BROWN WRIGHT STEIN

LAWYERS

TAX TRAINING NOTES

Monthly tax training

July 2019

Brown Wright Stein tax partners:

Andrew Noolan	E: ajn@bwslawyers.com.au	P: 02 9394 1087
Geoff Stein	E: gds@bwslawyers.com.au	P: 02 9394 1021
Matthew McKee	E: mpm@bwslawyers.com.au	P: 02 9394 1032
Michael Malanos	E: mlm@bwslawyers.com.au	P: 02 9394 1024

Brown Wright Stein Lawyers
Level 6, 179 Elizabeth Street
Sydney NSW 2000
P 02 9394 1010

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LAWYERS

Our tax training notes are edited by Matthew McKee and prepared by members of our team:

Gillian Tam	Helen Young	Isabelle Marcarian
Rachel Vijayaraj	Taseen Rafi	Thomas McAuliffe
Lora Ye	Rose McEvoy	

About Brown Wright Stein

Brown Wright Stein is a medium-sized commercial law firm based in Sydney. We provide legal advice in the following areas:

- Tax
- Dispute Resolution
- Corporate & Commercial
- Franchising
- Property
- Employment
- Estate Planning
- Elder Law
- Intellectual Property
- Corporate Governance
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Our lawyers specialise in working with business owners and their business advisors, such as accountants, financial consultants, property consultants and IT consultants – what we see as our clients' 'business family'. We develop long-term relationships which give our lawyers a deep understanding of our clients' business and personal needs. Over the years we have gained a unique insight into the nature of operating owner-managed businesses and the outcome is that we provide practical commercial solutions to business issues.

At Brown Wright Stein, we believe in excellence in everything we do for our clients. It's this commitment that enables us to develop creative, innovative solutions that lead to positive outcomes.

These materials represent the law as it stood on 9 July 2019.

1 Cases

1.1 Seabreeze Estate – GST margin scheme

Facts

In January 2005 Seabreeze Estate Pty Ltd as trustee for the Seabreeze Estate Unit Trust acquired land for $1,080,000 from two companies who carried on business as a partnership. The partnership had acquired the property in October 2003 for $1,200,000.

Only the front page of the contract could be located. The front page of the contract stated '*NOTE: Subject to clause 13, the price INCLUDES goods and services tax (if any) payable by the vendor*'. There was not otherwise any details about GST on the front page. At the time, the standard contract for sale of contained GST information on the second page. It was also the case that prior to 29 June 2005 the margin scheme was something that the vendor of property chose to apply, it was not something that needed to be agreed in writing between the vendor and the purchaser.

Mr Fabio, one of the former directors of Seabreeze and an accountant, was unable to confirm that the margin scheme 'yes' box on the second page had been crossed but that he had confirmed at the time the contract was signed that no GST was payable. Mr Fabio explained that he was always checked to see if GST was payable but could not recall whether he had checked to see if the margin scheme box was checked.

Seabreeze was not registered at the time it acquired the property but obtained an ABN and was registered for GST effective from 1 January 2006. Mr Fabio explained that Seabreeze was not registered for GST for the period it acquired the land and did not claim input tax credits for the purchase as it knew it was not entitled to claim any credits.

The partnership did not report the sale of the property in its business activity statement for the period ended 31 December 2003.

Between 2009 and 2011 Seabreeze developed 4 townhouses on the land and appears to have claimed input tax credits on the construction costs. The townhouses were then rented out as residential premises without, it appears, there being increasing adjustments recorded.

On 25 September 2015 one of the townhouses was sold. The contract for the sale provided that the sale was a taxable supply but that the margin scheme was being used. The sale of the townhouse was not reported in Seabreeze's business activity statement for the period ended 30 September 2015.

On 23 October 2015 a further townhouse was sold for $670,000. The sale of the townhouse was not reported in Seabreeze's business activity statement for the period ended 31 December 2015.

On 27 July 2016 the Commissioner informed Seabreeze that it was undertaking a review of certain business activity statements lodged by Seabreeze. On 12 September 2016 the Commissioner notified Seabreeze that it was proceeding to an audit given the sale of the townhouses had not been disclosed in the business activity statements.

On 21 March 2017 the Commissioner issued his audit position paper which concluded that Seabreeze was not entitled to apply the GST margin scheme as it could not be accepted that the GST on the supply of the land from the partnership to Seabreeze had been worked out under the margin scheme.

Under section 75-5 of the GST Act a person cannot apply the margin scheme to work out the GST on a supply of real property if they acquired the property through a taxable supply where GST was calculated without applying the margin scheme.

On 19 April 2017 the Commissioner issued notices of amendment assessment of net amount to Seabreeze for the periods ended 30 September 2015 and 31 December 2015 imposing GST calculated as 1/11th of the sale price of each townhouse.

On 21 April 2017 the Commissioner informed Seabreeze that the audit was completed and issue a notice of assessment for administrative penalty at the level of 25% of the tax shortfall.

On 19 June 2017 Seabreeze objected to the GST assessments and the administrative penalty.

On 5 March 2018, the Commissioner disallowed the objection in relation to the application of the GST margin scheme. The Commissioner maintained the view that there was not sufficient evidence that the margin scheme had been applied on the supply from the partnership to Seabreeze.

Seabreeze applied to Administrative Appeals Tribunal for review of the Commissioner's objection decision.

Seabreeze urged the Tribunal to apply a favoured maxim of human behaviour by former NSW premier Jack Lang which was to the effect 'always back the horse named self-interest, son. It'll be the only one trying', on the basis that given there was a loss it was in the partnership's best interest to apply the margin scheme on sale.

Issue

Whether the sale of the two townhouses by Seabreeze was eligible for the margin scheme?

Decision

The Tribunal was satisfied that on the evidence there was a strong inference that the partnership has applied the margin scheme given that:

1. the supply from the partnership to Seabreeze involved a negative margin;
2. the partnership did not report the sale in its business activity statement; and
3. the trustee did not register for GST until a year after it had acquired the land.

These facts were consistent with Mr Fabio's understanding that the sale from the partnership to Seabreeze was not a taxable supply.

TIP – although the lack of evidence meant that Seabreeze could not prove its case 'beyond reasonable doubt' the standard in the ATO is merely on the 'balance of probabilities'.

Citation *The Trustee for the Seabreeze Estate Unit Trust and Commissioner of Taxation* [2019] AATA 1395 (Lazanas SM, Sydney)
w http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/AATA//2019/1395.html

1.2 YCNM – capital v income and settlement sum

Facts

YCNM was employed by Star Track Express. As an employee of Star Track, he was covered under its insurance policy, the Star Track Express Executive Plan.

Under this insurance policy, if an employee became totally disabled, the insurer would pay 75% of the employee's salary at the date of the claim to the employer and an additional amount to the person's superannuation fund under the Superannuation Contributions Insurance.

As a result of suffering severe depression and anxiety, YCNM became unable to work from 7 March 2003 and has not worked since. YCNM made a claim under the insurance policy. This was accepted by the insurer sometime after 1 July 2003.

At some point in 2006, notwithstanding the terms of the policy, the insurer started making salary continuance payments directly to YCNM and the superannuation amounts to YCNM's superannuation fund. The insurer withheld PAYG amounts from the amounts paid and issued YCNM with PAYG payment summaries.

It was confirmed in a report from YCNM's psychiatrist that YCNM was unlikely to ever return to work.

From 2003, YCNM experienced late payments of his benefits, received payments in different income years, causing him to incur a higher level of tax in some years, difficulties in getting his claims escalated – which were all significant stressors on YCNM's mental health.

The insurer received medical reports from YCNM's psychiatrist reporting that the difficulties YCNM was experiencing in respect of his payments were significantly impacting YCNM's mental health. Although YCNM would receive assurances from the insurer that his payments would be paid on time and any mispayment would not happen again, YCNM continued to experience problems.

In about February 2009, it came to the insurer's attention that they had overpaid YCNM over a period of 2.5 years a total of over $5,000. It was agreed internally that they would not seek recovery due to YCNM's mental health and the administrative errors in his past payments.

YCNM engaged accountants to conduct an audit of his insurance benefits.

In a letter dated 19 July 2009, YCNM's wife wrote to the insurer advising that the PAYG summary was incorrect and that such error was causing fear in YCNM. YCNM's wife put the insurers on notice that the actions of the insurers were having a direct impact on the decline of her husband's mental health.

A psychiatric report to the insurer dated 17 August 2009 described YCNM as suffering severe chronic major depressive disorder which appeared treatment resistant.

After a number of complaints by YCNM and his wife, YCNM lodged a dispute dated 1 December 2009 with the Financial Ombudsman Services in relation to his policy. The dispute was only in relation to his superannuation insurance benefits.

While the FOS dispute remained on foot, YCNM continued to experience difficulties with the administration of his claim. Complaints continued to be made by YCNM to the insurer.

FOS made a determination on 8 March 2012 upholding YCNM's complaints. Notwithstanding the FOS determination, YCNM continued to experience difficulties in the administration of his claim.

By letter dated 23 July 2012, YCNM's solicitor wrote to the insurer to discuss a settlement offer with the objective of arriving at an agreeable settlement figure of about $1.2 million less taxes. There was no claim in respect of any damages suffered by YCNM. Rather, YCNM testified that by August 2013 he was contemplating suicide and that he had resolved to sue the insurer for damaging his health unless there was a satisfactory settlement.

A settlement amount was agreed upon and a deed of release was signed by YCNM on or about 27 March 2014.

The deed of release relevantly provided that the insurer would pay the settlement sum to YCNM in exchange for YCNM releasing the insurer from any obligations under the policy, the claim and the complaint.

The Commissioner assessed YCNM on the basis that the whole of the settlement sum was assessable as ordinary income. YCNM objected to the assessment.

YCNM contended that the settlement sum was not assessable income and that the settlement sum was paid to him for the following reasons:

1. in exchange for YCNM releasing and discharging the insurer from the complaints and all claims YCNM had against the insurer in respect of any damage suffered by him or otherwise in connection with the facts that gave rise to the complaint;
2. in exchange for the insurer being released from its liability to pay compensation for the following unapportioned amounts:
    a. lost salary under the policy;
    b. contribution to YCNM's superannuation fund;
    c. any liability to pay damages in connection with YCNM's complaints;
    d. YCNM's pledge of confidentiality under the deed.

Therefore, YCNM argued that the settlement amount was capital in nature and as the whole sum was unapportioned between capital and income, so that the entire amount is to be treated as capital. YCNM argued that there was no taxable capital gain for any of the following reasons:

1. he made no capital gain as his cost base consisted of the market value of the policy and the right arising from his complaints. Further, the money he paid in respect of acquiring his claim including his lost salary;
2. any capital gain was disregarded under the section 118-37 of the ITAA 1997 as it was compensation or damages YCNM received for a wrong, injury or illness that YCNM or his wife and children suffered personally;
3. any capital gain was disregarded under section 118-300 as it was a capital gain made from release of YCNM's interest under a life insurance policy on his life and he was the beneficial owner of the policy.

The first contention above is based on the market value substitution rule applying to deem YCNM to have a market value cost base. The relevant provision is section 112-20 of the ITAA 1997, which provides as follows:

> *(1) The first element of your * cost base and * reduced cost base of a * CGT asset you * acquire from another entity is its *market value (at the time of acquisition) if:*
> *(a) you did not incur expenditure to acquire it, except where your acquisition of the asset resulted from:*
> *(i) CGT event D1 happening; or*
> *(ii) another entity doing something that did not constitute a CGT event happening; or*
> *(b) some or all of the expenditure you incurred to acquire it cannot be valued; or …*

Issues

1. Whether the settlement sum was income or capital in character.
2. If the settlement sum was partly income and partly capital, whether it was capable of being dissected.
3. If part of the settlement sum was capital, whether YCNM had a taxable capital gain.

Decision

<u>What was the settlement amount was income or capital?</u>

The Tribunal noted that the characterisation of the settlement sum is to be determined objectively and not subjectively. The Tribunal noted that the fact that YCNM thought he had a right to sue the insurer for pain and suffering did not determine the character of the settlement sum as a receipt in his hand.

The Tribunal was satisfied that the settlement sum was paid as a compensation for the discharge of YCNM's claims under the policy. Under the policy, YCNM was receiving a monthly salary continuance benefit and a superannuation continuance benefit, both payable up to the age of 65 years of age.

The Tribunal was of the view that no part of the settlement sum was made to compensate YCNM for any damages relating to pain and suffering. There was no reference to a claim for damages in any of the evidence provided to the Tribunal. Rather, the evidence showed that YCNM refrained from raising the issue of damages in order to get a settlement.

The settlement sum was paid to compensate YCNM for future salary payments, which were income in nature, and future superannuation payments he would have received, which were capital in nature.

<u>Was settlement amount capable of being dissected?</u>

As only some of the settlement sum was on revenue account, being the monthly salary payments, the Tribunal member considered whether the whole amount was to be treated as one of capital.

The Tribunal noted that the principle that if an amount consists of income and capital it is to be treated as capital is confined to lump sums made up of income and capital amounts, which are incapable of being dissected. If the income component cannot be identified because the settlement amount was not based on a calculation but a negotiated amount to settle, then it is an undissected amount.

The settlement sum in this case was capable of being dissected as the monthly salary payments could be calculated and apportioned from the total settlement sum.

The Tribunal calculated that the settlement sum should be apportioned 88.2% to YCNM's claim for future salary continuance insurance, and assessed as ordinary income, with the balance relating to YCNM's superannuation continuance insurance benefits.

Was capital component taxable?

The Tribunal rejected YCNM's contention that his cost base was the market value of the policy and other rights arising from his complaints. The Tribunal noted that the CGT asset here, being the rights under the insurance policy arose from CGT event D1 or another entity doing something that did not constitute a CGT event. This meant that the market value substitution rule under section 112-20 did not apply to deem YCNM's cost base to be market value.

The Tribunal rejected YCNM's contention that his loss of earnings was money paid to acquire the right to claim against the insurer and concluded that YCNM had not given any money or other property to acquire the right. There was also no evidence of any incidental costs incurred by YCNM.

However, the Tribunal considered that the capital gain was disregarded under section 118-37 of the ITAA. That section provides as follows:

> *(1) A capital gain or capital loss you make from a CGT event relating directly to any of these is disregarded:*
> *(a) Compensation or damages you receive for:*
> *(i) any wrong or injury you suffer in your occupation;*
> *(ii) any wrong, injury or illness you or your relative suffers personally*

The Tribunal noted that the question to be answered was whether the compensation directly related to compensation YCNM received for a wrong or injury that he suffers. The Tribunal noted that benefits required to be paid to YCNM under the policy arose from illness or injury that resulted in him being totally unable to work, the claim under the policy was contingent on him being totally and permanently disabled and the quantum of benefits was determined based on the length of time he was disabled and his salary at the time became disabled.

The Tribunal acknowledged that the decision in *Federal Commissioner of Taxation v Scully* (2000) 201 CLR 148 provided that, in respect of the phrase 'consideration of a capital nature for, or in respect of, personal injury to the taxpayer' in the definition of 'eligible termination payment', it is not sufficient for the cause of a payment to be the suffering of illness or injury. The character or purpose of the payment must be to compensate the recipient for injury or illness. The Tribunal considered that a similar approach should be followed with the exemption section 118-37 of the ITAA 1997.

The Tribunal noted that there is a question of whether a payment of insurance is regarded as compensation for injury or illness. The Tribunal referred to the Explanatory Memorandum to the Bill that introduced section 160XB(1) (the predecessor to section 118-37) which provided as follows:

> *Sub-section 160ZB(1) refers to compensation or damages awarded for any wrong or injury suffered by a taxpayer to his or her person or in his or her vocation. Under the sub-section such a wrong or injury, or proceeding instituted or other act done or transaction entered into by the taxpayer in respect of such wrong or injury will not be taken to have resulted in the taxpayer having incurred a capital loss. Within this category are damages for personal injuries or for libel, slander or defamation, and insurance monies under personal accident policies.'*

The Tribunal concluded that, given the terms of the EM, section 118-37 was clearly intended to be available for insurance proceeds. The Tribunal was satisfied that the benefits under the policy had the necessary character or purpose of compensating YCNM for injury or illness and that, therefore, settlement sum related directly to compensation for injury or illness.

The Tribunal considered that the exemption under section 118-300 of the ITA 1997 was not available as that exemption applied to insurance of the life of the a person but the policy of insurance under which YCNM was paid benefits did not provide for death benefits. Therefore, it was not a policy of insurance on the life of a person.

Citation *YCNM and Commissioner of Taxation* [2019] AATA 1592 (SM Hespe, Melbourne)
w http://classic.austlii.edu.au/au/cases/cth/AATA/2019/1592.html

1.3 Downer – relevant contracts and services ancillary to goods

Facts

Between 1 July 2009 and 30 June 2013, the Foxtel Partnership engaged Downer EDI Engineering Pty Ltd to deliver and install Foxtel equipment for Foxtel Subscription Television customers. Downer subcontracted the majority of the work under the Foxtel contract to third party contractors. On a typical day, a subcontractor would be allocated 2 to 4 tickets of work for the next day The subcontractors performed the following activities, as stipulated under the contract:

1. collect Foxtel equipment from Downer's warehouse;
2. transport the Foxtel equipment to the customer's premises;
3. deliver the Foxtel equipment to the customer;
4. conduct a safety inspection of the customer's premises;
5. install the Foxtel equipment;
6. clean up any rubbish; and
7. provide a brief demonstration of the use of the equipment to the customer.

The subcontracts set out 77 discrete tasks that the subcontractor may have to perform. Most of these tasks were repetitive and usually described numerous ways of performing one activity.

The only listed task that related to pick-up and delivery was titled 'truck roll' which involved the subcontractor operating a delivery vehicle, picking up and delivering the Foxtel goods (such as a set top box) to the Foxtel customer. This was charged based on an estimated travel time, with extra charges for travelling to regional areas.

Downer charged Foxtel a ‘sell price’ for each discrete task. The ‘sell price’ included the cost of materials, labour and a profit margin for Downer, as agreed with Foxtel. The ‘sell price’ was based on Downer's estimate of the time and materials required to complete each task.

Downer would then pay a ‘buy price’ to the subcontractors for performing each discrete task. The ‘buy price’ remained fixed irrespective of the actual time taken by a subcontractor or the amount of materials required. Downer on-sold the materials required to perform the services to sub-contractors at-cost. This included Foxtel consignment equipment (set top boxes and smartcards provided by Foxtel), Foxtel sell-through equipment (satellite dishes, assembly kits and power lines), Foxtel free of charge equipment (the Foxtel remote control) and Foxtel approved parts and consumables (screws, silicon sealant – which subcontractors could purchase from Downer or from electrical wholesale suppliers, provided they met the specifications required by Foxtel). The subcontractors charged for travel time, with additional amounts charged for driving to regional areas. The subcontractor could also charge for non-labour costs incurred, including fuel, lease, registration, insurance, administration costs, parking, ferry costs and the cost of operating a service maintenance centre (for which Foxtel reimbursed Downer). The charges for the truck roll represented 21% of the payments to the sub-contractors.

Downer engaged Mr Heydenrych to conduct a time and motion study of 7 subcontractors, who tendered affidavits into evidence on how they spent a typical day performing the subcontract. That study revealed that subcontractors spent more time travelling in their vehicles than actually performing installation tasks. For example, Stavrianos, who completed 2 jobs on a relevant day spent 2 hours and 41 minutes travelling to pick up stock from the warehouse and attending the customers premises and a maximum of 2 hours and 8 minutes actually performing installation tasks. Similar ratios were provided by subcontractor Luu, who completed 3 jobs in a relevant day and spent 2 hours 28 minutes travelling and 3 hours 11 minutes performing installation tasks, and Butina spent 3 hours 47 minutes travelling and 3 hours 33 minutes on installation tasks.

The Chief Commissioner considered that the labour components were amounts attributable to the performance of work and liable for payroll tax. Downer and the Chief Commissioner agreed before the hearing that 42.3% of the

total sum paid by Downer to subcontractors in the period was attributable to the performance of work, which totalled $24,782,170 (the **Disputed Amount**). That is, the other 57.7% was not attributable to the performance of work (for example, the amounts paid for materials) and, accordingly, was not liable to payroll tax.

The Chief Commissioner contended that Downer was assessable on the entire Disputed Amount as the subcontracts were 'relevant contracts' under section 32 of the PTA and no exemption was available.

In April 2016, the Chief Commissioner amended the Downer's payroll tax assessments for the financial years ended 30 June 2010, 2011, 2012 and 2013 in relation to the subcontracts.

On 10 June 2016 Downer objected to the amended assessments.

On 9 August 2017, the Chief Commissioner disallowed Downer's objections, following which Downer appealed the decision to issue the amended assessments to the Supreme Court of New South Wales.

Downer's submissions

Downer submitted that both the Foxtel contract and the subcontracts were clearly directed to the supply and installation of Foxtel equipment to provide an operational Foxtel service to the customer. As a result, Downer submitted that the contracts were not 'relevant contracts' as they were excluded under either section 32(2)(a) or 32(2)(d)(i) of the PTA:

> *(2) However, a **relevant contract** does not include a contract of service or a contract under which a person (the **designated person**) during a financial year in the course of a business carried on by the designated person:*
>
> *(a) is supplied with services for or in relation to the performance of work that are ancillary to the supply of goods under the contract by the person by whom the services are supplied or to the use of goods which are the property of that person, or*
>
> *…*
>
> *(d) is supplied with: (i) services ancillary to the conveyance of goods by means of a vehicle provided by the person conveying them,*

Downer argued that a delivery by subcontractors of Foxtel equipment constituted a 'supply of goods' for the purposes of section 32(2)(a) of the PTA. Downer noted that the words in the PTA was careful to speak of who was supplying the services and who is receiving the services, but that any person may be the recipient of the goods (in this case being the Foxtel customer).

Downer argued that the services were 'ancillary' to a supply of the goods, as the conveyance of the equipment (delivery by truck), and the installation services once those goods have been conveyed are critical and essential to the performance of the subcontract. Downer referred to the NSW Court of Appeal decision in *Smith's Snackfood Company Ltd v Chief Commissioner of State Revenue (NSW)* [2013] NSWCA 470, as follows:

1. the Court of Appeal rejected the trial judge's conclusion that 'ancillary' should be restricted to 'secondary or subservient';
2. the meaning of 'ancillary' is that the services are supplemental or auxiliary or accessary, but that is not a mathematical exercise; and
3. determining whether a service is ancillary is a question of fact and degree.

Downer further noted that the fundamental objective of the subcontract was to deliver an operating Foxtel service and that the range of services facilitated the supply of the Foxtel equipment, including installation, transport, loading and unloading.

Downer noted that, while the 'truck roll' represents 21% of the payments to subcontractors, the evidence established that more than half the time spent by subcontractors on the job was driving. The remaining 79% of the aggregated payments to subcontractors were not compensation for installation services, but in large measure, compensation for the materials purchased, collected and conveyed by the subcontractors.

Accordingly, the payment attributable to the installation services was less than 42.3% of the total payments to subcontractors that was attributable to the labour component.

In response to the Chief Commissioner's contention that the exemption was not available as the key equipment (set top boxes and smartcards provided by Foxtel) was only supplied on consignment, Downer submitted that a transfer of title of goods was not necessary for the exemption to apply and, even if it was, this was satisfied as title to some of the equipment satellite dishes, assembly kits, power lines and the Foxtel remote control was transferred.

In relation to section 32(2)(d)(i) of the PTA, Downer noted that there was a conveyance of goods and that conveyance was by means of a vehicle provided by the person conveying them. Accordingly, the only issue in question is whether the services are ancillary to the conveyance.

Downer submitted that conveyance of goods included collecting the Foxtel equipment from Downer's warehouse, transporting the Foxtel equipment to the customer's premises and delivering the equipment to the customer's premises. Downer submitted that the services ancillary to this were conducting a safety inspection of the customer's premises, connecting the Foxtel items, cleaning up rubbish after installation and providing a brief demonstration of the use of the Foxtel service.

Downer submitted there was no material difference between the subcontract in this case and *Smith's*, and accordingly, the findings in *Smith's* should also apply as in both cases, the subcontractors were required to provide their own vehicle, undertake training by the head contractor (in this case Downer) on how to undertake the relevant tasks, collect and transport the relevant items using their vehicle, unload and manipulate those items to place them in their final location, clean the site and check installed equipment to ensure it was working.

Downer submitted it was a false position to look at the amount of time charged on a truck roll and conclude that only 21% of the payments related to conveyance, as this was a mathematical approach which reduced the broader substantive question of whether there is a nexus that amounts to an ancillary relationship.

Penalties

Downer submitted that if the principal argument was unsuccessful, the Chief Commissioner should further remit the penalties for any shortfall amount (20% remission was allowed).

Downer noted that the tax was outstanding longer than it should have been due to the Chief Commissioner's delays and erroneous earlier decision concerning the appointment of disputed liabilities and undisputed liabilities, as the Chief Commissioner had incorrectly calculated the apportionment of undisputed liabilities from disputed liabilities to be 25% undisputed (rather than 57.7%). Further, the Chief Commissioner had the information available to him to make this determination earlier. Downer also noted it made voluntary disclosures that were not driven by pressure from the Chief Commissioner.

The Chief Commissioner submitted that the Court had no authority to determine the amount of the penalty tax remission, and in the event the Court believed further remission was warranted, ought to revert the decision back to the Chief Commissioner to determine.

Issues

1. Should the subcontracts be excluded from being ‘relevant contracts’ under section 32(2)(a) of the PTA?
2. Should the subcontracts be excluded from being ‘relevant contracts’ under the former section 32(2)(d)(i) of the PTA?
3. If sections 32(2)(a) or 32(2)(d)(i) of the PTA do not apply, should the penalties and/ or interest be remitted?

Decision

Section 32(2)(a) of the PTA

The Court concluded that the subcontracts were excluded from being relevant contracts under section 32(2)(a) of the PTA.

The Court considered the evidence and concluded that the installation tasks were mechanical or menial. The Court disagreed with contentions put by the Commissioner that the installation amounted to skilled labour. The Court noted that the installation tasks did not require technical qualifications and merely required the subcontractor to attend a short training course conducted by Downer and to obtain the relevant occupational health and safety certifications, which was a short and straightforward process. Complex tasks, such as construction work, were performed by a civil works team from a different group.

The Court also accepted the evidence from the time and motion study and that subcontractors generally spent more time travelling in their vehicles than actually performing installation tasks.

The Court noted that if the question is posed: what is critical to the performance of the subcontract, the answer is the obligation to supply the Foxtel equipment. The subcontractor was also obliged to install the Foxtel equipment, as without the installation, the Foxtel services would not function and the customers would not receive the benefit of possession of the Foxtel equipment.

The Court found that the services were ancillary based on the evidence of the time actually spent in the performance of the services under the subcontract, as evidenced in the time and motion study. The Court accepted that comparing time spent on installation compared to other activities (time spent collecting, storing and delivering the goods) showed that installation was ancillary.

Section 32(2)(d)(i)

Payne J noted that the interpretation of section 32(2)(d)(i) of the PTA was set out by the Court of Appeal in *Smith's* case. Payne J noted a critical part of the conclusion from *Smith's* case was that it is not the point that some of the services, whether of de minimis character or otherwise, are in and of themselves not ancillary to the conveyance. The services do not need to be exclusively or solely ancillary to the conveyance.

Payne J concluded that conveyance not only included the pick-up and delivery of the Foxtel Equipment by the subcontractor, but also extended to the additional installation steps. Payne J noted that the evidence showed that conveyance activities are substantial and essential to the contractual outcome of supply the customer with a Foxtel subscription television service.

Payne J considered that, while there are some differences between the present case and *Smith's case*, those differences do not lead to a different conclusion, particularly as the key difference that the Chief Commissioner relied upon, being the alleged complexity of the installation, had been rejected.

Penalties and interest

Payne J concluded that, if the primary liabilities had remained, penalties and interest should be remitted by 50%. This is because the Chief Commissioner was in a position to know the apportionment between disputed and undisputed liabilities was incorrect, Downer was highly co-operative during the process (with unprompted disclosures) and significant delays were caused by the Chief Commissioner.

Citation *Downer EDI Engineering Pty Ltd v Chief Commissioner of State Revenue* [2019] NSWSC 743 (Payne J)
w http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/nsw/NSWSC/2019/743.html

1.4 McIntosh – land tax exemption for land used for primary production

Facts

McIntosh Bros Pty Ltd acquired land known as 'Denbigh' near Cobbity (on the outer fringes of western Sydney) in 1931 from members of the McIntosh family. It had been owned by the McIntosh family since 1868.

McIntosh Bros entered voluntary liquidation in 1987 and since then has been slowly wound up.

The 2 descendants of the original Mr McIntosh who now farm the property are Richard McIntosh and Ian McIntosh, who are cousins. Richard's and Ian's fathers used the land for dairy farming until the late 1980s when they decided to go into beef farming.

The shares in McIntosh Bros are held 50–50 by family trusts for Richard's and Ian's sides of the family.

Use of the land is informally divided by an agreement under which Richard and his father Ron and Richard's nephew, Jim Head, use the Bangor (east) side of the property for cattle, and Ian and certain agistees use the Denbigh (west) side of the property for cattle.

Ian conducted a cattle farming operation on the Denbigh side. At the same time a local dairy farmer agisted his heifer cattle on Ian's side prior to their introduction into the dairy herd or sale. There were 2 other minor agistees in later years.

Richard conducted a cattle farming operation on the Bangor side with help from his father Ron and other family including his nephew, Jim Head. Richard lived on his property at Molong NSW (about 4 hours drive away) where he conducted a substantial sheep farming business. There were also two cottages on the Denbigh side that were rented out to arm's length tenants for modest rent.

In 2014 Richard's nephew, Jim, began a cattle breeding and storage operation on the Bangor side.

There are 2 homesteads on Denbigh. Richard's father, Ron, lives in the Bangor Homestead (on the east side of the property) and Ian lives in the Denbigh Homestead (on the west side of the property).

As at 31 December 2013 the land was 451ha. The land was zoned residential by the State Government in 2007 and was subdivided into large 'superlots' in 2009. Carved out from the residential zoning was an area of approximately 207ha called the Heritage Curtilage surrounding the Homesteads which were zoned environmental living.

In May 2014, McIntosh Bros sold the Heritage Curtilage land in 2 parcels to Ian and to Richard's sister, Angela Head. However, the Heritage Curtilage continued to be used seamlessly with the other land of McIntosh Bros as it had been previously. This left McIntosh Bros with 244 ha in the 2015 and 2016 years.

The farming operations of Ian and Richard on the land made a trading profit but a net loss in each of the 2014 to 2016 years. If the farming operations of Richard off the land were taken into account, the operations made net profit of $13,000 in 2014, $256,000 in 2015 and $58,000 in 2016. The profits of Richard's cattle and sheep operations were $490,000 in 2014, $648,000 in 2015 and $522,000 in 2016.

Over the relevant years, small parts of the land were used for non-primary production purposes including a sewer pumping station and associated facilities, a one year storage lease, rental of 2 cottages, fencing, road works, planting and surveys.

The Commissioner assessed McIntosh Bros in respect of the land on the basis that it was not entitled to the primary production exemption for the 2014 to 2016 land tax years.

Following an objection being disallowed, McIntosh Bros applied to the NSW Civil and Administrative Tribunal for review of the assessments.

As the land was zoned residential to be eligible for the exemption it needed to be the case that the dominant use of the land was primary production, that the primary production activity had a significant and substantial commercial purpose or character and that the activity was carried on for the purpose of profit in a regular or continuous manner.

Issues

1. What was the dominant use of the land in each of the land tax years under consideration?

2. If primary production was the dominant use, did it have a significant and substantial commercial purpose or character?
3. Was the dominant use engaged in for the purpose of profit on a continuous or repetitive basis (regardless of whether or not a profit was actually made)?

Decision

Dominant use for primary production?

The exemption requires that the dominant use of the land be for primary production, including the maintenance of animals for the purpose of selling them or their natural increase or bodily produce.

The Tribunal found that the land was mainly devoted to primary production uses which significantly outweighed the competing non-primary production uses, being the residential use and use for a commercial rain gauge. The Tribunal considered that these competing uses were de minimis use.

The primary production use of the land during the relevant years was the dominant use given the area devoted to cattle, the number of cattle grazed, the number of cattle grazed relative to the area and the carrying capacity of the land, the amount of work done on the land by the McIntosh family, and the size and intensity of the continuing grazing activity on the broadacres of land by the McIntosh family and agistees who used the vast part of the surface area and produce most of the cash income generated by the land, even though the cattle operations on the land were not very profitable in the relevant years.

The commerciality test

The Tribunal held that the operations of the users of Ian's side of the property (being himself and the main agistee) had a significant and substantial commercial purpose or character.

The Tribunal noted that, if the cattle operations on Richard's side of the property were viewed on a standalone basis, as contended by the Chief Commissioner, it was doubtful they would satisfy the commerciality test. However, the Tribunal found that Richard's cattle operations on the Bangor Side of Denbigh could be regarded as part of his wider farming operation based at Molong through the relevant years because of the interconnecting integrative elements (management, financial, banking, insurance, accounting, and risk management) between the 2 operations. That was sufficient to enable Richard's sheep and cattle operations to be regarded as part of the one business whose use of both Bangor and Molong had a significant and substantial commercial purpose or character.

The purpose of profit test

The Chief Commissioner submitted that a primary production operation could not be regarded as profitable economically unless there was a provision in the calculation of profit for a notional cost of labour of the proprietor if that person works the land, and a notional cost for the use of the land.

The accounting experts agreed that notional costs were not required by the accounting standards. The Tribunal agreed with the submission of McIntosh Bros that there was no statutory requirement that profit should be read as meaning 'economic profit' and that the profit result was only one factor for consideration and should be calculated according to ordinary accounting principles, without taking account of expenses which had not, in fact, been incurred.

Accordingly, the Tribunal concluded that the dominant use of the subject land was for the maintenance of animals for the purpose of selling them or their bodily products, that that use had a significant and substantial commercial purpose or character, and that it was engaged in for the purpose of profit on a continuous or repetitive basis (whether or not a profit was actually made). Consequently, the Tribunal ordered that the Commissioner's assessments of land tax be set aside.

Citation *McIntosh Bros Pty Ltd (In Liq) v Chief Commissioner of State Revenue* [2019] NSWCATAD 124 (SM R L Hamilton, SC)
w http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/nsw/NSWCATAD/2019/124.html

1.5 Country Road – application to distribute trust income

Facts

Country Road Services Pty Ltd is the trustee of the Browne Family Trust, a trust established in February 1995.

The Browne Family Trust was established for the benefit of the late James Browne and his family. Mr Browne died unexpectedly in September 2015, leaving his widow, Diane Browne, and four children.

In November 2017, the assets of the Browne Family Trust consisted of a service station at Tamworth. The property was leased to the operators of the service station and the Browne Family Trust derived a rental income stream from the lease.

A second trust had also been established for the benefit of the Browne family in May 2006 known as the Browne North West Trust. The trustee of the Browne North West Trust is Daly River Pastoral Pty Limited.

The assets of the Browne North West Trust consist of two rural properties in the Northern Territory, known as 'Tarwoo' and 'Granite Creek Station'.

Prior to Mr Browne's death, Tarwoo was subdivided for the purposes of development and sale. The subdivision resulted in eighteen subdivided blocks ranging in size from approximately 20 hectares to 120 hectares. The subdivision was financed by the CBA.

The subdivision progressed slower than anticipated. In November 2017, the sale of only three blocks had been completed, and the debt to CBA had increased from approximately $1.4 million to $3.6 million.

The debt to CBA was secured on the assets of both the Browne North West Trust and the Browne Family Trust. It was also the subject of personal guarantees and indemnities by Diane and one of the adult children, Tony.

The remaining properties of the Browne North West Trust were not able to be easily liquidated. Diane and Tony wished to reduce the Browne North West Trust's debt to the CBA by having the Browne Family Trust sell the service station property and apply the proceeds to paying down the CBA debt.

The provisions of the trust deed of the Browne Family Trust was such that the trustee's discretionary power to appoint capital, and to appoint income otherwise than in accordance with the default distribution order, was limited to the lifetime of the deceased as Protector. Following the death of Mr Browne, the effect of the default distribution order was that Diane, as the deceased's widow, was entitled to all of the income of the Trust in each income year. Should the trust vest during Diane's lifetime, she would be entitled to the whole of the capital of the Trust. While there was an amendment power in the deed, it did not permit the trustee to amend the necessary terms of the trust after the death of the Protector.

In November 2017, an application was filed by the trustee of the Browne Family Trust to seek an order of the Court pursuant to section 81 of the *Trustee Act 1925 (NSW)* to empower the trustee to distribute the capital gain from the sale in the Browne Family Trust to the Browne North West Trust.

In the 2018 income year, the Browne North West Trust had carried forward capital losses of $1.22 million. The purpose of the distribution was to apply the capital losses to the capital gain in such a way which would minimise the amount of tax payable, thereby maximising the amount applied to debt reduction.

In late February 2018, the trustee of the Browne Family Trust exchanged contracts for the sale of the service station. The sale price was $2.6 million. Following completion of the sale in June 2018, the net proceeds of $2.465 million were paid to the CBA. The sale resulted in a capital gain in the 2018 income year of approximately $1.94 million. If the net capital gain was to be distributed to Diane as required by the trust deed, the estimated tax liability for Diane would be approximately $480,000.

If the 2018 capital gain in the Browne Family Trust was distributed to the Browne North West Trust, then, after deduction of losses, and assuming that the trustee did not exercise its discretion to the contrary, the residual gain of $0.72 million would pass to Diane, carrying with it a tax liability of approximately $110,000. This would result in a tax saving of $370,000.

The application also sought to empower the trustee of the Browne Family Trust to distribute any other income of the Trust in the 2018 income year to the Browne North West Trust. The Browne North West Trust has carried forward tax losses, on revenue account, which would be available to absorb that income.

Undertakings were made by the trustees of the Browne Family Trust and the Browne North West Trust to the effect that irrevocable amendments would be made by the Browne North West Trust to ensure it would vest before the Browne Family Trust.

On 30 June 2018, the Trustee of the Browne Family Trust passed a resolution in anticipation of the Court granting the power which was sought, which provided that, subject to the Court, by 30 June 2019, making the orders sought, all of the income of the Trust for the 2018 financial year, including the capital gain arising on the sale of the service station, be distributed to the Browne North West Trust.

Section 81 of the *Trustee Act 1925* (NSW) allows the Court to confer power on trustees in certain circumstances.

Issue

Whether the Court could exercise the power pursuant to section 81 of the *Trustee Act 1925* (NSW) to make an order to distribute the income and the capital gain of the Browne Family Trust to the Browne North West Trust, which was not a beneficiary of that trust.

Decision

The Court considered the leading judgment in the Court of Appeal decision in *Cisera v Cisera Holdings Pty Ltd* [2018] NSWCA 286 given by White JA. His Honour identified the central reasoning of *Re Dion Investments Pty Ltd* [2014] NSWCA 367 as being that

> 'the only dealings which can be authorised by the court under s 81(1) are dealings specifically related to the management or administration by trustees of trust property, quoad property.'

His Honour described the ratio of *Dion* as being:

> 'The power under s 81(1) must be exercised by only granting specific powers relating to the management and administration of the trust property that can be seen to be expedient.'

White JA considered that in substance the applicant in *Dion* was seeking to vary the terms of the trust, which was not authorised by section 81 and the appeal was dismissed.

In the current application, in considering the power of the Court under section 81, Parker J considered that the *Cisera* appeal was binding on him. His Honour considered that the specific power sought by the trustee of the Browne Family Trust to pay the capital gain and income in the 2018 income year to the Brown North West Trust would fall under one or more of the categories of 'expenditure', 'transaction' and 'disposition' for the purposes of section 81(1) which would enliven the Court's powers.

As to whether the making of the distribution would be a dealing 'in the management or administration' of the property of the Trust, his Honour considered that the case law drew distinction between the grant of a power not provided for in the trust deed as part of the 'management and administration' of trust property, on the one hand, and the alteration of the terms of the trust, on the other. According to those decisions, section 81(1) cannot be used for the latter purpose of altering the terms of a trust, which can only be achieved in jurisdictions which provided a wider statutory power to amend the terms of a trust.

In this case, the trustee was seeking a power to depart from the terms of the trust and make the distribution instead to the Browne North West Trust. It would only be in exceptional cases in which the 'management and administration' of the trust would justify the grant of a power to appoint capital or income otherwise than in accordance with the terms of the trust.

The Court considered the judgement of Barrett JA in *Chapman v Chapman* [1954] UKHL 1; [1954] AC 429, a UK case which considered the equivalent of section 81(1), and in particular [94] which provided:

> 'Variation of the terms of a trust (including by way of conferral of some new power on the trustee) is not something within the ordinary and natural province of a trustee. It is not something that is 'expedient' that a trustee should do; nor, fundamentally, is it something that is done 'in management or administration of' trust property. A trustee's function is to take the trusts as it finds them and to administer them as they stand. The trustee is not concerned to question the terms of the trust or seek to improve them. I venture to say that, even where the trust instrument itself gives the trustee a power of variation, exercise of that power is not something that occurs 'in the management or administration of' trust property. It occurs in order that the scheme of fiduciary administration of the property may somehow be reshaped.'

The Court concluded that the distribution of income and capital from the Browne Family Trust in the 2018 income year to the Browne North West Trust would not be a dealing in 'the management and administration' of the property of the Browne Family Trust, and falls outside the power provided at section 81 of the Trustee Act.

The Court further considered that even if the relevant dealings fell within section 81, the grant of the power would not be 'expedient' for the purposes of that section. Although the avoidance of tax would be expedient from a taxpayer's point of view, the expediency does not arise in the administration of the Browne Family Trust. The clear intent of the settlor of the trust deed, was that upon the death of the deceased as Protector, the trust would become a fixed trust in favour of Diane and then the children. Distributing the income and capital of the trust to the Browne North West Trust instead would be contrary to the objectives of the Trust and not a step which would be 'expedient' in the management and administration of the Trust assets.

Citation *Application of Country Road Services Pty Ltd (In the matter of the Browne Family Trust)* [2019] NSWSC 779 (Parker J, NSW)
w http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/nsw/NSWSC/2019/779.html

1.6 Khatiz – power to reassess for NSW taxes

Facts

Mr Khatiz owned an interest in a property in Quakers Road, Marayong in 2010. The property was a licensed childcare centre. Pursuant to s 10(1)(u) of the *Land Tax Management Act 1956* (NSW) childcare centres are exempt from land tax.

For the 2010 tax year, the property was not treated as exempt, but its value was below the threshold for land tax.

For the 2011 tax year, Mr Khatiz's land holdings exceeded the threshold and tax was payable. In August 2011 the Chief Commissioner sent a letter to Mr Khatiz stating that his property may be liable to land tax and if he wished to claim an exemption he should contact the Office of State Revenue. The same situation arose in the 2012 tax year.

For the 2013 tax year, the property was omitted from the schedule attached to the first notice of assessment, which was issued in February 2013. On 11 February 2013 Mr Khatiz called the Office of State Revenue and informed the officer about the omission of the property from the assessment, requesting that it 'be assessed as to the proper amount of land tax'. Mr Khatiz claimed that in this phone call he informed the officer that the property was used as a childcare centre. However, the Office of State Revenue's notes made no comment on this.

Mr Khatiz contended that at this time he was unaware of the childcare exemption, and so did not ask for it. He stated that the officer he spoke with advised him that it was unnecessary for him to put anything in writing, and that the Office of State Revenue would correct the issue regarding the inclusion of the property in his land tax assessment. The second assessment notice was later issued including the property. This assessment stated that the reason or reassessment was 'objection/review.'

Mr Khatiz accepted the second issued assessment and paid the land tax due. Mr Khatiz never lodged an objection in writing at this time.

For the tax years 2014 – 2018 notices of assessment were issued. They were not disputed until June 2018 when Mr Khatiz became aware of the childcare exemption. At this time, Mr Khatiz lodged a written exemption for the tax years from 2010 – 2018 and lodged an objection against assessments for the years 2010 – 2018.

The objections against the assessments for the 2010 – 2013 years were disallowed. The objections for years 2014 – 2018 were allowed.

Mr Khatiz applied to the NSW Civil and Administrative Tribunal for review of the assessments for the 2010 to 2013 years.

The 2013 claim was denied due to section 9(3)(a) and section 9(3)(d) of the *Taxation Administration Act 1996* (NSW) (**TAA**) preventing the Commissioner from reassessing.

> *(3) The Chief Commissioner cannot make a reassessment of a tax liability more than 5 years after the initial assessment of the liability, unless:*
>
> *(a) the reassessment is to adjust tax to give effect to a decision on an objection or review as to the initial assessment, or*
>
> *…*
>
> *(d) the reassessment is made as a consequence of an application by a taxpayer, being an application made within 5 years after the initial assessment of the liability, and the reassessment reduces the tax liability.*

The request for reassessment of the 2013 tax year was denied for two reasons. Firstly, when Mr Khatiz made a phone call in February 2013 in relation to the first notice of assessment, the property had not yet been included in the assessment and, therefore, no assessment in relation to land tax had been made. It is not possible to object to an assessment for land tax prior to it being made. The property was only assessed in the second assessment issued later that year, which Mr Khatiz accepted and paid. Further, objections must be made in writing as required by section 86 of the TAA, meaning a phone call would not constitute an objection as required by section 9(3)(a).

Secondly, the written objection lodged in June 2018 was outside the 60 day objection period prescribed by section 89 of the TAA, and also outside the 5 year reassessment period specified in section 9(3)(d). While the Commissioner has a discretion under section 90 of the TAA to accept a late objection that discretion was not exercised. There was, therefore, no power for the Commissioner to reassess the 2013 tax year. These same time bar issues also apply to Mr Khatiz's request for reassessment of the 2011 and 2012 tax years.

The 2010 year could not be objected to as the property was not assessed in this year.

The Commissioner was able to reassess the land tax payable on the property for the tax years 2014 - 2018. The childcare exemption was accordingly applied.

Issue

Whether the Chief Commissioner had the power to reassess the land tax paid over the tax years 2010 – 2013 to correctly apply the childcare exemption.

Decision

The Commissioner's decision was affirmed for the reasons set out above.

COMMENT – it is surprising that the Tribunal did not consider whether the Chief Commissioner should have exercised his discretion to allow the objection lodged in June 2018 to the 2011 to 2013 years out of time under section 90 of the TAA. This would have enabled the Chief Commissioner to re-assess under section 9(3)(a) of the TAA. It is not clear whether the effect of the Tribunal's decision that the power in section 9(3)(a) is limited by the restriction in section 9(3)(d) of the TAA

Citation *Khatiz v Chief Commissioner of State Revenue* [2019] NSWCATAD 121 (SM RL Hamilton SC, Sydney)
w http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/nsw/NSWCATAD/2019/121.html

1.7 Kranias – duty and cancelled agreements

Facts

On 14 May 2013 Stephen King and Jill Kranias, at the time de facto partners, entered into a contract to purchase a unit in Maitland, New South Wales off the plan for $285,000.

On 25 July 2013 the contract was stamped and duty was paid.

On 21 September 2015, pursuant to a deed of variation, Stephen and Jill agreed with the vendors to an increase in the purchase price to $295,700 and to an extension of the completion date.

The deed and the contract were submitted to the Chief Commissioner for further stamping.

On 7 December 2015 the Chief Commissioner up-stamped the contract with higher duty reflecting the increased consideration. The deed was stamped with fixed duty of $50 at the same time. The up-stamping was in accordance with section 31 of the *Duties Act 1997* (NSW), which provides as follows:

> *31 Effect of alteration in purchase price*
>
> *(1) If after an agreement for the sale or transfer of dutiable property is entered into and before the property is transferred:*
>
> *…*
>
> *(c) the consideration under the agreement is increased and the dutiable value when the consideration was increased is greater than the dutiable value when the agreement was entered into,*
>
> *the Chief Commissioner must assess or reassess the liability to duty of the agreement in accordance with the change in the consideration.*
>
> *(2) The liability to pay additional duty arising from an increase in the consideration occurs on the date the consideration is agreed to be increased.*

On 22 February 2017, following more delays in completion of the development, the vendor rescinded the contract and returned the deposit plus interest earned.

On 27 April 2018 one of Stephen and Jill signed a statutory declaration stating that the contract been rescinded.

On 14 August 2018 Stephen and Jill lodged an application for a refund of the stamp duty that they had paid, being 5 years and 20 days after the first stamping of the contract.

The refund was refused by the Chief Commissioner as being out of time in reliance on section 50 of the Duties Act, which provides as follows:

> *50 Cancelled agreements*
>
> *(1) An agreement for the sale or transfer of dutiable property that is cancelled is not liable to duty under this Chapter if the Chief Commissioner is satisfied:*
>
> *(a) that the agreement was not cancelled to give effect to a subsale, or*
> *(b) that the purchaser or transferee under the agreement is a promoter of a named company proposed to be incorporated and that the company is the purchaser or transferee of the dutiable property under a subsequent agreement, or*
> *(c) that the purchaser or transferee under the agreement and the purchaser or transferee under a subsequent agreement relating to the same dutiable property were related persons when the agreement that is cancelled was entered into.*

> *(2) If duty has been paid on an agreement that is not liable to duty under this Chapter because of this section, the Chief Commissioner must reassess and refund the duty if an application for a refund is made within:*
>
> *(a) 5 years of the initial assessment, or*
> *(b) 12 months after the agreement is cancelled,*
> *whichever is the later.*
>
> *(3) In this section,*
>
> *'cancelled' means rescinded, annulled or otherwise terminated without completion.*

The whole of the duty paid was refused to be refunded even though part of it had been paid less than 5 years before the application for the refund was lodged.

Stephen and Jill objected to the assessment. On 6 November 2018 the Chief Commissioner disallowed the objection. In the objection decision dated 6 November 2018 it said 'we note that the initial assessment was cancelled and the contract was reassessed due to an increase in the purchase price of the property'.

Stephen and Jill subsequently applied to the NSW Civil and Administrative Tribunal for review of the decision. Stephen and Jill contended that when the contract was up-stamped, the first stamping became 'void' such that the second stamping was the initial assessment as referred to in section 50 of the *Duties Act*. Stephen and Jill also noted that there actually no definition of 'initial assessment' in the *Duties Act* and that, in accordance with section 31, the assessment that occurred on the up-stamping of the contract is an 'initial assessment'.

The Chief Commissioner contended that the term 'initial assessment', which not defined in the *Duties Act*, should be interpreted in accordance with the text, context and purpose of the *Duties Act* and that the up-stamping of the contract on 7 December 2015 was a re-assessment and not an initial assessment as it was not a new and separate assessment, relying on the decision of White J in *Delmege v Chief Commissioner of State Revenue* [2014] NSWSC 1865.

Issue

Whether the Chief Commissioner was required to re-assess Stephen and Jill and refund the duty paid?

Decision

The Tribunal noted that the question is when the 'initial assessment', referred to in section 50, was made. If it was on 25 July 2013, then no re-assessment could be made as Stephen and Jill were 20 days too late for a refund.

The Tribunal agreed with the Chief Commissioner that the term 'initial assessment' should be interpreted by reference to the text, context and purpose of section 50 of the Duties Act and that the context in this case is the subject of the claim for refund with the purpose of the provision to set time limits for making a claim.

The Tribunal noted that assessment the subject of the claim for refund was the assessment that made in 2015, although credit was given in that assessment for the duty paid on the earlier assessment.

In the Tribunal's words:

> *This accords with a sensible reading of the provision. There is an important principle involved. In another case the first assessment may be for a very modest amount and the second assessment for a very large amount due to a sharp escalation in consideration, say due to an agreed new valuation. On the Chief Commissioner's approach, if the agreement is later cancelled, the limitation period for a refund starts from the date of the first assessment but sweeps up the second assessment. This can lead, potentially, to an absurd result.*

Accordingly, the Tribunal consider that the second stamping was an initial assessment for the purpose of section 50 of the *Duties Act*.

Citation *Kranias v Chief Commissioner of State Revenue* [2019] NSWCATAD 130 (SM RL Hamilton SC, Sydney)

w http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/nsw/NSWCATAD/2019/130.html

2 Legislation

2.1 Progress of legislation

Title	Introduced House	Passed House	Introduced Senate	Passed Senate	Assented
Treasury Laws Amendment (Putting Members—Interests First) 2019	4/7				
Treasury Laws Amendment (2018 Measures No. 2) 2019	4/7				
Treasury Laws Amendment (Combating Illegal Phoenixing) Bill 2019	4/7				
Treasury Laws Amendment (Making Sure Multinationals Pay Their Fair Share of Tax in Australia and Other Measures) 2019	4/7				
Treasury Laws Amendment (Tax Relief So Working Australians Keep More Of Their Money) 2019	2/7	2/7	4/7	4/7	5/7

2.2 NSW Budget

There were few tax changes announced in the NSW State budget. The only previously announced change is the removal of foreign person duty and land tax surcharges for persons who hold retirement visas (subclass 410 and 405).

The Budget noted the increase in the payroll tax threshold from $850,000 to $900,000 from 1 July 2019 with further increases over the next two years. These changes had already been announced.

The Budget also noted that the duty thresholds will be indexed to CPI from 1 July 2019. This change was previously announced.

w http://www.legislation.vic.gov.au/domino/Web_Notes/LDMS/PubPDocs.nsf/ee665e366dcb6cb0ca256da400837f6b/79f4e5b276d49e44ca258407002000ec!OpenDocument

2.3 Main residence exemption changes for foreign residents

The Treasurer, Josh Frydenberg, has indicated that the Government intends to proceed with the proposed changes to the main residence exemption for foreign residents.

In response to a question from ABC News as to whether the Government intends to revisit the changes in the future, the Treasurer stated that it 'remains our Government's policy'.

w https://www.abc.net.au/news/2019-07-05/large-capital-tax-changes-still-loom-for-expats/11278716

3 Rulings

3.1 TR 2019/3 - Religious practitioners and FBT

The Commissioner has finalised his views on when benefits provided to certain employees of a religious institution are exempt from FBT in Taxation Ruling 2019/3.

The ruling takes into account the commencement of the Australian Charities and Not-for-Profits Commission (**ACNC**).

From 3 December 2012, an entity can provide exempt fringe benefits where:

1. a benefit is provided by a registered religious institution;
2. to an employee religious practitioner, or their spouse or child;
3. in respect of the practitioner's pastoral duties or directly related religious activities.

Registered religious institution

An entity is a registered religious institution where it is registered as a charity with the ACNC with the subtype 'advancing religion'.

Religious practitioner

A 'religious practitioner' is defined to mean:

1. a minister of religion;
2. a student at an institution who is undertaking a course of instruction in the duties of a minister of religion;
3. a full-time member of a religious order; or
4. a student at a college conducted solely for training persons to become members of religious orders.

The ruling sets out the characteristics that the ATO would usually expect to be present in a minister of religion and a religious order.

Principally for pastoral duties or duties directly related to religious activities

The FBT exemption provides that to be exempt the benefit cannot be provided principally in relation to duties other than pastoral duties, or other duties or activities that are directly related to the practice, study, teaching or propagation of religious beliefs. The ATO state that this means that a benefit must be provided **principally** for pastoral duties or duties that are directly related to the practice, study, teaching or propagation of religious beliefs.

The word 'principally' is not defined in the FBTAA and the ruling notes that it takes its ordinary meaning of 'mainly' or 'chiefly'.

The ATO consider this looks to the connection between the benefit and a religious practitioner's duties or activities rather than the nature of the advantage the benefits represent, they give the example that paying school fees for children would not be precluded from being FBT free if the payment was connected to religious duties or activities.

The ruling provides the following examples of where activities will be principally for pastoral duties or duties directly related to religious activities or duties that are both pastoral and non-pastoral (extracted from the ruling).

Example 5 - duties that are solely or predominantly pastoral

Rod is a lay person commissioned to perform the ministerial duties of a church and meets all the criteria to be a minister of religion.

Rod is also employed by a private school to teach religious studies and to perform other duties as a spiritual guidance officer. The private school is a registered religious institution, which also maintains registration under another ACNC subtype.

The school provides Rod with the use of a car in relation to his employment.

The benefit is exempt from FBT, as the school is a registered religious institution and the benefit is provided principally in respect of pastoral and directly related religious activities that Rod solely or predominantly performs.

Example 6 - duties that are not solely or predominantly pastoral or directly related religious activities

Following from the facts of Example 5, in a subsequent year there is a restructure of the teaching duties at the school and Rod commences teaching the Mathematics and English curricula in addition to providing religious instruction.

Rod's role as a spiritual guidance officer is now shared with several other teaching staff. His teaching duties in subjects other than religious instruction take up the majority of his working time.

The school continues to provide Rod with benefits on the same basis.

The benefits are not exempt from FBT, as the arrangement between the school and Rod does not show that the benefits are provided principally for the pastoral duties or the directly related religious activities that he performs.

ATO reference *Taxation Ruling TR 2019/3*
w https://www.ato.gov.au/law/view/document?DocID=TXR/TR20193/NAT/ATO/00001

4 Determinations

4.1 Interaction of debt/equity rules and transfer pricing rules

The ATO has finalised draft Taxation Determination 2018/D6 (released in October 2018) setting out the Commissioner's view that, where the transfer pricing rules in Subdivision 815-B of the ITAA 1997 apply in respect of conditions that operate between an entity and another entity in connection with a cross-border financing arrangement that is a debt interest or an equity interest under the debt/equity rules in Division 974 of the ITAA 1997, the characterisation of the financing arrangement as a debt interest or an equity interest may be changed.

The object of Subdivision 815-B is to ensure that an entity's tax position in relation to its cross-border dealings is determined on the basis of conditions that might be expected to operate between independent entities dealing wholly independently with one another in comparable circumstances (the arm's length principle).

Once the actual terms of a cross-border financing arrangement that is a debt interest under Division 974 are replaced by the arm's length conditions that would be expected to apply to that cross border financing arrangement, it is possible that such a debt interest could be recharacterised as an equity interest under Division 974. In a similar fashion, a cross-border equity interest could be recharacterised as a debt interest. Such a recharacterisation could have implications for:

- whether returns received in respect of outbound cross-border financing arrangements are exempt income or assessable income;
- whether returns paid in respect of inbound cross-border financing arrangements are allowable deductions; and
- the rate at which withholding taxes might apply to returns paid in respect of inbound cross-border financing arrangements.

The Determination applies to income years commencing on or after 29 June 2013 (being the date of commencement of Subdivision 815-B).

ATO reference *Taxation Determination* TD 2019/10
w https://www.ato.gov.au/law/view/document?docid=TXD/TD201910/NAT/ATO/00001

5 Private binding rulings

5.1 Entitlement to a tax deduction as a result of a fraud

Facts

The company is an Australia resident private company.

The company was defrauded a sum of money over a period of time due to a breach of the company's IT systems. The breach resulted in payments being made by an employee of the Company as part of the employee's normal duties.

The payments were made after the employee obtained what was considered to be the usual approvals for making such payments. The fraud was reported.

The payment were made from the company's normal operating bank account or its overdraft facility.

The funds lost could not be recovered under the company's insurance policies. Further, it was considered to uneconomical to pursue recovery of the loss.

Issues

1. Is the company entitled to claim a tax deduction for funds transferred as a result of fraud under the ordinary deduction provision?
2. Is the company entitled to claim a tax deduction for funds transferred as a result of fraud under the provision dealing with theft by an employee or agent?
3. Is the company entitled to claim a tax deduction for funds transferred as a result of fraud under the black hole provisions?

Decision

General Deduction

The ATO ruled that the misappropriated funds were not ordinarily deductable.

The ATO noted that section 8-1 allows for a deduction for any loss or outgoing necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income, unless the loss or outgoing is capital, private or domestic in nature, or a provision prevents it from being deductible.

In this case, the ATO considered that an outgoing will be deductible under section 8-1 where:

1. the outgoing is incurred;
2. there is the relevant nexus between the loss or outgoing and the carrying on of a business for the purpose of gaining or producing assessable income; and
3. the outgoing is not of a capital or private or domestic nature.

While the ATO were satisfied that a loss was incurred, and that the relevant nexus existed, they considered the outgoing capital in nature.

The ATO reasoned that the funds that the company expended in making the payment were from the working capital of the business, and as a consequence the profit yielding structure of the business had been diminished. That is, funds that were available to acquire items that would have had an enduring benefit to the business were no longer available and accordingly, the character of the outgoing of funds was capital in nature.

Specific Deduction for theft

A deduction is allowable under section 25-45 of the ITAA 1997 where:

1. the taxpayer discovered the loss in the income year;
2. the loss was caused by theft, stealing, embezzlement, larceny, defalcation or misappropriation by the taxpayer's employee or agent (other than an individual the taxpayer employed solely for private purposes); and

3. the money was included in the taxpayer's assessable income for the income year, or for an earlier income year.

The ATO considered that the words '*theft, stealing, embezzlement, larceny, defalcation or misappropriation*' required an intent or knowledge on the part of the employees or agent of the taxpayer.

As there was no evidence of such intent or knowledge, the ATO ruled that no deduction was available under section 25-45 of the ITAA 1997.

Deduction for Blackhole Expenditure

The ATO considered that the capital expenditure was incurred in relation to a business.

Accordingly, the ATO ruled that the loss would be deductible over 5 years under section 40-880.

ATO reference *Private Binding Ruling Authorisation Number: 1051516319084*
w https://www.ato.gov.au/law/view/document?docid=EV/1051516319084

5.2 Incentive payment and assessable income

Facts

In March 201X Company A announced to the ASX that it was exiting personal financial advice.

Company A also announced that Company B, an unrelated business, would make offers to some Company A staff. All remaining staff would be made redundant.

The taxpayer's previous position in Company A entitled the taxpayer to a base salary and a share of the revenue from the advisors in the taxpayer's team.

The taxpayer received an offer from Company B, which provided 2 choices:

1. to decline an employment offer with Company B and receive 100% of redundancy entitlements; or
2. to accept an 'incentive payment from Company A' to transition to Company B on the basis that the taxpayer's current entitlements with Company A would be transferred to Company B and nil redundancy payments would be made by Company A.

Company A instead made an 'incentive offer/ex gratia payment/golden handshake' to entice employees to sign new employment contracts with Company B. The payment was to be made after the termination of the Company A's employment contract and after commencing new employment with Company B, with 50% payable in July 201X and the other 50% in July 20XX.

The basis for the calculation of the payment is for the forgone redundancy and other factors such as the value of the income stream being purchased by Company B.

Issues

1. Is the amount, proposed to be paid to you by Company A under an agreement, an employment termination payment?
2. Is the payment received considered income and taxable at marginal tax rates?
3. Is the payment to be treated on capital account?

Decision

Is the amount a termination payment?

The Commissioner ruled the amount is not an employment termination payment under section 82-130 of the ITAA 1997:

> *(1) A payment is an employment termination payment if:*
> *(a) it is received by you:*
> *(i) in consequence of the termination of your employment; or*

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(ii) after another person's death, in consequence of the termination of the other person's employment; and

(b) it is received no later than 12 months after that termination (but see subsection (4)); and

(c) it is not a payment mentioned in section 82-135.

The Commissioner noted that, whilst 'in consequence of' is not defined, the Courts have provided commentary on how to interpret the phrase. The Commissioner also noted that *Taxation Ruling TR 2003/13* which considered the meaning of the phrase in the context of the former provisions under the *Income Tax Assessment Act 1936* (Cth), could still be relied upon.

The Commissioner referred to case law finding that a causal nexus between the termination and payment was required, though it was not necessary for the termination to be the dominant cause of the payment. That is, while the payment was to be made in consequence of termination of employment, it had to follow on as a result or effect of that termination.

The Commissioner noted that in this case, the purposed payment was not made in consequence of the termination of employment, but rather, as a contractual obligation made in an agreement. There was no causal connection between the termination and the incentive payment. The incentive payment was not conditional on the termination of the taxpayer's employment and it cannot be said that the incentive payment followed on as an effect or a result of the termination of employment.

Accordingly, the payment was not an employment termination payment.

Is the payment taxable at ordinary marginal rates?

The Commissioner ruled that the proposed incentive payment will be assessable as ordinary income and, therefore, taxable at ordinary marginal rates.

The Commissioner referred to several cases which found that incentive payments or inducements made in connection with employment were be assessable income, including *McLean & Anor v. Federal Commissioner of Taxation* 96 ATC 4443 and *Pickford v. Federal Commissioner of Taxation* 98 ATC 2268.

Capital account

The Commissioner ruled that the payment is not to be treated on capital account in accordance with the reasons set out above as to why the payment is an income receipt.

ATO reference *Private Binding Ruling Authorisation Number 1051515439863*
w https://www.ato.gov.au/law/view/document?docid=EV/1051515439863

6 ATO and other materials

6.1 Division 7A unpaid present entitlements under sub-trust arrangements

The Commissioner has updated *Practical Compliance Guideline* PCG 2017/13 on 27 June 2019 concerning unpaid present entitlements (**UPE**s) under sub-trust arrangements to confirm that it applies to UPEs ending in the 2019 and 2020 income years.

The PCG confirms that, if a Division 7A loan agreement is put in place between the private company and the trust prior to the lodgement date for the year in which the sub-trust arrangement comes to an end, Division 7A will not cause there to be a deemed dividend from the private company to the trust.

ATO reference *Practical Compliance Guideline* PCG 2017/13
w https://www.ato.gov.au/law/view/document?DocID=COG/PCG201713/NAT/ATO/00001&PiT=99991231235958

6.2 Practical Compliance Guideline – dwellings acquired from a deceased estate

The Commissioner has released a Practical Compliance Guideline to outline:

1. a safe harbour compliance approach in relation to a sale of property acquired from a deceased estate outside of the two year period; and
2. the factors the Commissioner will consider when deciding whether to exercise the discretion to extend the two year period.

Under section 118-195 of the ITAA 1997, if an ownership interest in a principal place of residence passes to an individual beneficiary or trustee of a deceased's estate within two years of the deceased's death, any capital gain or loss made on the disposal is disregarded. The Commissioner has the discretion to extend the two year period in certain circumstances.

The PCG provides for a safe harbour which, if it applies, means that the taxpayer does not apply to the Commissioner for him to exercise his discretion but can, instead, act as if the discretion was exercised.

Safe Harbour

To qualify for the safe harbour, the taxpayer must satisfy **all** of the following conditions:

1. during the first two years after the deceased's death, more than 12 months was spent addressing one or more of the following circumstances:
    a. the ownership of the dwelling, or the will, is challenged;
    b. a life or other equitable interest given in the will delays the disposal of the dwelling;
    c. the complexity of the deceased estate delays the completion of administration of the estate; or
    d. settlement of the contract of sale of the dwelling is delayed or falls through for reasons outside of the taxpayer's control;
2. the dwelling was listed for sale as soon as practically possible after the above circumstances were resolved (and the sale was actively managed to completion)
3. the sale completed (settled) within 12 months of the dwelling being listed for sale
4. if any of the following circumstances were applicable, they were immaterial to the delay in disposing of the interest:
    a. waiting for the property market to pick up before selling the dwelling;
    b. delay due to refurbishment of the house to improve the sale price;
    c. inconvenience on the part of the trustee or beneficiary to organise the sale of the house; or
    d. unexplained periods of inactivity by the executor in attending to the administration of the estate; and
5. the longer period for which the discretion needs to be exercised is no more than 18 months.

The Commissioner's discretion

There are other factors that may be relevant to the exercise of the Commissioner's discretion, but that are not relevant for the safe harbour. These include but are not limited to:

1. the sensitivity of the taxpayer's personal circumstances and/or of other surviving relatives of the deceased;
2. the degree of difficulty in locating all beneficiaries required to prove the will;
3. any period the dwelling was used to produce assessable income; and
4. the length of time the taxpayer held the ownership interest in the dwelling.

How much weight the Commissioner gives to each factor will depend upon the circumstances of each particular case. The circumstances that caused the delay in disposing of the ownership interest will be more important than the length of the delay. The amount of any potential capital gain or loss is not relevant to whether the discretion is exercised.

ATO reference *Practical Compliance Guideline* PCG 2019/5
w https://www.ato.gov.au/law/view/view.htm?docid=%22COG%2FPCG20195%2FNAT%2FATO%2F00001%22

6.3 Employees guide for work expenses

The ATO has published a detailed guide in relation to work expenses to assist employees in determining whether their expenses are deductible, and what records should be kept to substantiate them.

There are six key areas addressed by the guide.

Part A sets out the conditions that a taxpayer must meet in order to claim a deduction. These conditions are, broadly speaking, that:

1. the taxpayer actually incurred the expense;
2. the expense was incurred gaining or producing employment income;
3. the expense not capital or capital in nature;
4. the expense is not private or domestic;
5. the expense was not incurred in gaining or producing exempt income or non-assessable non-exempt income; and
6. the taxpayer satisfies the relevant substantiation requirements.

Part B explains the concept of apportioning work related expenses and recommends record keeping methods for taxpayers. This part of the guide sets out that keeping a diary of usage of items such as a phone for a continuous 4 week period would allow for correct apportionment.

Part C sets out common scenarios where the taxpayer might consider claiming a deduction. There are 47 commonly claimed expenses which are considered in detail (including accommodation, bags, vehicles, clothing, self-education, home office, conferences, meals, travel and laundry expenses). For further information on any particular expense it is recommended that the taxpayer consult that particular section of the guide.

Part D sets out the manner in which a taxpayer should substantiate a work expense to claim a deduction.

Part E sets out the situations in which a taxpayer does not need to keep written records of their expenses, including in relation to overnight travel, overtime meals, laundry expenses and other work-related expenses.

Part F considers the decline in value of certain assets under the capital allowance provisions, including a consideration of the effective life of an asset and the methods of calculating the depreciation of the asset.

w https://www.ato.gov.au/law/view/document?docid=SAV/EGWE/00001

6.4 Uber and FBT

The ATO has confirmed that the FBT exemption for the provision of benefit of 'taxi travel' to and from work does not extend to Uber.

The ATO notes that the exemption is limited to travel in a vehicle licensed to operate as taxi due to the definition of taxi in the FBT Act.

w https://www.ato.gov.au/General/Fringe-benefits-tax-(FBT)/FBT-exemptions-and-concessions/Taxi-travel-expenses-exemption/

6.5 ATO tip off line runs hot

The ATO has advised that it has received a 42% increase in reports of alleged tax evasion, black economy or illegal phoenix activity since 31 May 2018. These reports mainly included topics such as under reported income, cash economy and non-lodgement. An Assistant Commissioner predicted the ATO will receive over 70,000 community tip offs before the end of the 2019 financial year.

The ATO state that non tax issues can also be reported, and give examples such as employers who demand or pay cash in hand, under-reporting or not reporting income, illegal phoenixing or overclaiming deductions, e.g. paying for home renovations through a business account.

w https://www.ato.gov.au/Media-centre/Media-releases/ATO-tip-off-line-runs-hot-as-record-numbers-of-businesses-report-cash-jobs/

6.6 QLD payroll tax – exemption for contractors ordinarily rendering services to the public

Queensland Treasury have released Public Ruling PTA021.2 which withdraws the former Public Ruling PTA021.1 from 1 July 2019 and confirms that a replacement ruling is being prepared.

The original ruling provided a non-exhaustive list of factors that the Commissioner of State Revenue in Queensland takes into consideration in exercising the discretion under section 13B(2)(b)(iv) of the *Payroll Tax Act 1971* (Qld), which provides that a contract where *'services are performed or rendered by a person who ordinarily performs or renders services of that kind to the public generally in the relevant financial year'* are exempt from being a *'relevant contract'* that is liable for payroll tax.

Reference *Public Ruling PTA021.2 Exemption for contractors ordinarily rendering services to the public*
w https://www.treasury.qld.gov.au/resource/pta021/