracy.

On balance, this is a good thing for most tax practitioners. It does necessitate staying up to date not only on tax technical topics, but also on a wider skillset including the use of these technologies, governance and conduct when using them and communicating new changes to clients.

The Institute's CPD events often include sessions on technology and its role for practitioners. I encourage you to keep an eye on events near you this year and to use them as an opportunity to brush up your skills and knowledge in this area.

Keeping our members informed

As we enter what is sure to be a period of change, The Tax Institute remains committed to ensuring that members are well-versed and updated on policy changes. I urge you to proactively reach out to Institute representatives with ideas, feedback and concerns about changes – both proposed and actual – in the coming months.

CEO's Report

by Scott Treatt, CTA

Learning and community in times of change

CEO Scott Treatt reflects on the role that education and community play in the success of the tax profession.

The Tax Institute is, first and foremost, a tax educator. As Tim has outlined in his report this month, in times of change – for example, an election year – our concern is with keeping our members up to date through both structured education and more self-driven learning opportunities.

Continued learning and education in tax is not just about shaping and growing your own career. The importance of tax education extends beyond our own career interests into the interests of our clients, their business and families, and indeed the wider economy. Learning about tax goes deeper than simply learning the theory and legislation – it's also about learning how to apply that knowledge in different circumstances and how to communicate it to others.

We believe in the importance of tax education because we understand that our members, as tax practitioners, require and deserve up-to-date, accessible resources. We pride ourselves on providing these resources to members and the wider tax profession. From our Tax Knowledge Exchange, which houses decades worth of tax thinking that demonstrates different applications of the tax law, to Tax Academy, which embraces a new way of learning specific skills as they're needed, we are continually focused on supporting you to grow your knowledge.

These, and our other resources, also help you meet your CPD hour requirements, and I encourage you to keep an eye out for free CPD provided to members throughout the year.

The importance of community

At the heart of the Institute is the fact that we are an organisation by members, for members. This member-driven ethos is vital to the kinds of resources and learning opportunities we can offer.

Our various networking events, where tax professionals of all levels can meet with their community and expand their knowledge, rely on the generous contributions of members, both as part of organising committees and as speakers. These events foster communication around tax industry issues, interdisciplinary collaboration, and professional development.

Our journals are filled with articles written by members of our community. Our Tax Knowledge Exchange is populated by the analysis and opinions of members. Our members are at the heart of our advocacy work, and their needs, concerns and opinions inform the resources we produce to assist and inform their fellow members.

We all benefit greatly from being part of this network of passionate, generous professionals.

Supporting you to grow and change

Regardless of the outcome of this year's election, tax policy will forever change and evolve. Our team of staff and volunteers are continually developing new tools, resources and approaches to deliver knowledge to members to assist them in this everchanging environment.

The Institute and its community of peers and volunteers are here to support you in changing and growing your career and your practice along with it.

Associate's Report

by Sumitha Krishnan, FTI

Parma and a pint: an FBT perspective

As the end of the current FBT year approaches, we explore the tax treatment of entertainment-related expenses, and what income tax deductions or GST credits may be available.

A "fringe benefit", as defined in the *Fringe Benefits Tax Assessment Act 1986* (Cth) (FBTAA), includes a benefit in relation to an employee or an associate of that employee, that is alternative or in addition to their salary and wages. That "benefit" includes the service or provision of a right, privilege or facility, which is to be provided in relation to the performance of work, a contract of insurance, or an arrangement to lend money.[1]

These benefits are then subject to FBT, which is an additional tax paid by employers on certain benefits provided throughout the FBT year. The FBT year runs from 1 April to 31 March, with FBT returns due and payable by 21 May, unless a tax agent lodges the return electronically, or an extension of time is accepted. Given that FBT is self-assessed, and the tax is calculated on the taxable value of the fringe benefit, it is important to consider the different categories of expenses incurred throughout the FBT year, and what this means for the impending FBT return.[2]

Different categories of fringe benefits may be provided to employees or their associates; some benefits are exempt, while others must be reported and are subject to FBT. Of the 13 different categories of fringe benefits, entertainment-related benefits continue to be one of the most confusing.

Entertainment-related expenses

Section 32-5 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) prevents a deduction for entertainment expenses. That is, unless those entertainment expenses are incurred in providing entertainment by way of a fringe benefit.[3] The FBTAA has adopted the definition of "entertainment" as provided in the ITAA97.[4] It is necessary to carefully consider the different circumstances surrounding the provision of entertainment, and have regard to the factors set out in TR 97/17 *Income Tax and fringe benefits tax: entertainment by way of food or drink*.[5]

The provision of "entertainment" means the provision of:

- entertainment by way of food, drink or recreation; or
- accommodation or travel in connection with, or to facilitate the provision of, such entertainment.

These expenses include recreation, such as amusement, sport and similar leisure-time pursuits. Some examples of the provision of entertainment include, but are not limited to:[6]

- business lunches and drinks, cocktail parties and staff social functions;
- providing entertainment to employees and clients by providing access to sporting or theatrical events, sightseeing tours, holidays and so on; and
- accommodation and travel when provided in connection with, or to facilitate, activities such as entertaining clients and employees over a weekend at a tourist resort, or providing them with a holiday.

Where entertainment expenses are incurred by a business, the question arises: are these an entertainment fringe benefit? There is no separate category of entertainment fringe benefits per se. However, the provision of entertainment may give rise to one or more different fringe benefits. Depending on the circumstances surrounding the entertainment, a fringe benefit may arise in the form of:

- a meal entertainment fringe benefit;
- an expense payment fringe benefit;
- a property fringe benefit; or
- a residual fringe benefit.

When self-assessing whether an expense is considered entertainment and therefore a fringe benefit, it is necessary to consider *why*, *what*, *when* and *where* food or drink is being provided. None of these factors alone will determine whether the provision is of entertainment. However, the *why* and *what* are considered more important factors.[7] Food or drink provided for the purposes of refreshment, such as morning tea, does not generally have the characteristics of entertainment. However, as its provision becomes more elaborate, such as a meal, it begins to enter the territory by which the ATO considers entertainment may be provided. This is especially the case where food or drink is provided in social settings, and the situation is considered more of a function than a refreshment provided by the employer.

Where expense payment fringe benefits, property fringe benefits, residual fringe benefits, or tax-exempt body fringe benefits arise from the provision of food or drink, employers can elect to classify these as meal entertainment fringe benefits. Where such an election is made under s 37AA FBTAA, all fringe benefits arising from the provision of meal entertainment during the relevant FBT year must be classified as meal entertainment fringe benefits. This election enables the employer to value the fringe benefits using special valuation rules, rather than the actual value, but only if the entertainment does not include recreation.

This distinction is important, as it impacts the exemptions that can be utilised thereafter for that FBT year. If an employer elects to value all meal entertainment benefits under one of the two methods provided in Div 9A FBTAA – being either the 50/50 split method or the 12-week register method – any food or drink provided throughout that FBT year must be dealt with according to those methods. If the employer does not make an election to treat the expense as a meal entertainment fringe benefit, the taxable value is determined according to the actual expenditure.[8] Employers should carefully consider the full implications of both the 50/50 split method and the 12-week register method of calculating the taxable value of meal entertainment fringe benefits as the employer may be better off determining the taxable value according to actual expenditure.

Practical application

There is no set rule for the FBT treatment of Christmas parties, as the circumstances vary greatly between employers.

If an employer chooses not to elect to classify food and drink-related entertainment as meal entertainment for the FBT year, the costs associated with the party are exempt from FBT if they are provided on a working day and on the business premises, and consumed only by current employees. If associates of those employees attend, a taxable fringe benefit will arise in respect of the expenses relating to those associates.

Additionally, where no election is made and the cost of a Christmas party is less than $300 per head, the minor benefits exemption applies, meaning no FBT is payable. This exemption cannot be applied where the employer elects to use 50/50 split method, but can apply where the employer elects to use the 12-week register method when calculating the registered percentage over the 12-week period.

Any other benefits associated with the Christmas party must also be considered. While the party may be exempt from FBT if the cost of hosting it is less than $300 per head, the cost of any gifts, such as hampers, wine or other, must be considered separately to determine if the minor benefits exemption can apply to these benefits. Considered separately, a gift to an employee costing less than $300, such as a bottle of wine, will be exempt under the minor benefits exemption.

Employers cannot claim GST credits or income tax deductions for benefits provided other than as a fringe benefit.

Conclusion

Given that the onus is on the employer to self-assess whether any fringe benefits were provided during the FBT year, it is paramount that employers understand the nuances pertaining to entertainment-related expenses.

Understanding these FBT complexities will be especially important if the Coalition's proposal to introduce a capped deduction of $20,000 for business-related meal and entertainment expenses for small businesses becomes law. As part of this proposal, alcohol would be excluded, and the cost of the meal and entertainment expenses up to the cap would be exempt from FBT. Many areas of the FBT regime would have to be considered, and clarity would be needed to better understand what this means from an apportionment perspective, particularly where alcohol is included in the cost of the meal – what would this mean for the "parma and a pint"?

References

1 S 136 FBTAA.

2 The standard due date for FBT returns is 21 May. However, where an agent lodges the FBT return electronically, the due date is generally 25 June. Agents must ensure that clients are on their list prior to 21 May to be eligible for the June lodgment and payment date.

3 S 32-20 ITAA97.

4 S 32-10 ITAA97 and s 136(1) FBTAA, respectively, provide definitions of "entertainment".

5 Specifically, para 7 of TR 97/17 lists the important factors for employers to consider.

6 TR 97/17.

7 Ibid.

8 Para 29 of TR 97/17.

Tax News – the details

by TaxCounsel Pty Ltd

February – what happened in tax?

The following points highlight important federal tax developments that occurred during February 2025.

Government initiatives

1. Amending legislation

An amending Bill (the Treasury Laws Amendment (Tax Incentives and Integrity) Bill 2024) that is currently before parliament contains amendments that are to give effect to several previously announced measures.

Deductions for interest charges

Amendments in the amending Bill are amending ss 25-5 and 26-5 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) to deny the income tax deductions for amounts of general interest charge (GIC) and shortfall interest charge (SIC) incurred by a taxpayer.

GIC and SIC are incurred where tax debts have not been paid on time, or a tax liability has been incorrectly self-assessed and resulted in a shortfall of tax paid, respectively. Both GIC and SIC are currently tax-deductible for all entities.

The amendments seek to reinforce the requirements imposed on all taxpayers to correctly self-assess their income tax liability, pay their tax on time, and assist in lowering the amount of collectable debt owed to the ATO.

These amendments are to apply to GIC and SIC incurred in income years commencing on or after 1 July 2025.

Retaining refunds: ATO notification period

The amending Bill is also amending the *Taxation Administration Act 1953* (Cth) to extend from 14 to 30 days the period within which the Commissioner must notify a taxpayer of his decision to retain a refund amount arising from a BAS or another notification under the BAS provisions for verification of information. The extension of this mandatory notification period aims to strengthen the ATO's ability to combat fraud during periods of increased risk of fraudulent activity.

These amendments are to apply to amounts due to be refunded on or after the first 1 July to occur after the day the amending Bill receives royal assent.

Luxury car tax

Amendments that are being made to the *A New Tax System (Luxury Car Tax) Act 1999* (Cth) will:

- update the definition of a "fuel-efficient car" by reducing the maximum fuel consumption for a car to be considered fuel-efficient for the purposes of luxury car tax (LCT) to 3.5 litres per 100 kilometres from the current 7 litres per 100 kilometres; and
- amend the index number used to index the LCT threshold from All Groups CPI to the motor vehicle purchase sub-group of the CPI.

The amendments seek to incentivise the take-up of fuel-efficient and electric vehicles and ensure that the concessional treatment of fuel-efficient cars is consistent with the Australian Government's National Electric Vehicle Strategy.

These amendments are to apply to taxable supplies and taxable importations of luxury cars on or after 1 July 2025.

The Commissioner's perspective

2. Areas of focus 2024–25

The ATO has released the key risk areas that it intends to focus on for private wealth in 2024–25.

The key areas of focus are based on the risks and issues identified through the ATO's intelligence collection, risk detection and analysis, and case work. While the ATO is focused on improving tax performance across all tax and superannuation compliance obligations for the privately owned wealthy groups population, the key areas are the foundational, emerging and evolving risks and targeted focus areas where the ATO is investing more resources. The following are some of issues identified by the ATO.

Incorrect reporting

Incorrect reporting risks and issues include:

- incomplete reporting of returns, activity statements and schedules (including information labels such as shareholder loans, assets and liabilities); and
- ineligible research and development (R&D) expenditure being claimed.

Tax advisers and professional firms

Risks and issues with tax advisers and professional firms include:

- inappropriate allocation of professional firm profits (PCG 2021/4); and
- intermediaries (including R&D consultants) encouraging aggressive tax arrangements or promoting tax avoidance or exploitation schemes.

Division 7A

Division 7A of the *Income Tax Assessment Act 1936* (Cth) (ITAA36) risks and issues include:

- inadequate record-keeping; and

- loan repayment arrangements that fall within s 109R ITAA36 (including loans repaid just before the private company's lodgment day with the intent to reborrow similar or larger amounts from the same company).

Capital gains tax

Capital gains tax risks and issues include:

- using the small business restructure roll-over (Subdiv 328-G ITAA97) incorrectly, including for reasons other than a genuine restructure of an ongoing business;
- capital losses from related-party transactions (market value substitution rule); and
- incorrect application of Div 855 ITAA97 (non-resident access to concessions).

Property and construction

Risks and issues related to property and construction include capital versus revenue misclassifications on disposals of real property.

International transactions

Risks and issues related to international transactions include:

- intangible migration arrangements;
- mischaracterisation of service transactions which results in mispricing and creates risk from a corporate residency and controlled foreign companies' perspective; and
- related-party financing (including concerns with the use of non-commercial terms to push up financing costs in the property and construction industry).

Other domestic transactions

Risks and issues related to other domestic transactions include:

- non-arm's length income in self-managed superannuation funds;
- misinterpretation or disregard for family trust elections;
- residents not including distributions from foreign trusts (s 99B ITAA36); and
- the 45-day holding rule (the franking credit integrity rules).

Incorrect reporting

Emerging or evolving risks and issues with incorrect reporting include incorrectly claiming GST credits on employee allowances.

CGT

Emerging or evolving risks and issues with CGT include:

- Div 149 ITAA97 (pre-CGT asset); and
- reduction in capital gains and losses arising from CGT events in relation to certain voting interests in active foreign companies (Subdiv 768-G ITAA97).

Other emerging areas

Other emerging or evolving risks and issues include:

- inappropriate use of private ancillary funds to hide wealth, offset CGT events, or extract other tax benefits by moving taxable income or assets through not-for-profit vehicles; and
- trust loss trafficking (inappropriate generation and use of losses).

It is of interest to note that the ATO Private Wealth Deputy Commissioner recently stated her priorities for 2025 as follows:

> "Succession planning, and the tax risks associated with it, is our number one focus in 2025. In recent years we've observed an increase in reorganisations that appear to be connected to succession planning.
>
> We're seeing that succession planning behaviour is primarily done by group heads who are approaching retirement. They typically own groups that family members are a part of, and wealth is transferred to the next generation to keep it within the family (via trusts and other means). Individual risks we're seeing in these arrangements include Division 7A loans being settled, assets moving around the group, family member interests being restructured, and trust deeds being amended. A significant concern is where the restructure is cited as a reason for late lodgment.
>
> Trusts will also continue to be a key focus area for us. In 2025, we'll be continuing to raise awareness about family trust distributions tax (FTDT) and how it applies to distributions made outside the family group."

Recent case decisions

3. Default assessments upheld

The Administrative Review Tribunal (ART) has rejected an individual taxpayer's challenge to default assessments (and penalty assessments) that were made by the Commissioner for the five income years 2016 to 2020 on the basis that unexplained deposits into a joint bank account that the taxpayer held with his wife were ordinary income assessable to the taxpayer (*Smith and FCT*[1]).

In July 2015, a company, Stacpoole Pastoral Holdings Pty Ltd (Stacpoole Pastoral), of which the taxpayer was a co-director (with his father) and a joint shareholder (with his wife and his father), purchased, with the assistance of funds borrowed from Westpac Bank, a cattle station in Western Australia (Wonganoo Station). Wonganoo Station was purchased as a "family cattle farm".

It seemed that things did not go well with the family cattle farm. In May 2021, Westpac agreed to forbear, until 31 October 2021, from taking action to recover moneys, pending the sale of Wonganoo Station and another property. On 10 May 2021, the taxpayer and his father entered into a deed with Westpac whereby they agreed that the net proceeds of any cattle sale would be reported to Westpac and paid towards reducing the moneys that Westpac had advanced to Stacpoole Pastoral.

On 7 December 2020, the Commissioner commenced a review of the taxpayer's income tax returns and, following an audit, formed the view that the taxpayer had failed to report all assessable income in his income tax returns for the income years in question.

Specifically, the Commissioner was concerned about recurring unexplained deposits comprising proceeds from cattle sales for Wonganoo Station, as well as other deposits into the joint bank account, which appeared not to have been reported by the taxpayer in his income tax returns. The Commissioner was concerned that these amounts had been used by the taxpayer for his personal expenses and had the character of income assessable to him.

The Commissioner issued a position paper to the taxpayer on 18 March 2022, setting out the audit process and advising him that the Commissioner had determined his assessable income using a "financial analysis methodology" involving "the examination principally of [your] bank account statements and bank transactions lists to identify deposits which are unexplained and have the characteristic of ordinary income". The Commissioner identified each of the deposits made to the joint account associated with Wonganoo Station and informed the taxpayer that he characterised these as ordinary income of his.

Due to the effluxion of time, the Commissioner could only amend the assessments for the 2016, 2017 and 2018 income years if there was fraud or evasion. In respect of these income years, the Commissioner made a tax evasion determination. The grounds for this determination included the following:

- the tax reported in the taxpayer's income tax returns bore no relationship to his private expenses and amounts withdrawn over the relevant tax period;
- the taxpayer used moneys from deposits for private expenses;
- the taxpayer exercised control over the accounts to which the deposits were made and would have been aware of the quantum of deposits received over the financial years, which he used personally;
- as director of Stacpoole Pastoral, the taxpayer used the joint account as a conduit to receive deposits and pay expenses for the company;
- the taxpayer's living expenses for the financial years exceeded his reportable income. A reasonable person would have suspected that not all of their income had been reported; and
- the quantum of unreported income was significant and occurred in five consecutive years.

Based on the above, the Commissioner formed the view that the taxpayer had committed a blameworthy act, namely, non-disclosure of income to the Commissioner, and that the taxpayer had engaged in avoidance of tax due to evasion.

The ART held that:

- it could not be satisfied that the taxpayer had demonstrated that the moneys from the business of Stacpoole Pastoral which were deposited into the joint account were not assessable to him because they were reported as assessable to Stacpoole Pastoral;
- in the circumstances, it could not be satisfied that the Commissioner had incorrectly treated all deposits made to the joint account as the taxpayer's income alone, even though the personal bank account where the deposits were made belonged to both the taxpayer and his wife;
- the taxpayer had also failed to establish what his correct income should be; and
- the taxpayer had not demonstrated that the Commissioner should not have formed the opinion that there had been evasion in the income years 2016 to 2018.

Accordingly, the ART affirmed the decisions under review.

4. TPB decision: stay order refused

The ART has refused to make a stay order in respect of a decision of the Tax Practitioners Board (TPB) which terminated the registration of a tax agent and imposed a four-year ban on the agent from applying for re-registration (*Kambourakis and Tax Practitioners Board*[2]).

The conduct of the applicant which gave rise to the decision of the TPB to cancel the applicant's registration comprised breaches of the Code of Professional Conduct (the Code) obligations to act honestly and with integrity and to comply with the tax laws in the conduct of the agent's personal affairs. These breaches satisfied the TPB that the applicant had ceased to be a "fit and proper person" as required by s 20-5(1)(a) of the *Tax Agent Services Act 2009* (Cth) (TASA).

More particularly, the applicant's conduct included:

- making false and misleading statements to the TPB in his continuing professional education log;
- failing to comply with the tax laws in the conduct of his personal affairs;
- failing to comply with the terms of a written undertaking given to the TPB in relation to ensuring compliance with payment arrangements that he had made with the ATO and keeping future lodgments up to date; and
- failing to comply with his personal tax obligations in respect of income tax account debts for over 12 years, and in respect of integrated client account debts for over 10 years.

In addition, when making its decision, the TPB noted that the applicant had previously been sanctioned by it in each of 2017 and 2020 in relation to his non-payment of outstanding tax debts.

The applicant applied to the ART for a review of the TPB's registration termination and banning decisions and also for a stay of the TPB's decisions pending the ART's determination of the review application.

In dismissing the applicant's stay order application, the ART said that the two key points which emerged from the applicant's history were, first, that there had been issues associated with the applicant's failure to comply with the TASA since 2010 and, second, that two previous sanctions imposed on the applicant by the TPB had not been successful in bringing the applicant into compliance with the Code.

The power to order a stay under s 32(2) of the *Administrative Review Tribunal Act 2024* (Cth) is only to be exercised for the purpose of securing the effectiveness of the hearing and determination of the application for review. It is the applicant who, for practical purposes, bears the onus of satisfying the tribunal that a stay is desirable for the requisite purpose, and the tribunal must have sufficient evidence before it to draw that conclusion.

While the ART accepted that the applicant would suffer financial loss as a result of the decision of the TPB being implemented and that that factor weighed in favour of the granting of a stay, the preponderance of relevant factors weighed against the granting of a stay. The ART was not persuaded on the material currently before it that the applicant's prospects of success were sufficiently strong that a stay ought to be granted or that the public interest weighed in favour of a stay order.

For another recent decision in which the ART refused a stay of a decision of the TPB that cancelled a tax agent's registration and imposed a ban on the agent from applying for reregistration for a period, see *Can Do Accounting Services Pty Ltd and Tax Practitioners Board*.[3]

5. Rectification of trust deed

The Tasmanian Supreme Court (Blow CJ) has recently made orders for the rectification of a family trust deed that failed to carry out the real intention of a settlor which was that a proposed transfer to the trustees of the trust would qualify for an intergenerational rural transfer stamp duty exemption (*Holloway v Commissioner of State Revenue*[4]).

More particularly, the trust was established to allow the plaintiffs (a Mr Holloway and his spouse), who were the trustees of the trust, to purchase farming land from the executor of the estate of Mr Holloway's great uncle, and for that purpose to qualify for the intergenerational rural transfer exemption provided for by s 225 of the *Duties Act 2001* (Tas).

The trust deed was drafted by a Launceston solicitor who was also the settlor of the trust. As a result of an error and oversight in drafting, the solicitor did not amend her firm's template discretionary trust deed so as to comply with the instructions of the plaintiffs. In particular, the trust deed, as executed, did not limit the beneficiaries of the trust to the two plaintiffs. Also, it did not restrict the powers to add beneficiaries so that only someone who was a relative of the transferor, according to the meaning of "relative" in s 225(3), could be added, and so that such a beneficiary could only be added by a deed of variation naming that beneficiary.

The Launceston solicitor did not realise that she had failed to comply with the plaintiffs' instructions. She signed the trust deed as settlor and provided the document to the plaintiffs who signed it believing that it had been drafted in accordance with their instructions. When the transfer of the property to the trustees was submitted for stamping, the State Revenue Office determined that the transaction was dutiable and assessed the duty in the sum of $269,685. The trustees brought proceedings for the rectification of the trust deed.

Blow CJ said that rectification is an equitable remedy that is available to reform documents where there has been a mistake that has caused the document not to operate as intended by the parties. It is available to reform documents but not to reform the bargain or arrangement between the parties. In this case, there was no bargain. The trustees contended that the trust deed did not express their intentions or the intentions of the settlor. His Honour said that there are some cases about trust deeds and rectification in situations where the trust deeds did not reflect the intentions of the parties that had been formed for the purpose of minimising or avoiding tax or duties. In this regard, Blow CJ referred to *Keadly Pty Ltd*[5] and *FCT v The Trustee for the Michael Hayes Family Trust*.[6]

Blow CJ said that, from these cases, the following propositions emerged:

- rectification is available where there is a mistaken expression of the true intention of the maker or makers of a document. In the case of a trust deed, the mistake must be on the part of the settlor;
- rectification is generally not available where the mistake is only as to the legal effect of the document. However, it is no bar to rectification that the rectification is sought to avoid stamp duty or that a fiscal benefit will result from the order;
- it is no bar to an order for rectification that the parties have previously entered into a deed of rectification in an attempt to record the true state of affairs;
- it is no bar to rectification that the mistake was due to negligence;
- what is required is convincing proof justifying the making of an order permitting the correction of a mistake in the relevant document; and
- an order for rectification takes effect retrospectively, so that the document is rectified with effect from the date of its making.

The evidence in the case was all one way. It was unchallenged, uncontradicted and constituted convincing proof that the trust deed did not reflect the intention of the settlor or the intention of the plaintiffs.

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2 [2025] ARTA 1.
3 [2025] ARTA 24.
4 [2024] TASSC 45.
5 [2015] SASC 124.
6 [2019] FCAFC 226 (and at first instance, *Trustee for the Michael Hayes Family Trust v FCT* [2019] FCA 426).

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Tax Tips

by TaxCounsel Pty Ltd

Tax disputes: onus of proof issues

A recent decision of the Full Federal Court considers issues that arise out of the onus a taxpayer has of establishing that an assessment is excessive.

Background

The recent unanimous decision of the Full Federal Court in *FCT v Liang*[1] provides useful guidance in relation to the operation of the statutory onus of proof that is imposed on a taxpayer on an appeal from or a review of the Commissioner's decision on an objection.

The case had its origin in a decision of the AAT[2] that was adverse to the taxpayers. This decision was subject to a successful appeal by the taxpayers to the Federal Court[3] (Logan J). The decision of Logan J has now been reversed by a unanimous Full Federal Court. The decision of the Full Federal Court is considered in this article.

The facts

In the *Liang* case, the taxpayers (who were referred to as Mr Chen and Ms Li) were a husband and wife who controlled various restaurant and takeaway businesses conducted by the trustees of two discretionary trusts (trading trust 1 and trading trust 2). The taxpayers also controlled the trustee of another discretionary trust (the property trust) which conducted property investment activities. The taxpayers were the beneficiaries of the three trusts.

In the 2017 and 2018 income years, deposits were made into the bank account of the property trust by Ms Li depositing sums of cash and one bank cheque totalling $735,825 (the deposits). The deposits were recorded in the general ledgers of the property trust for the 2017 and 2018 income years where they were described as either a "Loan from related party" or a "Beneficiary contribution". The property trust made a number of property acquisitions in these income years. In the 2017 and 2018 income years (the relevant income years), the property trust distributed income to Mr Chen and Ms Li as to 50% each. The property trust's income was rent from various investment properties.

The Commissioner issued amended assessments to each of the taxpayers for the relevant income years on the basis that the deposits were ordinary income and were to be included in the net income of the property trust. Pursuant to s 97 of the *Income Tax Assessment Act 1936* (Cth) (ITAA36), as beneficiaries presently entitled to a share of that net income, the taxpayers were assessed on their respective shares of those amounts by the issue of amended assessments. It was those amended assessments which were the subject of the litigation.

As indicated, that litigation has involved a review by the AAT, an appeal to the Federal Court, and a further appeal to the Full Federal Court.

The AAT decision

Before the AAT, the taxpayers' evidence was that the deposits were loans or equity contributions from their parents to the property trust. The AAT did not accept that evidence and was not satisfied that the deposits were cash provided by the taxpayers' parents. Having no explanation for the source of the deposits, the AAT concluded that the taxpayers had not discharged their burden of proving that the assessments were excessive.

Federal Court at first instance

The taxpayers appealed from the decision of the AAT to the Federal Court and the appeals were allowed by Logan J.

Logan J considered that the rejection of the taxpayers' evidence did not inexorably lead to a conclusion that the objection decision must be affirmed. Having rejected the taxpayers' evidence, the task remained for the AAT to consider whether, on the material before it, the objection decision, in light of the issues as refined and particular concessions made by the Commissioner, should be affirmed. In other words, although their evidence had been rejected, it remained possible for the taxpayers to discharge their onus on the basis of the remaining material before the AAT and "what was common ground".

Accepting that it was for the taxpayers to demonstrate that the deposits did not have the character of income under ordinary concepts in the hands of the trustee, Logan J said:

> "53. Given the way in which the parties had confined the issue, if that material admitted of, and only of, a conclusion that whatever the Deposits were, they were not ordinary income, the Tribunal was obliged to set aside the objection decision. And that was so even though the Tribunal had rejected the descriptions offered by [the taxpayers] as also reproduced in the books of account."

Logan J formed the view, based on the materials before the AAT and matters which his Honour considered were concessions, that the taxpayers had demonstrated that the deposits were not income under ordinary concepts because the deposits "were not income from services, were not interest, were not dividends, were not opportunistic profit-making gains" and "were not in the nature of rent in respect of the investment properties". Logan J considered that the material before the AAT ought to have inexorably led to a conclusion that "whatever these Deposits might be, they were not, in the hands of the [trustee], income" and to the extent necessary, made findings of fact under s 44(7) of the *Administrative Appeals Tribunal Act 1975* (Cth).

Full Federal Court

The Full Federal Court (Perram, Wheelahan and Hespe JJ) has now unanimously allowed the Commissioner's appeal from the decision of Logan J.

Concession issues

In a joint judgment, the Full Federal Court said that it had formed a different view to that of Logan J as to whether any concessions had been made by the Commissioner to the AAT, and as to the substance of any such concessions. The Full Court considered that no error had been shown in the AAT's conclusion that the taxpayers had not discharged their onus of demonstrating that the amended assessments issued to them were excessive.

The Full Court said that, before the AAT, the Commissioner confined the dispute to the issue of whether the deposits were ordinary income of the property trust. The Commissioner did not otherwise put the taxpayers to proof of the actual amount of their taxable incomes but accepted that the taxpayers would discharge their onus under s 14ZZK of the *Taxation Administration Act 1953* (Cth) (TAA) if they established that the deposits were not ordinary income in the hands of the trustee of the property trust.

The Full Court went on:

> "14. Critically, [Logan J] proceeded on the basis that it had been accepted in the Tribunal by the Commissioner that the activities of the Property Trust consisted *only* of property investment activities and that the only such property investment activities were those evidenced in the material before the Tribunal … It was on the basis of this 'concession' that [Logan J] concluded that the Deposits could not be ordinary income of the Property Trust because they were not income from services, interest, dividends, opportunistic profit-making gains or in the nature of rent."

Before the Full Court, the Commissioner denied conceding before the AAT that the only activity of the property trust was property investment. The Full Court said:

> "20. … it is clear that Counsel for the Commissioner maintained emphatically that the source of the cash for the Deposits remained a mystery, and that therefore in relation to those Deposits, the taxpayers had not discharged their onus of showing that they were not income.
>
> …
>
> 22. The Tribunal found that the taxpayers conducted property investment activities through the Property Trust … The Tribunal recorded … that the Property Trust's income was from rent from various investment properties in its recitation of the distributions of trust income made by the Property Trust. The Tribunal did not record in its reasons any concession by the Commissioner confining the activities of the Property Trust only to those activities and this Court was not referred to any reference in the transcript of the hearing before the Tribunal recording such a concession. The Commissioner's Amended Statement of Facts, Issues and Contentions before the Tribunal does not record any such concession but discloses that the Commissioner was not advancing a positive case as to the likely source (and therefore character) of the Deposits. The Commissioner's written submissions before the Tribunal do not record any such concession.
>
> 23. The heart of the Commissioner's case before the Tribunal was that the source of the Deposits was not known. The Commissioner did not know whether the Deposits related to any activities conducted by the trustee of the Property Trust because he did not know where the Deposits had come from. Because the Commissioner did not know the source of the Deposits, the Commissioner did not know how the Trustee came to be entitled to those Deposits. The Commissioner did not know the precise scope of the activities undertaken by the Property Trust and whether those activities were only limited to the conduct of a property investment business.
>
> 24. The Commissioner confined the issue in dispute to whether the Deposits were assessable. It is not disputed that the taxpayers bore the onus of proving that the amended assessments were excessive. The Commissioner put the taxpayers to proving that the Deposits did not represent amounts of ordinary income of the Property Trust. The premise of the Commissioner's case was that the material before the Tribunal was incomplete because it did not disclose the basis on which the Deposits had been made."

Discharge of onus issues

The Full Federal Court said that the issue in the case was not who bore the onus of proving that the assessments were excessive but how that burden might be discharged by a taxpayer. The Full Court said that both Logan J and the taxpayers placed much reliance on the following statement of Windeyer J in *Elsey v FCT*:[4]

> "13. The taxpayer has 'the burden of proving that the assessment is excessive' (s. 190 [ITAA36]). But, unless it appears that there were facts on which the Commissioner could properly rely for including a particular receipt of money as part of the taxpayer's assessable income, that burden is, I consider, discharged. I do not think the Act requires one to start with a presumption that all moneys which a taxpayer receives from any source form part of his assessable income."

It was said by the taxpayers that it followed from this statement that, unless the Commissioner could point to a basis for including the deposits as part of the net income of the property trust, the taxpayers would have discharged their burden of proof.

The Full Court then went on:

> "28. The statement quoted from *Elsey* consists of three sentences. The first is entirely uncontroversial and reflects part of s 14ZZK of the TAA. As [Logan J] recognised, the second sentence must be read in light

of the following statement expressed by Mason J in [*Gauci v FCT* [1975] HCA 54]:

> The Act does not place any onus on the Commissioner to show that the assessments were correctly made. Nor is there any statutory requirement that the assessments should be supported by evidence. The implication of such a requirement would be inconsistent with s 190(b) [ITAA36] for it is a consequence of that provision that unless the appellant shows by evidence that the assessment is incorrect, it will prevail."

The Full Court said that Logan J construed the second sentence in the quote from Windeyer J's judgment in *Elsey* in the following way:

> "29. … it seems to me that all that his Honour was intending to convey was that if there were a particular confined issue as to the basis for the assessment and the evidence before the Court disclosed that that basis did not exist, then the onus of proof would be discharged."

The Full Federal Court then said that this statement was to be construed having regard to the High Court's decision in *FCT v Dalco.*[5] In that case, the taxpayer had submitted that, if the basis of assessment was known and was shown to be incorrect, the taxpayer would have shown the assessment to be excessive. The taxpayer in that case had furnished returns, but the Commissioner was not satisfied with those returns and issued amended assessments. The taxpayer had shown that the bases on which the Commissioner had proceeded in making the assessments were wrong. The High Court nonetheless upheld the amended assessments because the taxpayer had failed to discharge the onus of proving that his taxable income was in truth less than the amount assessed.

The Full Federal Court said:

> "34. A distinction is to be drawn between showing an error where all material facts are known and showing an error where all material facts are not known."

In relation to the third sentence of the quoted passage from *Elsey*, the Full Federal Court said that Logan J considered it to be "unremarkable" but subject to the qualification that "the burden of proving that a receipt is not income under ordinary concepts always remains with the taxpayer". The third sentence was thus of no assistance. The Full Federal Court referred to the following observation of Walsh J in *Krew v FCT*[6] concerning an unexplained surplus of assets was equally applicable to a case of unexplained deposits:

> "35. … It was said that where there is a surplus of assets over those which would be explained by returned income, there is no presumption that surplus is income, or is assessable income. In a sense that is true: cf *Elsey v Commissioner of Taxation.* But, in my opinion, that is of no assistance in deciding the present case … [W]hen the [Commissioner] made assessments which included the betterment funds as assessable income and disallowed the appellant's objections, the matters were taken to the board of review and the onus was then on the appellant to show that the assessments were wrong."

It followed, the Full Federal Court said, that it was wrong "to say that as a matter of law the appellant must succeed if the [Commissioner] has not proved affirmatively that the disputed receipts were taxable income because (as was submitted) there was no presumption that they were".

The Full Federal Court pointed out that *Elsey* was a case in which both the source of the moneys and the activities of the taxpayer were known. Unlike the present case, the issue for determination in *Elsey* was the purpose of the taxpayer in acquiring the land and in carrying out the transactions in fact carried out. In those circumstances, the relevant objective facts were known.

Their Honours said that the circumstances of the present case were a long way from those considered in *Elsey*. Here, the Commissioner assessed the taxpayers on the basis that the deposits were ordinary income of the trustee of the property trust and confined the case before the tribunal to that issue. This was not a case in which the transaction giving rise to the property trust's entitlement to the deposits was known. In these circumstances, it was for the taxpayers to disprove the basis of that assessment by establishing the relevant facts. It was not for the Commissioner to posit or prove a basis from which it might be inferred that the deposits were income but for the taxpayers to place the relevant facts before the tribunal.

The Full Federal Court went on:

> "43. As a general rule, a taxpayer proves an amount is not assessable as income under ordinary concepts by proving what the amount represents and demonstrating that what the amount represents is not ordinary income. It would be a very rare instance where a taxpayer was able to prove an amount was not income under ordinary concepts without positively establishing the source and character of the amount. As a matter of logic, it is difficult to prove a negative by proving a series of other negatives unless those other negatives represent the entire universe of possibilities."

The Full Court pointed out that it is well-established that "[i]n considering whether a profit arising from a transaction is of an income or capital nature, it is necessary to make both a wide survey and an exact scrutiny of the taxpayer's activities" (*Western Gold Mines NL v FCT*[7]). The application of that principle requires the identification of the transaction giving rise to the profit or receipt and an understanding of the relationship or connection between that transaction and the taxpayer's activities. However, the material before the tribunal did not enable the wide survey and exact scrutiny of the activities of the property trust. Absent a concession from the Commissioner that the property trust conducted no activity beyond the acquisition of property and the leasing of those properties, the material before the tribunal could not support findings of the precise scope and nature of the activities of that trust. The Full Federal Court was not satisfied that the Commissioner made such a concession before the tribunal.

On the evidence that was accepted by the tribunal, the taxpayers had not established the source of the deposits beyond establishing that Ms Li was the individual who physically deposited the cash into the property trust's bank account. The basis for the deposits and the legal nature of the transaction by which the property trust became entitled to receive the deposits were not explained.

Accordingly, the tribunal had not erred in law in concluding that the taxpayers in this case had not discharged the onus of proving that the deposits were not ordinary income of the property trust.

Observations

It is not as yet known whether the taxpayers in the *Liang* case will seek special leave to appeal from the decision of the Full Federal Court to the High Court. It is considered, however, that the decision of the Full Federal Court is correct.

Clearly, where it is at all likely that a question may arise as to the nature of an amount that is received (for example, as in the *Liang* case, whether the amount is or is not assessable income), steps must be taken by the taxpayer's advisers to ensure that the relevant facts are established.

The absence of the facts relating to an amount received by a taxpayer that is not returned as assessable income may have further consequences. For example, the Commissioner may (as in the *Liang* case) impose administrative penalties (50% for recklessness in the *Liang* case).

Additionally, it is suggested that, in some circumstances, potentially significant issues may arise for the taxpayer's tax agent when preparing an income tax return and the agent does not establish the facts and the particular amount is not returned as assessable income. For example, there may be an issue as to whether the tax agent has been negligent.

Further, and importantly, there may be an issue as to whether there has been a breach by the tax agent of the Code of Professional Conduct (the Code) that applies to tax agents under the *Tax Agent Services Act 2009* (Cth). In the context of the Code, reference may be made, for example, to the Code obligations relating to ensuring that a tax agent service is provided competently and to taking reasonable care in ascertaining a client's state of affairs, to the extent that ascertaining the state of those affairs is relevant to a statement that the agent is making or a thing that the agent is doing on behalf of the client.

Also, if a concession is being made by the Commissioner and the concession is to be relied on, the specific terms of the concession must be spelled out.

A final point. It is encouraging that the extensive jurisprudence that developed from the former s 26(a) ITAA36 is still of current relevance!

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References

1 [2025] FCAFC 4.

2 *CVMW and FCT* [2023] AATA 4039.

3 *Liang v FCT* [2024] FCA 535.

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Mid Market Focus

by Josh Chye, ATI, and Monika Lam, CTA, HLB Mann Judd

Marriage or relationship breakdowns: key tax issues

Given the emotional consequences arising when there is a relationship breakdown, appropriate tax planning is often overlooked. This article summarises the key tax issues to consider when dealing with family property settlements.

Introduction

When dealing with family property settlements, it is important that tax practitioners work together with family lawyers to ensure that relevant tax implications, both realised and unrealised, are considered and accounted for so that the after-tax outcome of the settlements for both parties are in line with what is intended as agreed or decided by the court.

Each asset in the pool of assets to be divided among the separating couple will carry its own tax history, ownership structure and resulting tax implications, both at the time of the settlement and in the future when held by the transferee spouse until the time the asset is sold. This article explores the capital gains and income tax implications of the common asset types for division among separating couples and any available roll-over or tax exemptions to consider.

Family home

Due to the widely known main residence exemption and the CGT relationship breakdown roll-over under Subdiv 126-A of the *Income Tax Assessment Act 1997* (Cth) (ITAA97) that will automatically apply when property is transferred to the other spouse under a court order, unrealised CGT implications on the transfer of family homes are often overlooked.

However, considering the complexity of the main residence exemption rules, the potential traps affecting eligibility and the different ownership structures that a family home can be held under, the CGT implications to the transferee spouse could be significant. For example, the CGT implications on the sale of a family home that is originally held under individual names can be significantly different from a family home that is previously held under a company or trust structure (as illustrated below).

Example

Bob bought a property on 21 January 2010 to live in as his main residence for $500,000. He married Deb in 2012 and the property became their family home until their separation on 15 July 2020 when Bob moved out while Deb continued to live in the property as her main residence. During this time, Bob lived in another property that he owned.

In accordance with the Family Court order, Bob transferred the property to Deb's name on 15 February 2022. Deb continued to live in the property as her main residence until she sold it on 30 November 2023 for $1m.

What are the CGT implications for Bob and Deb when the property ownership changed on 15 February 2022 and 30 November 2023, respectively?

For Bob, there was no CGT consequence on the transfer of the property to Deb on 15 February 2022, regardless of whether Bob acquired the property in his personal name or a trust structure due to the CGT relationship breakdown roll-over that automatically applied.[1] However, Bob's ownership structure of the property would make a significant difference to Deb's CGT liability when she sold it.

Scenario 1: Bob acquired the property under his personal name

In this scenario, Deb inherited Bob's cost base and historical use of the property.[2] She is taken to have acquired the property on 21 January 2010 for $500,000 and used the property as her main residence until 15 July 2020.

The main residence exemption can also apply during their separation period of 15 July 2020 to 15 February 2022, provided Bob has made a choice to continue to treat the property as his main residence during the separation period and has not made a choice to make another dwelling his main residence during the period.[3]

As a result, the full main residence exemption can potentially apply when Deb sold the property on 30 November 2023.

Scenario 2: Bob acquired the property under a trust structure

In contrast to scenario 1, in this case, Deb will not be able to claim the main residence exemption during the period when the family home was owned by the trust, despite any other provision that would otherwise allow the property to be treated as her main residence.[4]

Consequently, Deb is only eligible to a partial main residence exemption for her ownership period after the property was transferred to her and used as her main residence (ie 653 days out of a total of 5,061 ownership days from 21 January 2010), resulting in a $217,744 net capital gain after taking into account the partial main residence exemption portion of 12.9% (ie 653/5,061 days) and the 50% CGT discount.

The tax implication for Deb could be up to $102,339 in scenario 2 if Deb is on the top marginal tax rate, which makes proper tax consideration at the time of the division of assets process desirable.

Investment assets

Similar to the family home, passive investment assets such as rental property, shares or units can be transferred to a spouse pursuant to a Family Court order as a result of a relationship breakdown, with no CGT implications for the transferor spouse due to the application of the CGT relationship breakdown roll-over.[5] However, in some circumstances, it may be preferable to trigger CGT instead to ensure that the assets are held under an appropriate structure for the transferee spouse, as well as getting the cost base uplift to market value at the time of the transfers.

For example, in instances when the transferee spouse is already in the highest marginal tax bracket or exposed to higher litigation risk, holding investment assets under a discretionary trust may be more appropriate despite triggering a CGT liability for the transferor spouse. In this case, a tax practitioner can assist in estimating the CGT liability for the transferor spouse and the potential future tax savings for the transferee spouse if the investment assets are held under a different structure that is to be considered as part of the family property settlement negotiation process.

In addition, should the CGT relationship breakdown roll-over apply, any unrealised CGT liability for the transferee spouse should be considered, especially where there has been significant appreciation in value since the assets were acquired as the transferee spouse will inherit the transferor's cost base as a result of the roll-over.[6] In some cases, where a sale of assets is expected or likely to occur, provision for unrealised CGT may be taken into account in the family property settlement valuation.[7]

Family businesses

Family businesses can be carried on using a few different structures (as discussed below). Depending on the size, complexity and structure of the business, the potential tax implications to consider can be complex and vary widely. Some common tax issues that may arise in family property settlements involving a family business are discussed below.

Discretionary trust structure

A discretionary trust structure is commonly used for family business in Australia due to the flexibility of income distribution among family members and the asset protection that it offers. When a discretionary trust structure is used, a family trust election is at times required to be made to enable the trust to recoup prior years' revenue tax losses[8] or pass the "qualified person" test[9] to access franking credits on the franked distributions that it receives.

When dealing with family property settlements involving a family business in a discretionary trust structure, the following key tax issues should be considered:

- the implications of the family trust election and any interposed entity election previously made and whether any variation or revocation is appropriate. If required, the family trust election can be varied and a new specified individual nominated if, under a Family Court order due to a relationship breakdown, the new individual or a group comprising the new individual and members of the new individual's family, have control of the trust;[10]
- if the roles of the leaving spouse in the trust remain after divorce (eg as a beneficiary, an appointor or a guardian) and any trust resettlement risk that may result from any required variation made to the trust deed; and
- any unpaid present entitlements owing to the leaving spouse or their entities, as well as any Div 7A ITAA36 implications that may arise.

Company structure

Another common structure used in a family business group is the company structure, both as the trading entity and a corporate beneficiary of a discretionary trust (ie a bucket company).

Common key tax issues associated with the company structure to consider include:

- any Div 7A implications on loans or debt forgiveness, payments or the transfer of assets to a spouse. It is worth noting that any deemed dividend arising due to family law obligations may be franked under s 109RC ITAA36;
- top-up tax on dividend payments when cash or assets need to be extracted from the company. Depending on the circumstances, provision for tax on dividends to meet family law obligations may be considered by the court in the family property settlement valuation;[11] and
- the ability to recoup prior years' company tax losses if the family property settlement results in the continuity of ownership test being failed, in which case, the business continuity test would then need to be passed to access any prior years' tax losses.[12]

Restructure

In some cases, it may be preferable to restructure the family business to a new structure that is more appropriate following a divorce, especially where tax concessions or exemptions, such as the small business CGT concessions, are available. Depending on each client's circumstances, a restructure may give a better tax outcome and allow for a more suitable structure to meet current and future business needs.

Superannuation benefits in SMSFs

Some separating couples may have their own self-managed superannuation funds (SMSFs) that present unique challenges in a family property settlement, especially when the SMSFs invest mainly in illiquid assets, such as properties. In this case, the following relief provisions may be helpful:

- CGT roll-over relief for the transfer of assets between SMSFs (eg in specie roll-over of a superannuation benefit) as a result of a Family Court order or a superannuation agreement as part of a binding financial agreement under s 126-140 ITAA97. This CGT roll-over applies automatically, provided all conditions are met. As a result of the roll-over, the transferee SMSF will inherit the transferor's cost base of the assets and any CGT resulting from the transfer is disregarded; and
- s 66(2B) of the *Superannuation Industry (Supervision) Act 1993* (Cth) provides relief for an acquisition by an SMSF of assets that would otherwise be prohibited (eg residential property or units in an unlisted unit trust) due to relationship breakdown.

Motor vehicles

Motor vehicles, such as cars and motorcycles, are not subject to CGT.[13] However, depending on the ownership structure and business use of the vehicles, there may be income tax, FBT and GST consequences to consider.

For example, while the transfer of a car owned individually for private use to a spouse may not have any tax implications, the transfer of a company car to its shareholder or associate will potentially give rise to GST and income tax implications, such as a balancing adjustment event or a Div 7A issue.

Personal use assets

In general, a personal use asset is any CGT asset, apart from collectables, that is used or kept mainly for one's personal use or enjoyment, such as boats, white goods and household items.[14] Land, a stratum unit or a building taken to be a separate CGT asset under Subdiv 108-D ITAA97 are specifically excluded.[15]

While these assets are unlikely to appreciate in value, family property settlements involving personal use assets costing more than $10,000 can potentially be subject to CGT, should there be market value appreciation. However, the CGT relationship breakdown roll-over will automatically apply when personal use assets are transferred to the other spouse under a court order.[16]

Transfers of personal use assets costing less than $10,000 will have no CGT consequences as any capital gain or capital loss arising from the transfer of the assets would be disregarded.[17]

Collectables

Unlike other personal use assets, collectables are more likely to gain in value.

Collectables are personal use assets in the form of any of the following assets (or an interest in any of the following assets):

- artwork, jewellery, an antique or a coin or medallion;
- a rare folio, manuscript or book; or
- a postage stamp or first day cover.[18]

Family property settlements involving collectables costing more than $500 (or with a market value of over $500 for an interest in collectables at the time of acquisition) will potentially be subject to CGT. As is the case with personal use assets, CGT roll-over under Subdiv 126-A ITAA97 will apply when they are transferred to the other spouse under a court order.

Transfers of collectables costing less than $500 (or an interest in collectables with a market value of $500 or less when acquired) will have no CGT consequences as any capital gain or capital loss arising from the transfer of the assets would be disregarded.[19]

Other tax planning considerations

The following are other tax planning considerations when dealing with family property settlements.

Pre-CGT assets

When dealing with pre-CGT assets, preserving the pre-CGT status is often desirable. It is important to note that the CGT relationship breakdown roll-over is valuable in this case. For example, if a transferee spouse is allocated the shares in a company that owns a pre-CGT property, it may be preferable to the transferee spouse to have them transferred to their individual name instead of their trust. It will then trigger the CGT relationship breakdown roll-over to apply, which results in the pre-CGT status of the property being preserved.[20] Without the CGT relationship breakdown roll-over, the property may otherwise be taken to be post-CGT assets under Div 149 ITAA97.

Small business CGT concessions

Another vital consideration in deciding whether to trigger the CGT relationship breakdown roll-over is the transferee spouse's eligibility to access the small business CGT concessions after the transfer. If the transferee spouse receives an asset under the CGT relationship breakdown roll-over, they can make a choice under s 152-45(2) ITAA97 to inherit the transferor spouse's acquisition date to assist in satisfying the active asset test,[21] the 15-year ownership period and significant individual test[22] that could be useful in accessing the small business CGT concessions.

Satisfying conditions for CGT relationship breakdown roll-over

If the roll-over is intended to apply, it is essential to make sure that all of the steps and requirements as outlined in Subdiv 126-A ITAA97 and as per the court order are satisfied. For example, assets transferred to a related entity that was not identified in the court order and settlement agreements may cause the roll-over provisions to be ineffective.

Record-keeping and documentation

When the CGT relationship breakdown roll-over applies, it is also necessary to ensure that historical data, records regarding prior use by the transferor spouse, and other relevant documentation about the assets are kept for future reference. For example, the purchase contract and documentation about prior use of the main residence by the transferor spouse will be required when calculating any CGT liability when the transferee spouse eventually sells the property. In addition, any choice made by the transferor spouse during an absence period would also need to be agreed and documented.

Review of family group structure

Relationship breakdowns often provide an opportunity to review whether the current family group structure is still appropriate or whether it should be started afresh. Any carried forward tax losses in the group will also need to be considered as part of the process as the potential tax saving would likely be valuable. Planning for a more appropriate group structure as part of the family property settlement will ensure that allocated assets are held in a tax-efficient structure that serves the long-term objectives of the former spouses.

Duty exemption

Duty can be a significant transaction cost that may apply to the transfer of properties (eg in Victoria, the rate is 6.5% for real estate valued at over $2m). However, a duty exemption may be available for property transfers occurring due to the breakdown of a marriage or domestic relationship (eg in Victoria, see the duty exemption under s 44 of the *Duties Act 2000*).

Child maintenance trust

A child maintenance trust (CMT) can be set up to provide support or satisfy child maintenance obligations as a result of a relationship breakdown.

While income distribution to children is not exempt from income tax under s 51-50 ITAA97 as a maintenance payment, income derived by a CMT is considered as "excepted trust income" under s 102AG ITAA36 and consequently taxed at normal individual rates to the trustee or child beneficiaries.

A CMT can therefore provide a tax-effective structure for a high-income spouse with child maintenance obligations if it is structured properly with each child's beneficiary having an absolute vested interest in the property from the inception of the trust. However, proper planning is recommended as property transferred to a CMT is considered "vested" to the child. That is, the child will obtain possession of the property on vesting of the trust and it will be paid to the estate of the child should the child die before the trust ends according to TR 98/4.

Conclusion

Given the complexity and significance of the potential tax implications in family property settlements, proper tax planning is recommended to ensure that both realised and unrealised tax consequences are considered and quantified where practicable so that both parties are well-informed of their respective after-tax position following the settlements. In addition, proper tax planning also provides an opportunity to review the suitability of the current structure given the changes arising from a relationship breakdown to ensure that a more appropriate structure is used for the future. Tax practitioners should therefore work together with family lawyers to achieve the best outcome for the clients.

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Higher Education

Paving the path to a manager's success

The dux of CommLaw1 Australian Legal Systems in Study Period 2 2024 showcases how problem-solving and time management skills help accelerate your path to success.

Ron Bao
Manager
Wis Australia, Sydney

Excelling as a manager after only seven years in the tax industry is an impressive feat. What's even more impressive is that Ron Bao maintained his performance as manager of a business and tax team while also achieving dux of CommLaw1 last year.

Ron has a diverse set of skills up his sleeve, having worked in business services and advisory/transaction roles. He boasts an impressive résumé, with a clientele spanning real estate, energy, automotive and e-commerce, to name a few, and he holds a Chartered Tax Adviser designation, CAANZ membership and a Master of Professional Accounting. We wanted to find out more about Ron's developing tax career.

Ron's decision to work in tax

Ron's decision to get into the tax industry came about because of his analytical and problem-solving nature and his keen interest in business operations. "I relish the challenge of interpreting complex regulations and developing strategic solutions that deliver tangible value to clients," Ron told us.

Ron is undoubtedly passionate about his work in tax and we asked him what most he loved about what he does. "The most rewarding aspect is assisting clients in navigating complex tax challenges while ensuring full compliance," he said.

The choice to study CommLaw1

We are always interested to hear what our students have to say about our subjects. Ron said he knew that CommLaw1 would deepen his expertise in tax and align with his career goals. He recognised the course as a valuable deep dive into the Australian legal environment and a key step to becoming a registered tax agent.

"The most interesting part was the practical application of theoretical tax principles in real-world scenarios. The course provided extensive exposure to the evolving Australian legal system, particularly in commercial contract law, through detailed case studies and engaging introductory webinars on key topics," Ron said.

What specific skills or knowledge did you gain undertaking the CommLaw1 subject?

"This subject has improved my problem-solving abilities and developed a robust understanding of current tax laws, including aspects of tort law, contractual remedies, and the Australian legal system and processes," Ron said. "The insights I gained from studying contracts in Australian commercial law have been instrumental in analysing and understanding key provisions within clients' SPA agreements. This has enabled me to evaluate their overall positions from both a tax and a legal perspective."

Ron's advice to tax professionals considering further study

It's no secret that Ron has accomplished a lot in his seven years working in the tax industry. So, what's his advice for other tax professionals considering further study? "I recommend embracing continuous learning and staying curious. Apply new knowledge directly to your work, remain open to innovative approaches (eg AI's power), and continuously seek professional growth in this ever-evolving field. The subjects offered by The Tax Institute Higher Education are an excellent choice."

Ron will also be embracing industry seminars and workshops to stay up-to-date.

Want to take the next step in your career? Learn more here.

Member Spotlight

A career journey with purpose and passion

Belinda Piffl
LBK Advisory

Belinda Piffl's contributions to accounting have earned her national recognition as a finalist for Principal of the Year in the Women in Finance Awards not once, but four times. "To be acknowledged nationally from a small practice in Adelaide is a huge honour," Belinda reflects, humbled by the recognition.

In this article, we sat down with Belinda to understand her career journey and learn how she got to where she is today.

From audit to practice co-owner

Belinda's career started back in 2001 in audit, where she got a solid grounding in the accounting world. "I enjoyed the exposure to different facets of accounting," she says, but it wasn't until a secondment overseas that she realised tax was where her real interest lay.

After returning to Australia in 2005, she moved into commerce as a financial accountant for a global mining company. This role saw her working closely with tax professionals across the Asia Pacific and even teaching staff in New Zealand, China, Laos and Thailand about tax compliance.

A stint in London followed, where she managed a diverse team in housing management before eventually returning home to Adelaide and rejoining the mining sector. But it was after starting a family and moving back into public practice that Belinda's career really took a pivotal turn. In 2018, following the sudden passing of her firm's principal, she and her co-director, Linda Ciampa, stepped up to lead the practice. "It was a steep learning curve, but we've grown the practice into a successful business over the past seven years," she says proudly.

Balancing motherhood and career growth

After stepping back from full-time work to raise her two children, Belinda returned to work part-time and in 2017 joined a small taxation practice – a move that came with its own challenges, especially catching up on changes in tax legislation. To rebuild her confidence, she completed a foundational subject with The Tax Institute, which she describes as "a crucial refresher that gave me the confidence to step back in".

Passion for education and clients

Belinda's love for her work goes beyond tax returns. "I enjoy educating clients about their responsibilities and helping them feel confident in their financial decisions," she explains. Whether it's guiding new business owners, simplifying tax concepts, or advocating for clients with the ATO, she thrives on making tax less intimidating.

She has also developed a strong interest in SMSFs. "A lot of clients misunderstand SMSFs," she says. "I enjoy helping them to navigate the complexities of the superannuation legislation."

Running a small practice in today's economic climate has had its challenges. Rising costs and the broader cost-of-living pressures have made balancing service fees with client affordability tricky. "Clients value what we do, but we've had to be mindful of their financial pressures," Belinda shares. Finding that balance while maintaining high service standards has been key to the practice's success.

Achievements and recognition

Belinda's professional milestones reflect her dedication. Becoming a registered tax agent was a proud achievement, especially later in her career. She also credits The Tax Institute for supporting her growth, particularly through education programs and timely updates during the COVID era.

Her industry contributions haven't gone unnoticed. Along with her multiple Principal of the Year nominations, her recognition as a Director of the Year finalist in 2024 highlights her impact in the field.

Inspiring the next generation

Belinda is passionate about encouraging more people to consider a career in tax. Her advice to those starting out? "Keep learning, be adaptable, and make the most of memberships like The Tax Institute. Their advocacy and resources are invaluable."

Belinda's journey is a testament to her genuine passion for helping others. Whether mentoring her team, supporting her clients, or steering her practice, she continues to lead with heart – showing what's possible when you combine purpose with passion.

Division 7A: some things you may not know

by Todd Want, CTA, Partner, William Buck

This article considers some of the subtleties within Div 7A of the *Income Tax Assessment Act 1936* (Cth) (ITAA36). Division 7A is an area of the tax law that private clients and practitioners in the private client space will generally have an awareness of. In particular, the core concept that loans, payments and forgiveness from a private company to a shareholder or their associate can have adverse tax implications if not appropriately managed. However, issues such as the application of ss 109R and 109T ITAA36, the question of whether Div 7A or FBT has priority, and whether a deemed dividend is actually such a bad thing are all important and can have a material impact on the tax outcomes that arise for the particular situation.

Introduction

Division 7A of the *Income Tax Assessment Act 1936* (Cth) (ITAA36) is a bugbear of many practitioners and clients, putting a layer of additional tax considerations around flows of funds and assets within a private group. While the Division is designed to treat particular amounts as assessable income of shareholders or their associates, most practitioners try to manage their clients' Div 7A obligations as simply and efficiently as possible. Although this is generally a sensible objective, it can run the risk of oversimplifying the provisions to such an extent that many of the subtleties are inadvertently overlooked, leading to a range of potentially adverse tax outcomes. This article looks at some of these subtleties and how to manage them.

When is a repayment not a "repayment"?

Section 109R

Section 109R ITAA36 is an anti-avoidance provision within Div 7A, designed to ensure that only certain repayments are treated as repayments for Div 7A purposes. Essentially, the provision is designed to prevent many situations where there has been a further borrowing from the company to repay the loan, or an intention to borrow again from the company after the repayment has been made.

While such an anti-avoidance measure may seem reasonable to ensure the credibility of Div 7A, the subtleties of the provisions, and the unintended consequences, are crucial to understand.

Which parts of Div 7A does s 109R apply to?

Section 109R applies for particular payment purposes in respect of loans and minimum repayments, and treats the repayment as though it wasn't made:

> "(1) This section provides for some payments to a private company in relation to a loan the private company made to an entity not to be taken into account for the purpose of working out:
>
> (a) how much of the loan has been repaid for the purposes of sections 109D and 109E (which treat amounts of loans that have not been repaid as dividends); or
>
> (b) the minimum yearly repayment for the loan under subsection 109E(5)."

When are repayments not taken into account?

While s 109R can apply in respect of loans and repayments, it only applies in particular circumstances:

> "(2) A payment must not be taken into account if:
>
> (a) a reasonable person would conclude (having regard to all the circumstances) that, when the payment was made, the entity intended to obtain a loan or loans from the private company of a total amount similar to, or larger than, the payment; or
>
> (b) both of the following subparagraphs apply:
>
> (i) the entity obtained, before the payment was made, a loan or loans from the private company of a total amount similar to, or larger than, the amount of the payment;
>
> (ii) a reasonable person would conclude (having regard to all the circumstances) that the entity obtained the loan or loans in order to make the payment."

There are a number of aspects within s 109(2) which are relevant to consider in order to determine if a repayment will not be taken into account for the s 109D and s 109E ITAA36 purposes noted above, being:

- the amount of the loan(s);
- intention;
- all the circumstances;
- reasonable person; and
- subtleties of whether the loan(s) is made before or after the repayment.

The amount of the loan(s). For s 109R to apply, the amount of the "new" loan taken out needs to be similar to, or larger than, the repayment. Hence, if the additional loan is considerably smaller than the repayment amount, it should not trigger the application of s 109R.

Intention. Where a "new" loan is taken out after the repayment has been made, s 109R can only apply where there was an intention at the time the repayment was made that such "new" loan (of a similar or larger amount than the repayment) would be taken out. If there is no intention at that time, this requirement will not be met and hence s 109R should not apply.

Where a "new" loan is taken out prior to the repayment being made, it is necessary for a reasonable person (discussed below) to conclude that the entity obtained the loan(s) in order to make the repayment. Absent this link between the "new" loan and the repayment, s 109R should not apply.

All the circumstances. A core part of the s 109R analysis is that regard needs to be had to all the circumstances. This implies a wider-reaching consideration of the situation than merely the particular loan or repayment in isolation.

Reasonable person. A core aspect of s 109R is the "reasonable person" test. This requires the conclusions within s 109R(2) to be made through the eyes of a "reasonable person". When combined with the intention aspect mentioned above, it is clear that s 109R(2) is only intended to be applied in particular circumstances, not merely every time there is a loan made by the company in a subsequent year.

Subtleties of whether the loan(s) is made before or after the repayment. As noted above, the intent of s 109R remains consistent irrespective of whether the "new" loan(s) is drawn down before or after the repayment. However, the subtleties of the wording of the provisions do vary slightly depending on whether the loan is drawn down before or after the repayment.

Exclusions from s 109R(2)

Offsetting. Certain situations where there is an offsetting of amounts against a loan are specifically excluded from having s 109R apply to them (ie there is an exclusion to s 109R(2)):

"(3) Subsection (2) does not apply to a payment made by setting off against an amount payable in relation to the loan:

(a) a dividend payable by the private company to the entity; or

(b) work and income support related withholding payments and benefits payable by the private company to the entity; or

(ba) payments covered by section 12-55 in Schedule 1 to the *Taxation Administration Act 1953*; or

(c) if the entity has transferred property to the private company—an amount equalling the difference between:

(i) the amount that a party at arm's length from the entity would have paid for the transfer of the property to the party; and

(ii) the amount that the private company has already paid the entity (by way of set-off or otherwise) for the transfer."

Hence, a borrower who is making the repayment by offsetting their dividend or salary (an amount subject to PAYGW) from the company against their loan from the company can do so without the potential application of s 109R. However, as noted below, beware of whose dividend, salary or loan it is.

Assessable payment made by another. In certain circumstances, a specific exclusion from s 109R applies to situations where another party has made the repayment on behalf of the borrower:

"(4) Nor does subsection (2) apply to a payment made on behalf of the entity (the borrower) by another entity paying to the private company an amount that:

(a) is payable by the other entity to the borrower; and

(b) is assessable income of the borrower for the year of income in which the payment was made or an earlier year of income."

This exclusion in s 109R(4) is relatively narrow, given that para (b) requires the amount to be, or to have been, assessable income of the borrower during that year or an earlier income year. A mere use of someone else's credit loan balance would generally not be expected to meet this requirement.

Switching from 7 to 25-year loans. In some instances, a Div 7A loan may be refinanced from a 7-year loan to a 25-year loan (or vice versa). In such instances, particular exclusions from s 109R applying are contained in s 109R(6) and (7).

Offsetting loan accounts. Within groups of entities, it is not uncommon for the parties to want to "tidy up" loan balances such that only one entity in the group has loans with the shareholders (or associates). While this may make sense from a commercial and accounting perspective, care needs to be taken from a tax perspective, including Div 7A.

As well as s 109R, the interposed entity provisions in ss 109T, 109V and 109W ITAA36 (discussed further in subsequent sections of this article) need to be carefully considered and navigated when offsetting loans within groups. While a mere offsetting of a credit loan owed to a shareholder from one entity with a debit loan that shareholder has with another entity should not on its own trigger an adverse Div 7A implication, the underlying transactions which led to the loans and the amount of offsetting within the group to achieve the outcomes need careful consideration.

Where debit loans from multiple entities in a group are being "merged" into a single debit loan from one company to the shareholder, particular care needs to be taken to ensure that ss 109T and 109W do not apply, and that the repayment is not disregarded under s 109R(2). While there are the "reasonable person", "intention" and "all the circumstances" aspects to consider (as noted above), it should not be automatically assumed that they will allow for loans within a group to be "tidied up" free of Div 7A implications. It should also be remembered that, even if Div 7A can be technically navigated, Pt IVA ITAA36 can still apply to relevant circumstances.

When taking on new clients with existing Div 7A loans, it is crucial to gain a full understanding of the underlying composition of the loans to ensure that you appropriately address the Div 7A implications in the period you are engaged to attend to tax matters for. Don't just assume that positive actions (such as physically making a repayment on a loan) will always be accepted for Div 7A purposes (for example, if s 109R applied to not take that repayment into account).

Where did that loan really come from?

The reach of Div 7A can go beyond the initial entity in a chain, and instead operate in such a way that the eventual recipient of the payment or loan (the target entity) is the one to which adverse Div 7A implications may apply. However, this deeming only operates in certain instances, with the core starting point being a consideration of s 109T ITAA36.

Section 109T

Section 109T states:

"(1) This Division operates as if a private company makes a payment or loan to an entity (the ***target entity***) as described in section 109V or 109W if:

(a) the private company makes a payment or loan to another entity (the ***first interposed entity***) that is interposed between the private company and the target entity; and

(b) a reasonable person would conclude (having regard to all the circumstances) that the private company made the payment or loan solely or mainly as part of an arrangement involving a payment or loan to the target entity; and

(c) either:

(i) the first interposed entity makes a payment or loan to the target entity; or

(ii) another entity interposed between the private company and the target entity makes a payment or loan to the target entity.

This section operates regardless of certain factors

(2) For the purposes of this section, it does not matter:

(a) whether the interposed entity made the payment or loan to the target entity before, after or at the same time as the first interposed entity received the payment or loan from the private company; or

(b) whether or not the interposed entity paid or lent the target entity the same amount as the private company paid or lent the first interposed entity.

This section does not operate if the payment or loan to the first interposed entity is treated as a dividend

(3) This Division does not operate as described in subsection (1) (and sections 109V and 109W) if the private company is taken under Subdivision B (as it applies apart from this Subdivision) to pay a dividend as a result of the payment or loan to the first interposed entity."

There are various aspects that can be gleaned from the above, including:

- interposed entity(ies);
- when the loan is made and its amount;
- all the circumstances;
- reasonable person; and
- intention.

Interposed entity(ies). For s 109T to have application, there needs to be a chain of entities whereby there is an eventual recipient of the payment or loan (the target entity), and there was a private company which initially made a payment or loan that made its way to the target entity. How many entities are in between (ie interposed entities) is not of direct relevance other than in respect of s 109T(3) whereby s 109T does not operate if the initial loan or payment from the company to the first entity already resulted in the payment of a dividend under Div 7A.

When the loan is made and its amount. Section 109T is clear that, for the purposes of whether the section applies, it does not matter the amount or timing of the loan from the interposed entity to the target. This contrasts to s 109R(2)(b) whereby the timing and amount of the loans are relevant to the s 109R conclusion. Hence, the potential application of s 109T could have a notable breadth to it. Notwithstanding this, if s 109T does have application, the amount of the potential deemed dividend under s 109V or 109W does need to have regard to the circumstances and flow from the company to the target entity.

All the circumstances. A core part of the s 109T analysis (similar to that in s 109R) is that regard needs to be had to all the circumstances. This implies a wider-reaching consideration of the situation than merely the particular loan or payment in isolation.

Reasonable person. A core aspect of s 109T is the "reasonable person" test. This requires the conclusions within s 109T(1) to be made through the eyes of a "reasonable person". When combined with the intention aspect mentioned below, it is clear that s 109T is only intended to be applied in particular circumstances, not merely every time there is a loan made by the company.

Intention. The intention of the private company making the payment needs to have a sufficient link to the payment or loan to the target entity. As s 109T(1)(b) states, the payment or loan needs to be made by the company "solely or mainly as part of an arrangement involving a payment or loan to the target entity". If the loan or payment from the company is merely incidental to an interposed entity making a loan or payment to a target, s 109T should not be enlivened.

Historic loans. As noted above, there may be no mischief intended when funds flow within a group, or loans are offset within a structure. However, care needs to be taken to not inadvertently trigger adverse Div 7A issues. Section 109R has the ability to effectively ignore (for Div 7A purposes) certain repayments, while s 109T can trace through a chain of entities in certain instances to deem a dividend to be paid from an entity different to the one which the ultimate borrower physically borrowed their funds from.

Importantly, sufficient understanding of all the circumstances, which may include aspects arising in other years, is needed to accurately consider the potential application of ss 109R and 109T. Hence, when taking on new clients, it may be necessary to look at prior period items in some detail in order to correctly attend to the Div 7A implications during the period in which you are engaged for.

Division 7A or FBT?

On face value, Div 7A and FBT both seek to impose tax implications on some overlapping items such as loans, payments and forgiveness. While FBT may be targeted at situations where these items are provided to employees (or associates), and Div 7A where they are provided to shareholders (or associates), what happens where an individual is both an employee and a shareholder of the company? Does Div 7A or FBT have taxing rights in that instance, or do they both?

The type of item matters

The priority system for Div 7A or FBT having first taxing rights depends on the type of item involved.

Loans and forgiveness

Section 109ZB ITAA36 contains certain clarification in respect of whether Div 7A or FBT has priority in respect of loans and forgiveness, granting Div 7A priority as follows:

> "(1) This Division applies to a loan of an amount to an entity by a private company, even if the loan is made:
>
> (a) to the entity in its capacity as an employee (as defined in the *Fringe Benefits Tax Assessment Act 1986*) or an associate of such an employee; or
>
> (b) in respect of the employment of an employee (as defined in that Act).
>
> Note: This helps ensure that a loan is not a fringe benefit for the purposes of that Act.
>
> (2) This Division applies to a private company's forgiveness of a debt owed by an entity to the private company, even if:
>
> (a) the entity owed the debt in its capacity as an employee (as defined in the Fringe Benefits Tax Assessment Act 1986) or an associate of such an employee; or
>
> (b) the forgiveness occurs in respect of the employment of an employee (as defined in that Act).
>
> Note: This helps ensure that the forgiveness of a debt is not a fringe benefit for the purposes of that Act."

Payments

A payment for Div 7A purposes is broad, and can include the use of a company asset. Notwithstanding this, s 109ZB states:

> "(3) However, this Division does not apply to a payment made to a shareholder, or an associate of a shareholder, in their capacity as an employee (as defined in the Fringe Benefits Tax Assessment Act 1986) or an associate of such an employee."

Is that it?

While the intent of having loans and forgiveness dealt with under Div 7A and payments under FBT may be evident, there are still aspects of the provisions which are not entirely clear.

> "There may be no mischief intended … However, care needs to be taken to not inadvertently trigger adverse Div 7A issues."

In Treasury's October 2018 consultation paper "Targeted amendments to the Division 7A integrity rules", a number of aspects of the Div 7A/FBT interaction were flagged as requiring clarification, which has yet to be provided. The paper noted the following:

> "To improve the clarity and integrity in relation to the interaction between Division 7A and the FBT provisions, amendments will be made to clarify that:
>
> - the exception in subsection 109ZB(3), which provides that Division 7A does not apply to payments made to shareholders (or their associates) in their capacity as an employee (or an associate of such an employee), only applies where that payment would constitute a fringe benefit. In determining if a payment is a fringe benefit within the meaning of subsection 136(1) of the *Fringe Benefits Tax Assessment Act 1986*, paragraph (r) should be disregarded;
> - former shareholders (or their associates) should be treated consistently with current shareholders. The exception in subsection 109ZB(3) will be extended to ensure that Division 7A will not apply to payments to former shareholders or associates of former shareholders in their capacity as an employee if the payment was a fringe benefit; and

- FBT will not apply to payments to former shareholders and their associates that are otherwise captured by Division 7A.

These amendments will clarify and provide integrity in relation to the interaction between Division 7A and the FBT provisions."

25-year loans

Although Treasury's 2018 consultation paper flagged the possibility of introducing a single 10-year loan arrangement for Div 7A, we continue to have two core loan terms under the current provisions, a 7-year or a 25-year loan. While the 7-year arrangement is by far the most commonly used of the two, is the 25-year loan underutilised?

The common criteria

Whether entering into a 7-year or a 25-year loan, there are certain criteria common to both loans which must be satisfied. These are set out in s 109N ITAA36 as:

"(1) A private company that makes a loan to an entity in one of the private company's years of income is not taken under section 109D to pay a dividend at the end of the year of income because of the loan if, before the lodgment day for the year of income:

(a) the agreement that the loan was made under is in writing; and

(b) the rate of interest payable on the loan for years of income after the year in which the loan is made equals or exceeds the benchmark interest rate for the year; and

(c) the term of the loan does not exceed the term (the ***maximum term***) for that kind of loan worked out under subsection (3)."

Hence, the loan must:

- be in writing;
- have an interest rate at or exceeding a particular benchmark; and
- be of a maximum term (see below).

The benchmark interest rate is the indicator Lending Rates – Bank variable housing loans interest rate last published by the Reserve Bank of Australia before the start of the year of income. Practically, this means the May rate, published early June. For the 2025 year, the rate is 8.77%.

If the above criteria are met, it is important to then determine the maximum permitted term of the loan.

The 25-year loan

When thinking about the two types of Div 7A loans, many people refer to 7-year loans as unsecured and 25-year loans as secured. While it is correct that a 25-year loan requires appropriate security (refer below) in order to be a complying 25-year Div 7A loan, Div 7A is silent on the security aspect for 7-year loans, meaning they could be secured (if the parties wanted) or unsecured. In practice, the 7-year Div 7A loans would typically be unsecured. Section 109N(3) provides:

"(3) The maximum term is:

(a) 25 years for a loan if:

(i) 100% of the value of the loan is secured by a mortgage over real property that has been registered in accordance with a law of a State or Territory; and

(ii) when the loan is first made, the market value of that real property (less the amounts of any other liabilities secured over that property in priority to the loan) is at least 110% of the amount of the loan; and

(b) 7 years for any other loan.

However, the maximum term for a loan is the period worked out under the regulations, if they provide for working out the maximum term for that kind of loan."

Hence, some points to note:

- the 25-year or 7-year terms are the maximum terms;
- the amount of security and when to consider the value of the security is specified in the legislation; and
- the type of acceptable security is set out in the legislation.

25 years or 7 years. While the legislation specifically mentions 25 years and 7 years, these are the maximum terms. It is possible to have a shorter-term loan, for example, if all other relevant aspects of a secured loan were addressed, a 15-year loan could be put in place rather than 25 years. Similarly, a 3-year rather than 7-year loan could be put in place for a loan that met all relevant aspects other than the security part. In reality, Div 7A is only generally capturing loans with related parties, so unless there is a commercial imperative to draft the loan arrangement with terms less than 25 or 7 years, the loan could be repaid faster than the maximum term if the parties agreed.

The amount of security. To meet the relevant security amount criteria, the entirety of the loan must be secured and the value of the security must be at least 110% of the amount of the loan when the loan is first made. Practically, this translates to a loan-to-value ratio of just over 90%.

Importantly, the value of the security does not need to be re-tested during the life of the facility, and there is no requirement for the security to be a first mortgage.

The type of security. The loan must be secured by a mortgage over real property. The security must be registered in accordance with a law of a state or territory.

There is no requirement for the security to be owned by the borrower. However, it must be real property.

Use of 25-year loans in a private group

Where a private group structure allows for it, creating an investment company which is the "banker" of the group can prove a useful strategy. The banker may lend funds to other entities in the group, such as trusts, to acquire growth assets. From a commercial perspective, the company holding secured passive-style assets (in this instance loans) can be an effective asset protection mechanism, while the 25-year loan term can ensure that the principal of the loan is steadily paid off over time. Furthermore, with interest rates on Div 7A loans being in excess of 8% for the 2025 year, it can provide notable tax deductions for the borrower entity and a source of growth in the investment pot of the banker company.

Depending on the other sources of income of the banker company, its tax rate may be 25% or 30%. Either way, this is significantly lower than the top marginal tax rate.

In some instances, funds may be loaned from an existing trading company to another entity in the group, such as a trust. While this approach might have certain practical advantages, such as minimising the number of entities in the group (ie not needing to set up a new company to act as the banker of the group), there are notable disadvantages from an asset protection perspective and also from an active asset test perspective (the loan from the trading company is unlikely to be an active asset, which could impact on the ability to access small business CGT concessions on the sale of shares in the trading company).

Deemed dividends

Most taxpayers and their advisers try to ensure that the requirements of Div 7A are complied with in such a manner that the adverse outcome, in the form of the payment of a deemed dividend, does not happen. However, if a deemed dividend is triggered, who is taxed on it and is the payment of a deemed dividend always a bad thing?

Who is taxed on a deemed dividend?

A "regular" dividend paid validly in accordance with the *Corporations Act 2001* (Cth) should be assessable in the hands of the relevant shareholder. However, under Div 7A, dividends are deemed to be paid for income tax purposes if certain criteria are met; an "actual" dividend is not triggered.

Under s 109C(1) ITAA36:

> "(1) A private company is taken to *pay a dividend to an entity* at the end of the private company's year of income if the private company *pays an amount to the entity* during the year and either:
>
> (a) the payment is made when the entity is a shareholder in the private company or an associate of such a shareholder; or
>
> (b) a reasonable person would conclude (having regard to all the circumstances) that the payment is made because the entity has been such a shareholder or associate at some time." (emphasis added)

Thus, while s 109C(1)(a) requires the shareholder or associate relationship to the company in order for Div 7A implications to be triggered, the deemed dividend itself is paid for tax purposes to the relevant party who has received the payment (or the benefit of the payment). There is no requirement that such a party is the actual shareholder of the company.

Franked or not?

The default position is that a deemed dividend is unfranked. However, in certain instances, the dividend may be able to be franked, such as:

- under s 109RB ITAA36 where there was an honest mistake or inadvertent omission; or
- under s 109RC ITAA36 where the dividend is taken to be paid because of a family law obligation.

When dealing with relationship breakdown situations, the ability to frank dividends can be a useful way of managing the tax implications that arise when dividing the assets of the separated couple.

Is the payment of the deemed dividend problematic?

The answer "it depends" is generally appropriate to the question of whether the payment of a deemed dividend is problematic. In some instances, the deemed dividend will mean more tax payable for the relevant parties, but in other instances, it may actually result in less tax than a regular dividend situation.

Consider the following scenarios:

1. Bob is the sole shareholder of his company, PrivCo Pty Ltd, but is not an employee of the company. PrivCo has significant amounts of retained earnings and franking credits. PrivCo pays certain private expenses of Bob's, totalling $15,000. Unless the requirements of Div 7A are otherwise addressed, an unfranked dividend of $15,000 is likely to be deemed for tax purposes in Bob's hands. This is likely to be less tax-effective for Bob than if he had received a "regular" fully franked dividend of the equivalent amount (which was subsequently used to pay for the private expenses).
2. Consider the same scenario as (1), but assume that the company has no franking credits. In that instance, there may be no practical difference in tax outcomes for Bob whether PrivCo pays him an actual dividend of $15,000 (unfranked) or a deemed dividend of that amount under Div 7A.
3. Consider the same scenario as (1), but assume that the private expenses were actually those of Frank, Bob's grandson. If Div 7A is not appropriately addressed, Frank may be assessable on a $15,000 unfranked dividend. If Frank has no other income, while Bob is on a higher marginal tax bracket, Frank receiving a deemed dividend may actually be more tax-effective than if PrivCo had paid Bob a fully franked dividend, with which he then gifted the money to his grandson.

Concluding comments

Navigating Div 7A effectively requires an understanding of both the technical subtleties of the provisions, along with the intricacies of the particular client group. While sections such as s 109R can be problematic, a carefully designed and executed plan that doesn't seek to overcomplicate the situation can ensure that Div 7A doesn't become "Division Trouble, with a Capital A"!

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This article is an edited version of "Division 7A – some things you may not know" presented at The Tax Institute's Tasmanian Convention held in Hobart on 17 to 18 October 2024.

Residency status: CGT implications for assets

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This article explores the CGT implications for taxpayers transitioning between Australian tax residency and non-residency, focusing on asset classifications, applicable CGT events, and the effect of residency status on exemptions and liabilities. Through detailed scenarios, it examines the treatment of taxable Australian property and non-taxable Australian property during residency changes, asset disposals, and the re-establishment of residency. The article discusses the CGT impact on the sale of properties and shares, with a focus on scenarios where assets are sold before or after ceasing residency. For instance, the availability of the main residence exemption and the 50% CGT discount depends on residency status at the time of the CGT event and compliance with the life events test. Adjustments to the CGT discount percentage for non-resident periods are also analysed. The article highlights the importance of strategic planning in managing CGT implications during residency transitions, considering cash flow needs, the timing of disposals, and legislative provisions.

Introduction

This article examines the CGT implications for assets when a taxpayer transitions from resident to non-resident status and the subsequent treatment of those assets. Through means of a case study, the article considers the impact on selling CGT assets while a resident versus selling after ceasing to be a resident on moving overseas. Additionally, it addresses the implications for CGT assets when the taxpayer regains residency status, as well as the CGT implications of transferring assets to foreign resident beneficiaries on the taxpayer's death.

Tax residency and CGT

Residency is a key factor in determining the calculation of CGT. When a taxpayer ceases to be an Australian resident, CGT implications arise, depending on whether the CGT asset is classified as taxable Australian property (TAP) or non-taxable Australian property (non-TAP) and whether the asset is a pre-1985 or post-1985 acquisition. Foreign residents and temporary residents are only subject to CGT on TAP, which includes Australian real estate and assets used in conducting business in Australia.

The 50% CGT discount is unavailable to foreign and temporary residents for assets acquired on or after 8 May 2012. Similarly, the main residence exemption does not apply to foreign residents unless they meet the criteria outlined in the life events test.

When a non-resident regains Australian residency, the CGT treatment of their assets is reassessed, potentially altering the CGT liability on previously held assets.

Additionally, foreign residents who sell Australian real estate are subject to foreign resident capital gains withholding tax, requiring a portion of the sale proceeds to be withheld and remitted to the ATO.

On ceasing residency, the following CGT events are triggered:

- CGT event I1: applies to individuals or companies in relation to non-TAP at the time residency ceases; and
- CGT event I2: applies to trusts when the trust stops being a resident trust.

For TAP, CGT is only triggered on the actual sale of the asset. Conversely, for non-TAP, CGT event I1 triggers a deemed disposal when the taxpayer leaves Australia.

The key CGT implications for actions taken in relation to the non-TAP assets are as follows:

1. deemed disposal for non-TAP:
    a. taxpayers must calculate capital gains or losses based on the difference between the asset's market value at the time of ceasing residency and its cost base;
    b. tax is levied on unrealised gains at resident tax rates, with access to the 50% CGT discount; and
    c. subsequent sales of non-TAP are exempt from CGT under s 855-10 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97);
2. election to disregard CGT on non-TAP (s 104-165 ITAA97):
    a. individuals can opt to disregard CGT event I1 for non-TAP by making an election;
    b. this election reclassifies all non-TAP as TAP, deferring the CGT liability until the actual sale of the asset;

c. under this election:
    i. gains on the sale while the taxpayer is a non-resident are taxed at non-resident tax rates; and
    ii. the 50% CGT discount is not fully available, with the discount percentage reduced based on the number of non-resident days before the sale;
d. the decision to make the election depends on factors such as cash flow needs and the expected appreciation or depreciation of the asset. If an election is made:
    i. the taxpayer must lodge a tax return at the time of each asset's sale; and
    ii. the accrued gain from the cessation of residency to the CGT event (or re-establishment of residency) becomes taxable; and
e. if no election is made, gains accrued while the taxpayer is a non-resident remain exempt from CGT; and

3. pre-CGT assets:
    a. gains or losses arising from CGT event I1 are disregarded for assets acquired before 20 September 1985.

In summary, the CGT implications of ceasing residency depend on the classification of assets, the application of relevant CGT events, and the choices made by the taxpayer under available provisions. Each scenario requires careful consideration of the tax implications, including current and future cash flow impacts and the timing of potential asset disposals.

Some scenarios are now considered and the CGT implications analysed, assuming that the applicable tax laws do not change during the periods mentioned in the analysis.

Scenarios 1 to 7: background

Mr A is an Australian resident for tax purposes. He holds 1,000 post-1985 shares, acquired on 1 July 2015 for $1,000. Additionally, he owns two properties located in Australia:

- a property in Sydney:
    - purchased on 1 July 2010 for $1,000,000; and
    - used as his primary place of residence since acquisition; and
- a property in Melbourne:
    - purchased on 1 July 2020 for $500,000;
    - used as an investment property since purchase; and
    - currently rented out and generating rental income.

Mr A decided to permanently relocate to Sudan on 1 January 2025 to join his girlfriend who resides in Sudan.

CGT implications for properties when MR A ends Australian residency

Both properties will be classified as TAP. As a result, there will be no deemed disposal at the time Mr A ceases his Australian residency. However, CGT will be applicable on the actual sale of these properties.

Scenario 1

In this scenario, Mr A sold the Sydney main residence property prior to his relocation to Sudan on 1 January 2025. The contract for the sale of the Sydney property was signed on 24 December 2024, with settlement occurring after 11 January 2025.

In this case, since the Sydney property had been Mr A's main residence and had never been used to produce income during his ownership, the full main residence exemption applies in accordance with s 118-110 ITAA97. The exemption is available as Mr A was an Australian resident at the time the CGT event occurred (ie when the contract for sale was signed).

Scenario 2

Let us now consider the scenario where Mr A does not sell the property before relocating to Sudan and instead decides to sell it two years after settling in Sudan. The main residence exemption is only available to foreign residents if they satisfy the life events test. In this case, Mr A would not qualify for the main residence exemption as he is a foreign resident for tax purposes and does not meet the criteria for the life events test as outlined in s 118-110(3) ITAA97.

As a result, Mr A will not be eligible for the main residence exemption, even for the period during which he used the property as his main residence. Therefore, he will be liable to pay CGT on the gains from the time the property was purchased on 1 July 2010 to the date of its actual sale, which occurs two years after his relocation.

This scenario highlights the significance of residency status in determining the availability of tax exemptions. It should also be noted that Mr A will not be eligible for the 50% CGT discount on the capital gain. However, the discount percentage will be reduced in proportion to the number of days he was a non-resident.

The method of calculating the CGT discount depends on the date the asset was purchased. If the asset was acquired before 8 May 2012, the taxpayer's residency status as of 8 May 2012 is relevant for determining the applicable discount.

If the discount testing period starts after 8 May 2012, the formula for calculating the discount will be as outlined in s 115-115(2) ITAA97. This is expressed as a percentage:

$$\frac{\text{Number of days during discount testing period that you were an Australian resident (but not a temporary resident)}}{2 \times \text{Number of days in discount testing period}}$$

If the discount testing period starts on or prior to 8 May 2012, the calculation is based on the formula outlined in s 115-115(3) ITAA97. This is expressed as a percentage:

$$\frac{\text{Number of days in discount testing period} - \text{Number of apportionable days that you were a foreign resident or temporary resident}}{2 \times \text{Number of days in discount testing period}}$$

Let us assume that Mr A will sell the Sydney property on 1 January 2027 for $4,000,000. As Mr A was a resident as of 8 May 2012 and the property was purchased prior to that date, the second formula will be applied.

The discount testing period starts on the day Mr A acquired the property (1 July 2010) and ends on the day the CGT event occurs (proposed sale date of 1 January 2027). Mr A was a foreign resident for two years during this period. Therefore, after applying the formula, the gross gain on the sale of the property before applying the discount is $3,000,000. After applying the discount percentage, the taxable capital gain is calculated as follows:

Discount percentage = (17 years – 2 years) / (2 × 17 years) = 44.12%

Gross gain on the sale of the property before discount = $3,000,000

Discount = $3,000,000 × 44.12% = $1,323,600

Thus, the taxable gain = $3,000,000 – $1,323,600 = $1,676,400

Mr A will be liable to pay tax on $1,676,400 at non-resident tax rates.

Scenario 3

In scenario 3, Mr A sold the Melbourne investment property prior to his relocation to Sudan on 1 January 2025. The contract for the sale of the Melbourne property was also signed on 24 December 2024, with settlement scheduled to occur after 11 January 2025.

In this instance, as the Melbourne property had been used by Mr A as an investment property and had generated income during his ownership, the main residence exemption does not apply. However, Mr A would be entitled to the full 50% CGT discount as the property was held for more than 12 months and Mr A was a resident at the time the CGT event occurred.

Scenario 4

Let us now consider the scenario where Mr A does not sell the Melbourne investment property before relocating to Sudan and instead decides to sell the property on 1 January 2027 for $1,000,000. CGT implications apply as this investment property is TAP and the CGT discount percentage will be reduced. The discount testing period commences after 8 May 2012 and hence uses the following formula:

$$\frac{\text{Number of days during discount testing period that you were an Australian resident (but not a temporary resident)}}{2 \times \text{Number of days in discount testing period}}$$

Number of days during the discount period that Mr A was an Australian resident = 1 July 2020 to 1 January 2025 = 1,646 days

Number of days in the discount testing period = 1 July 2020 to 1 January 2027 = 2,376 days

Discount percentage = 1,646 / (2 × 2,376) = 34.64%

Gross gain = $1,000,000 – $500,000 = $500,000

Discount = $500,000 × 34.64% = $173,200

Thus, the taxable gain = $500,000 – $173,200 = $326,800

Mr A will be taxed on $326,800 at non-resident tax rates.

Scenario 5

Now, let us consider a situation where Mr A returns to Australia permanently. While living in Sudan, Mr A did not purchase any more CGT assets and did not sell any of the existing CGT assets.

In this scenario, Mr A departed Sudan on 31 December 2026 and resumed his Australian tax residency as of 1 January 2027. During his absence, both of the properties are rented out and Mr A lodged Australian tax returns to report the rental income for this period. He now intends to sell the Sydney property in January 2029.

According to s 118-110 ITAA97, for the main residence exemption to apply, the taxpayer must be a resident at the time of the CGT event. As Mr A will be a tax resident at the time of the sale, he satisfies this requirement. Furthermore, pursuant to s 118-145 ITAA97, the Sydney property retains its main residence status as it was rented out for only two years and Mr A reoccupied the property on his return to Australia on 1 January 2027. Therefore, the full main residence exemption will apply to the sale.

An important consideration is that the period of non-residency will not affect the exemption as Mr A did not purchase another property during his absence.

CGT implications for shares when Mr A ends his residency in Australia

Post-1985 shares are classified as non-TAP, which results in deemed disposal implications on Mr A ceasing his Australian residency.

At this point, CGT event I1 will be triggered, requiring Mr A to calculate and report the unrealised capital gain or loss based on the market value of the shares at the time of his residency change. The resulting tax liability on any capital gains will be assessed at resident tax rates and included in his 2025 income tax return.

If actual sale occurs at a later date while Mr A was overseas, no CGT implications occur for the shares as per s 855-10 ITAA97. This is because Mr A is a foreign resident at the time of the CGT event and shares retain their non-TAP status because Mr A paid tax at the time he become a non-resident.

Alternatively, Mr A has the option to defer the CGT liability by making an election under s 104-165 ITAA97. If such an election is made, the shares will be treated as TAP and CGT will only arise on their actual sale, with the gains subject to non-resident tax rates.

Scenario 6

In scenario 6, Mr A intends to sell his shares on 1 January 2026, with an expected gross capital gain of $2,000. At the time of the actual sale, Mr A will be required to lodge an Australian tax return to report the capital gain and pay the applicable tax at non-resident rates. Additionally, the CGT discount percentage will be proportionately reduced to account for the period during which he was a non-resident at the time of the sale.

If the discount testing period starts after 8 May 2012, the formula for calculating the discount will be as outlined in s 115-115(2) ITAA97. This is expressed as a percentage:

$$\frac{\text{Number of days during discount testing period that you were an Australian resident (but not a temporary resident)}}{2 \times \text{Number of days in discount testing period}}$$

Number of days during the discount period that Mr A was an Australian resident = 1 July 2015 to 1 January 2025 = 3,473 days

Number of days in the discount testing period = 1 July 2015 to 1 January 2026 = 3,838 days

Discount percentage = 3,473 / (2 × 3,838) = 45.24%

Gross gain = $2,000 (expected gain)

Discount = $2,000 × 45.24% = $905

Thus, the taxable gain = $2,000 – $905 = $1,095

Mr A will be taxed on $1,095 at non-resident tax rates.

However, if the shares are not sold while Mr A is a non-resident and he subsequently returns to Australia on 1 January 2027, regaining his status as a tax resident, the shares will be reclassified as non-TAP on his return as per s 104-165(3) ITAA97. If Mr A chooses to sell the shares after resuming his Australian residency, he will be eligible for the full CGT discount as only the residency status at the time of the CGT event is relevant.

Scenario 7

In this scenario, prior to executing his decision to sell the CGT assets, Mr A passed away on 1 January 2029. As per his will, the shares and the Sydney property are passing to a non-resident beneficiary. World Vision is entitled to his investment property in Melbourne.

On an individual's death, their estate is created and there are no immediate CGT implications arising from this event. However, CGT event K3 is triggered at the time of death for shares classified as non-TAP if these assets are passed to a non-resident beneficiary. The purpose of s 104-215 ITAA97 is to ensure that CGT is captured on non-TAP previously owned by Australian residents when such assets are transferred to non-resident beneficiaries. This provision ensures that these assets, which would otherwise escape taxation, are subject to CGT at the appropriate time. In the case of Mr A, who was a resident at the time of death and whose shares were acquired after 20 September 1985, the executor of the estate is obligated to pay CGT on the deemed disposal of the shares in the deceased's date of death tax return.

A capital gain will be realised if the market value of the shares at the time of death exceeds their original cost base, whereas a capital loss will occur if the market value is lower than the original purchase price. Furthermore, the CGT discount is available in this context, provided the relevant eligibility criteria are satisfied.

Mr A's estate is classified as a fixed trust as per s 272-65 of Sch 2F to the *Income Tax Assessment Act 1936* (Cth). If the shares are sold by the trustee while administering the estate, CGT will be disregarded according to s 855-40 ITAA97 as the beneficiary is a foreign resident, with the estate being a fixed trust and the shares classified as non-TAP at the time of the CGT event.

> "The CGT implications of ceasing residency depend on the classification of assets … and the choices made by the taxpayer …"

For TAP that is transferred to a foreign resident beneficiary, CGT event K3 is not triggered and Australia captures tax at a later date, ie when the actual sale occurs. Conversely, if the taxable property is passed to an exempt entity, CGT event K3 applies unless the entity is a deductible gift recipient (DGR) in Australia as outlined in s 118-60 ITAA97. In this scenario, since the investment property is being transferred to the charity World Vision, which is recognised as a DGR, CGT event K3 does not arise.

If the main residence (the Sydney property) is transferred to a non-resident beneficiary, CGT event K3 is not triggered. However, if the property is not settled within two years from the deceased's date of death, it will become subject to CGT unless the Commissioner exercises discretion to extend the time limit under the safe harbor provisions outlined in PCG 2019/5.

In this scenario, as the main residence is being transferred to a non-resident beneficiary, the CGT discount will not be applicable if the property is sold after the two-year period.

Conclusion

The CGT implications associated with the sale of real property and shares can vary extensively depending on whether the individual is a resident or non-resident at the time of sale, and in the case of non-TAP, whether the individual exercised the option to defer the CGT at the time their residency status changed from resident to non-resident. A person regaining their residency status can restore the CGT status of their assets and the associated benefits available at time of sale of the assets after becoming a resident again.

In the case of a person passing away, the resident status of the beneficiary also greatly affects the CGT treatment of the assets passing to a beneficiary. It is therefore important that people consider all of these implications as part of their tax and estate planning in order to maximise the benefits of their portfolio for themselves and for their beneficiaries.

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Superannuation

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Foreign resident CGT withholding: impact on SMSFs

From 1 January 2025 onwards, a purchaser is required to withhold 15% of the value of taxable Australian real property unless the vendor shows the purchaser a clearance certificate obtained from the ATO.

Most people by now are aware of the foreign resident CGT withholding obligations (the withholding regime) which arise for vendors disposing of certain property. Broadly, the withholding regime was introduced to allow the federal government to obtain tax in respect of foreign vendors. However, the withholding regime applies to most transfers of real estate in Australia unless an exclusion applies.

An aspect of the new withholding regime that has not gained much attention is its implications for SMSFs. This article discusses the relevant background and how the withholding regime impacts SMSFs.

What is the non-resident CGT withholding regime?

The withholding regime applies to transactions entered into from 1 July 2016 in relation to direct property interests and to indirect Australian real property interests (eg certain company title interests), as well as to an option or a right to acquire such property or such an interest.

From 1 January 2025 onwards, a purchaser is required to withhold 15% of the value of taxable Australian real property unless the vendor shows the purchaser a clearance certificate obtained from the ATO.

Table 1 details how the withholding regime has increased over time. From 1 January 2025, there is no minimum threshold and a 15% withholding applies to all taxable property unless a clearance certificate is obtained. In contrast, prior to 1 January 2025, a $750,000 threshold applied before a withholding obligation arose.

Acquisition and property are broadly defined

The legislation focuses on who acquires an asset (discussed below) which is broadly defined and applies to a range acquisitions and not just to purchases for monetary consideration (unless a relevant exception applies). More specifically, s 14-200(1) of Sch 1 to the *Taxation Administration Act 1953* (Cth) (TAA) provides that:

> "(1) You must pay to the Commissioner an amount if:
>
> (a) you become the owner of a CGT asset as a result of acquiring it from one or more entities under one or more transactions; and
>
> (b) subsection 14-210(1) (about foreign residents) applies to at least one of those entities at the time one of those transactions is entered into; and
>
> (c) at that time, the CGT asset is:
>
> (i) taxable Australian real property; or
>
> (ii) an indirect Australian real property interest; or
>
> (iii) an option or right to acquire such property or such an interest;
>
> unless a transaction referred to in paragraph (a) is excluded under section 14-215.
>
> Note: You must pay the amount on account of income tax possibly payable by the entities on their capital proceeds resulting from your acquisition of the CGT asset."

The ATO confirms that taxable Australian real property includes:

- vacant land, buildings, residential and commercial property in Australia;
- mining, quarrying or prospecting rights where the material is situated in Australia; and
- a lease over real property in Australia if a lease premium has been paid for the grant of the lease.

For SMSFs, the withholding regime is likely to be relevant whenever an acquisition or a transaction occurs with regard to real estate in Australia. Typically, the property lawyers handling the conveyancing aspects related to the transfer

Contracts between	1/07/2016 and 30/06/2017	1/07/2017 and 31/12/2024	From 1/01/25 onwards
Withholding rate	10%	12.5%	15%
Threshold that withholding applies to (ie only withhold on property values above this amount)	$2m threshold value	$750,000 threshold value	Nil – all property values covered

will assist with complying with the withholding regime. However, there are a number of transfers discussed below that SMSFs and their advisers need to be on top of to ensure that they comply with the law.

Key impact of the withholding regime

The key impact of the withholding regime is that it will require an SMSF trustee purchasing or otherwise acquiring property in Australia to withhold 15% of the purchase price or the market value of the property (more particularly defined as the first element of the CGT asset's cost base) just after the acquisition, unless a clearance certificate is obtained from the vendor or another exception under the TAA is satisfied.

The Australian resident entity or its representative (eg the SMSF trustee or its tax agent) can complete an online application for a clearance certificate via the ATO's website. It is the vendor's responsibility to obtain the clearance certificate and to provide it to the purchaser at or before settlement. Where a valid clearance certificate is provided, the purchaser is not required to withhold.

It is expected that, in many cases, a clearance certificate will be made available by the vendor in the usual conveyancing process and that no withholding will be required. However, if a clearance certificate is not provided, eg the vendor is a foreign resident, or another exception is not satisfied prior to settlement, then a withholding obligation falls on the purchaser of the property even where no capital gain arises in connection with the disposal.

Key exception: obtain a clearance certificate

Broadly, while the regime was introduced to tax foreign residents, the withholding regime applies to everyone, including Australian residents, unless the vendor obtains a clearance certificate or otherwise satisfies another exception.

Furthermore, it is the vendor's responsibility to obtain the clearance certificate and to provide it to the purchaser/transferee prior to or at settlement. Without being presented with a valid clearance certificate, the purchaser/transferee will be required to withhold and remit 15% to the ATO if no other exception applies. On the other hand, where a valid clearance certificate is provided, the purchaser/transferee is not required to withhold.

Traps: how might SMSFs otherwise be covered?

Australian real estate remains a popular investment choice for SMSFs, and where an SMSF trustee acquires real estate in any manner, the SMSF trustee must be mindful of the potential application of the withholding regime.

In particular, the meaning of "acquiring a CGT asset" is broadly defined and includes any type of acquisition covered by s 109-5 of the *Income Tax Assessment Act 1997* (Cth) (ITAA97), subject to a relevant exception applying. Thus, the withholding regime applies to more than just a standard purchase/sale arrangement for monetary or other valuable consideration. The following types of transactions are covered by the withholding regime (assuming the relevant property has a market value above $750,000):

- a transfer in kind/in specie of business real property by a member to an SMSF trustee (eg pursuant to a relevant contribution cap) whereby the SMSF trustee becomes the owner of the property at this time. Even though this kind of transfer does not involve valuable consideration, the withholding regime is still applicable and the member must provide a clearance certificate to the SMSF trustee;
- a lump sum payment in kind/in specie of residential property from an SMSF trustee to a member whereby the member becomes the owner of the property at this time. As noted above, the withholding regime must be managed in this circumstance and a clearance certificate must be provided to the member by the SMSF trustee; and
- a transfer of property from a retiring SMSF trustee to a new individual or corporate trustee or to the continuing individual trustee(s). Note that one of the real hassles of having individual trustees is the possibility of multiple retirements and appointments occurring during an SMSF's lifetime. On each change of trustee, the title to fund assets must be transferred, and thus, the withholding regime needs to be managed on an ongoing basis.

What amount must be withheld and paid to the ATO?

If a withholding obligation arises and a clearance certificate cannot be obtained (for whatever reason), a further analysis must be undertaken by the purchaser to determine what constitutes the first element of the asset's cost base. The first element is the amount paid for the asset and the market value of any other property you gave, or are required to give, in respect of acquiring it under s 110-25(2) ITAA97.

Note that this amount (ie the first element of the CGT asset's cost base) may, in some cases, differ significantly to the asset's market value. Thus, where a withholding obligation arises, care is required to ensure that the correct amount is withheld. Moreover, further complexities may arise if the transaction is subject to GST. Accordingly, expert advice should be obtained.

The relevant withholding amount is due for payment to the ATO on or before the day you become the owner of the asset, which is typically settlement in the context of a sale transaction.

Various penalties apply for non-compliance. These include administrative penalties in relation to clearance certificates where a person makes a false or misleading statement to the Commissioner, and penalties for failing to withhold. The offence of failing to withhold is one of strict liability, meaning that a potential withholder will be liable for the offence even if their failure to meet a withholding payment obligation is unintentional.

Conclusion

SMSF trustees, members and advisers should ensure that they are aware of their obligations under the withholding regime, and they should take appropriate action to ensure that these obligations are appropriately satisfied. SMSF trustees should be aware that any change in ownership of property and each change in trustee will need to consider the withholding regime unless an exclusion applies. Expert advice should be sought where there is any doubt.

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Successful Succession

by Tim Donlan, ATI, Donlan Lawyers

Proprietary estoppel in Australia

While the law of estoppel has evolved over a number of years, there is still a way to go before a unified approach to the various categories is reached.

Introduction

The law in relation to proprietary estoppel in Australia involves something of an evolving taxonomy. With each case determined by the superior courts, the law becomes a little clearer, although there is still a way to go before the law reaches certainty as to the application of the doctrine or certainty of the remedy.

In a prior issue of this column,[1] the author considered the doctrine of equitable estoppel and its potential application to familial and commercial dealings. In summary:

> "In simple terms, if A represents to B that it will do something and B relies on that representation to its detriment, subject to the various criteria that must be satisfied, B may have a remedy in equity to enforce the substance of the representation."

It was noted that, in Australia, equitable estoppel traditionally comprises two branches: promissory estoppel and proprietary estoppel.

Proprietary estoppel concerns representations or promises relating to land and can itself be broken down into to two sub-branches:

1. estoppel by encouragement; and
2. estoppel by acquiescence.

Estoppel by encouragement arises "where the owner of land creates or encourages in another an expectation that the person will have a certain interest in the land and that person changes his or her position on the faith of that expectation".[2]

Estoppel by acquiescence is established where an owner of land, being aware of their own rights relating to their land and also that they are being infringed by another who is knowingly mistaken as to their rights, stands in silence with the intention of profiting from the other party's mistake.[3]

As at the time of writing the previous journal article, the New South Wales Court of Appeal had handed down its judgment in *Stone v Kramer*.[4]

Background

The proceedings concerned a rural property of approximately 100 acres at Upper Colo, New South Wales (the Colo property). The plaintiff, David Stone, brought an application in 2017 against the executor of the estate of the late Dame Leonie Judith Kramer (the deceased). At her death in 2016, she was the sole proprietor of the land. By her will, she left the entire property to her daughter. During her lifetime, she had made oral representations to Stone that she would leave the farmland to him.

Prior to his death in 1989, the other owner of the land had been Dame Leonie's husband, Dr Harry Kramer. He had also made representations to Stone about leaving the land to him.

Unlike in many farming estoppel cases, the Kramers and the Stones were not family relatives.

The basis of the claim, and the relief sought by the plaintiff (Stone), was that both Dr Harry and Dame Leonie had represented to him that the land would be left to him in their wills and that it was unconscionable in the circumstances that the land was instead left to another.

Facts

The plaintiff (Stone) had share farmed the land with Dr Harry and Dame Leonie for approximately 40 years pursuant to a share farming agreement that was purely oral in nature. He claimed that the representations made to him by Dr Harry and Dame Leonie had induced him to remain on the farm and to forgo other more lucrative endeavours on the basis of his future ownership of the land.

The representations collectively alleged by the plaintiff Stone were:

- some time in the 1980s, Dr Harry had represented to him that he would, through his will, leave him a life interest in the land;
- later in 1987 or 1988, shortly prior to his death, Dr Harry had represented that he was leaving ownership of the land via his will to Dame Leonie but that she would leave the land to the plaintiff in her own will thereafter; and
- in 1988, after Dr Harry's death, Dame Leonie (the deceased) represented to him that she would leave the land to him in her will, together with money.

On Dame Leonie's death, she left a will that did not leave the farm to Stone, it left it to one of her daughters and instead left Stone a gift of $200,000 only. Stone sought relief and that the promise to leave him the farm be enforced.

The plaintiff alleged that all three representations were predicated on the basis that he continue to manage and share farm the land and perform other services with respect to it.

The court reached the view that the relationship between Stone and Dr Harry and Dame Leonie was something of "an informal halfway house between a commercial and a domestic [relationship], and that even though there was an underlying commercial relationship in the form of the share farming agreement, the parties to that agreement substantially acted upon the basis of trust and the give and take that would commonly characterise a domestic relationship".[5]

The precise terms of the legal relations between the parties and Stone's future ownership of the land were held to be unnecessary to establish. The court held that Stone was entitled to have the Colo property transferred to him. In doing so, it rejected an argument from the defendants that an appropriate remedy could be something less than transfer of the property, and emphasised the general principle in proprietary estoppel cases that the estopped party can only fulfil their obligation by making good the expectation that has been encouraged.[6]

The executor of Dame Leonie's estate appealed to the New South Wales Court of Appeal. The decision of the primary judge was upheld. The executor then appealed to the High Court.

High Court decision

On 11 December 2024, in a majority judgment (Gageler CJ, Gordon, Edelman and Beech-Jones JJ, with Gleeson J dissenting), the High Court dismissed the executor's further appeal, affirming the lower courts' rulings.[7]

The majority confirmed certain elements of proprietary estoppel by encouragement, including that there must be a clear or unequivocal representation from party A and that there must be reliance on that representation by party B to its detriment.

The court outlined four essential elements for establishing proprietary estoppel by encouragement:

1. clear and unequivocal promise: the promisor must have made a definite promise regarding the future acquisition of property;
2. expectation of reliance: a reasonable person in the promisor's position would expect, or the promisor actually expected, that the promisee would act or refrain from acting based on the promise;
3. actual reliance: the promisee must have taken action or refrained from action in a manner that was reasonably foreseeable as a result of the promise; and
4. detriment: the promisee would suffer a detriment if the promise were not fulfilled.

Each of those criteria had been established in this case. However, while the majority accepted that party A (or a reasonable person in party A's position) must have expected or intended party B to rely on the representation by some action, the majority rejected the executor's grounds of appeal and submissions that:

- party A must have engaged in conduct after the original representation which *further* encouraged party B to act in detrimental reliance on the representation; and
- party A must have *actual knowledge* that party B *in fact* relied on the representation to its detriment.

The High Court rejected the appellants' arguments that additional requirements were necessary, such as the promisor engaging in further conduct encouraging reliance after the initial promise or having actual knowledge of the promisee's reliance. The court emphasised that these additional criteria are not requisite for establishing proprietary estoppel *by encouragement*.

The court stated:

> "44. The first proposed additional requirement inappropriately transposes the principles concerning the circumstance in which equity is said to perfect an imperfect gift. The second proposed additional requirement erroneously conflates the principles of estoppel by encouragement from a promise with the principles concerning estoppel by acquiescence."

The majority held that actual knowledge on the part of the representor is only required in cases of proprietary estoppel by acquiescence and not in cases of proprietary estoppel by encouragement.

Readers will recall that cases of proprietary estoppel by acquiescence differ from cases of proprietary estoppel by encouragement in that estoppel by encouragement involves clear promises or representations by a representor.

Conversely, estoppel by acquiescence involves cases where a party stands by, while another improves land or acts to their detriment based on a mistaken assumption and does nothing to correct the assumption.

To be clear, the appeal to the High Court was based on an agreed position between the parties that the matter was one concerning proprietary estoppel by encouragement, rather than mere acquiescence, by Dame Leonie. It was accepted that her own representations had acted as an inducement to Stone. She was not a mere observer.

As such, the court's comments on actual knowledge being required in circumstances of mere acquiescence were made more as "observations" in the case. The court did not rule on other overarching estoppel doctrines.

The court stated:

> "32. As in *Giumelli v Giumelli*, there is no occasion in this appeal to consider whether there is any difference between these descriptions or if there is any 'single overarching doctrine' of estoppel. In the appeal to this Court, the parties were agreed that the category of estoppel in issue should be described as 'proprietary estoppel by encouragement'. That agreed nomenclature can be accepted provided that 'proprietary estoppel by encouragement' is understood to refer to an estoppel which affords relief in equity 'found in an assumption as to the future acquisition of ownership of property … induced by representations upon which there had been

> detrimental reliance by the plaintiff' and which arises in the circumstances of this case solely by reason of detrimental reliance on a promise of a future conferral of a proprietary interest in land. This case does not call for consideration of whether, or when, any doctrine exists which might permit the creation of rights through any broader form of 'estoppel by encouragement'." (footnotes omitted)

The further consolidation of equitable principles in Australian law will have to wait for another day. Until then, the High Court seems to be taking a slow step-by-step approach. That said, the court did not expressly rule on or address in detail the precise requirements to be satisfied regarding what might constitute "actual knowledge" of reliance in cases of promissory estoppel by acquiescence. What satisfies actual knowledge in those cases will need to be developed and refined over time. Each case will turn on its own circumstances.

Implications

This decision underscores the significance of clear promises concerning property and the legal consequences of inducing reliance on such promises. It highlights that individuals making assurances about property should be aware that such promises can create enforceable rights, especially when the promisee acts to their detriment based on the assurance.

The case also delineates the boundaries between proprietary estoppel by encouragement and estoppel by acquiescence, clarifying that the former does not require ongoing encouragement or actual knowledge of reliance beyond the initial promise.

Conclusion

The High Court's ruling in *Kramer v Stone* reinforces the principles of proprietary estoppel by encouragement, affirming that a clear promise, reasonable expectation of reliance, actual reliance, and resultant detriment are sufficient to establish an equitable estoppel.

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2 E Finnane, *Equitable interests in land arising from estoppel*, College of Law, Sydney, 9 March 2010, citing K Handley, "Estoppel", (2006) 20(2) *Commercial Law Quarterly* 29 at 31.

3 Ibid; see also *Ramsden v Dyson* [1866] UKLawRpHL 7.

4 [2021] NSWSC 1456.

5 [2021] NSWCA 1456 at [41].

6 *Giumelli v Giumelli* [1999] HCA 10.

7 *Kramer v Stone* [2024] HCA 48.

Events Calendar

Upcoming months

MARCH
20–21
Thu–Fri

VIC

VIC Tax Forum

12 CPD hours

MARCH
27–28
Thu–Fri

NSW

Financial Services Taxation Conference

12 CPD hours

APRIL
2–3
Wed–Thu

Online

Superannuation Intensive

8 CPD hours

APRIL
3–4
Thu–Fri

SA

SA Tax Forum

12 CPD hours

APRIL
30
Wed

NSW Online

Not-for-profit Tax Intensive

7 CPD hours

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Giving back to the profession

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