Coster Galgut
Chartered Accountants

JUNE / 2023

TAX UPDATE – JUNE 2023

What did I miss?

Whew what a month! The long awaited Skills and Technology Boosts passed Parliament just at the point we thought the concept was dead and buried. Oh wait, your clients have less than 24 hours to maximise their technology boost deductions (it covers expenditure incurred from 29 March 2022 until 30 June 2023).

And, then there's the raft of rulings and determinations finalised over the month. Plus, a few interesting cases.

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INSIDE

From Government 2
Amending the non-arm's length expense rules 2
Specific expenses 2
General expenses 2
Date of application 3
From the Regulators 3
Clarity on professional firm profit guidelines.............3
Key changes for 2023 returns 4
Updates to ATO data matching 4
Interest deductions for rental property owners.........4
Rulings, Determinations & Guidance............................5
Final ruling on residency tests for individuals 5
When labour costs are capital in nature....................5
Final ATO guidance on income derived from fame 6
Commissioner's discretion on the control rules for connected entities 7
Interaction between the NALI and CGT rules 7
Alert on SMSFs and property development projects. 8
Updated risk framework for corporate tax residency 8
PCG 2018/9DC1 8
Cents per km rate for 2023....................8
Reasonable travel and overtime meal allowance rates....................8
WPN holder exemption from STP..............................9
Cases 9
ATO win against *Nudie Juice* family group.................9
Section 100A and creating a mismatch between trust income and taxable income....................10
Deductibility of settlement payments after business ceases 11
Legislation....................11
Before the House of Representatives 11
Reporting subsidiary information......................... 12
Amendments to the thin capitalisation provisions 12
Passed Parliament 12

From Government

Amending the non-arm's length expense rules

Treasury has released exposure draft legislation relating to the 2023-24 Budget measures to amend the non-arm's length expense rules for superannuation funds.

For SMSFs and small APRA-regulated funds the tax treatment for expenses that are incurred on a non-arm's length basis will depend on whether you are dealing with a specific expense or a general expense.

- **General expense** - an expense that is not related to gaining or producing income from a particular asset of the fund.
- **Specific expense** - any other expense.

Specific expenses

The existing treatment will continue to apply. The amount of income that will be taxed as non-arm's length income (NALI) will be the amount of income derived from the scheme in which the parties were not dealing at arm's length.

Specific expenses (related to gaining or producing income) are likely to include:

- Maintenance expenses for a rental property
- Investment advice fees for a particular pool of investments
- A limited recourse borrowing arrangement for the purchase of a specific asset
- The purchase of an asset such as a rental property or shares

An expense incurred in relation to gaining or producing income as a beneficiary of a trust through holding or acquiring a fixed entitlement to the income of a trust will always be a specific expense.

General expenses

Currently, general expenses result in all fund income being taxed at the highest marginal rate. However, the Government is planning to change this treatment.

Under the new rules, general non-arm's length expenses will result in a maximum of twice the difference between the amount that would have been expected at arm's length and the amount actually incurred being treated as NALI, with no deductions applying against that amount. The total amount taxed at the highest marginal rate is then capped to income minus deductions, excluding assessable contributions and deductions against them.

General expenses are likely to include:

- Actuarial costs
- Accountant fees
- Auditor fees
- Administrative costs in managing the fund
- Trustee fees
- Costs of complying with the regulatory obligations of the fund
- Investment adviser fees, where those fees relate generally to the operation of the fund and **not** to a specific investment or a particular pool of investments

Example 1.1 of the draft Bill deals with an accountant, Al, supplying accounting services to his SMSF (he is the sole trustee and member). The fees are worth $3,000 but are provided free of charge to the SMSF.

The acquisition of accounting services by the SMSF constitutes a scheme between Al and his SMSF in which the parties were not dealing with each other at arm's length, and no expense was incurred when the SMSF would have been expected to have incurred an expense had the parties been at arm's length. As a result, the non-arm's length expenditure provisions apply.

The total income of the SMSF in 2023-24 is $20,000 in rent from a rental property to which $5,000 in eligible deductions for maintenance apply, resulting in a taxable income in 2023-24 of $15,000. No assessable contributions were made in that income year.

The accounting services are general in nature. The amount of NALI under the 2 factor approach will be twice the amount that might have been expected to have been incurred: $3,000 x 2 = $6,000.

Applying the cap on the total non-arm's length component, the cap amount is the total of income other than assessable contributions, minus deductions other than deductions against assessable contributions. In this case, the cap is the $20,000 in rental income minus the $5,000 in deductions against that rental income, giving $15,000. As the cap on the total non-arm's length component is higher than the non-arm's length component arrived at above, the non-arm's length component remains at $6,000, to be taxed at the highest marginal rate. This leaves a low-tax component of $9,000. The low tax component is any remaining taxable income after calculating the non-arm's length component.

Date of application

The changes are intended to apply to income derived in the 2023-24 income year or later income years, and expenses incurred or expected to have been incurred on or after 1 July 2023.

APRA funds will be excluded from the non-arm's length income rules.

More information
Treasury Laws Amendment (Measures for Consultation) Bill 2023: Non-arm's length expense rules for superannuation funds

From the Regulators

ATO clarifies professional firm profit guidelines questions

Of late, many practitioners have been working through the ATO's guidelines on the allocation of profits generated from professional firms in PCG 2021/4. However, there are some issues that are not covered directly in the PCG. We have raised some of the more common queries with the ATO and have received some helpful responses.

Key points which have recently been clarified by the ATO are summarised below:

- If an individual who is related to an individual principal practitioner (IPP) but is not an IPP themselves is employed in the firm on commercial terms (i.e., paid a market salary for their work) then the amount paid to them can be treated in much the same way as you would deal with salary or wages paid to an unrelated employee. This can help reduce the risk score associated with risk factors 1 and 2.
- If the firm is operated in a company structure and some profits are retained in the company, the ATO would attribute a share of those profits to the IPP based on their shareholding, regardless of whether they are the controller of the firm or whether they

are simply one of a number of unrelated business partners. For example, if an IPP holds a 35% stake in the company (directly or indirectly through a family trust etc) then 35% of any profits retained in the company are treated as part of the profit entitlement from the whole of firm group attributable to the IPP. Tax paid by the company on the retained profits can be included as part of the effective tax rate calculation.
- When a company pays out franked dividends the ATO will generally include the franking credits in the income of the relevant shareholders, but won't apply the tax offset relating to those franking credits when performing the effective tax rate calculation. The ATO is basically trying to ensure that a shareholder of a corporate firm is treated in much the same way as a partner in a partnership when applying the guidelines.

Key changes for 2023 returns

The ATO has published some key points to consider for 2023 year income tax return preparation.

For individual returns, the main changes to keep in mind are:

- The low and middle income tax offset (LMITO) ended on 30 June 2022. As a result, some clients might receive a lower refund or a tax bill that they were not expecting. The proactive approach would be to advise clients of this change, potentially when initially requesting tax return information.
- The revised fixed rate method applies for working out deductions for working from home expenses. This method has more onerous record keeping requirements in relation to establishing the hours worked, and modifies the expenses covered when compared with the previous set rate method.

In relation to business entities (companies, trusts and partnerships), the changes include:

- The availability of the Small Business Skills and Training Boost and the Small Business Technology Investment Boost. Legislation has recently been passed in connection with these measures.
- A new offset is available for qualifying companies in relation to expenditure connected with the development of digital games.
- Changes with respect to the franking of dividends funded by capital raising, and amendments to the rules governing off-market share buybacks by listed companies are also expected to become law and may need to be considered in completing a company return and tax returns for shareholders.

More information

Overview of key changes

ATO data matching expanded

The ATO has warned taxpayers that its data matching program in relation to residential rental property loans and insurance has been expanded. The ATO now has access to bank records and insurers records which can be used to ensure deductions for loan interest and insurance premiums are being claimed correctly. This is an area the ATO is increasingly focusing on, and advisers will need to continue to take great care to ensure the accuracy of returns and reduce client risk.

The sharing economy reporting regime will also commence from 1 July 2023. Electronic distribution platforms relating to services such as taxi services, ride-sourcing and short-term accommodation will be required to report details of customer activities. That is, businesses such as Uber and Airbnb will now report income derived through those platforms to the ATO.

More information

ATO expands data matching to ensure fair play

Interest deductions for rental property owners

Continuing the focus on rental property owners, the ATO has issued a new fact sheet that reinforces the circumstances in which interest on a loan relating to an investment property will be deductible. The ATO confirms that interest expense should generally be

deductible if the borrowed funds are used for the following purposes:

- Buying a rental property
- Buying a depreciating asset for the rental property (for example, a new air conditioner)
- Making repairs to the rental property (for example, roof repairs due to storm damage)
- Financing renovations to the rental property.

Interest expenses are not deductible to the extent that they relate to private use of the property or where some of the borrowed funds are used for private purposes (e.g., acquiring a main residence or a car used for private purposes). Advisers will need to review information provided by clients carefully and ask relevant questions to determine whether apportionment is required.

The other key point to remember is that loan repayments will often need to be apportioned across all uses of the loan funds on a pro-rata basis if the loan has been used for mixed purposes.

More information
Claim rental property interest correctly
Rental properties - Interest expenses

Rulings, Determinations & Guidance

Final ruling on residency tests for individuals

TR 2023/1 provides updated guidance on the application of the four residency tests for individuals. The ruling is the finalised version of TR 2022/D2 and consolidates previous guidance in this area.

The ruling explains the circumstances in which each of the four residency tests are more likely to be relevant. For example, the ATO indicates:

- The ordinary concepts test is mainly relevant for taxpayers who are (or have been) physically present in Australia;
- The domicile test is most likely to be applicable where a taxpayer has previously been living in Australia but has now moved overseas, or when individuals frequently travel overseas during a year;
- The 183 day test is more relevant to taxpayers who were not previously residents but have come to Australia.

The final ruling is similar to the draft ruling in many respects, although the ATO has added some further examples and updated some of the commentary in response to feedback received from the tax community.

While the ruling doesn't cover every conceivable scenario that practitioners will encounter, this should be a useful reference point when dealing with clients who move between countries.

The ATO briefly refers to situations where an individual might be classified as a resident of Australia and one or more foreign countries, but the ruling doesn't look at this area in detail. When practitioners come across clients who are classified as dual residents it is vital to determine whether a double tax agreement (DTA) could potentially apply. Many DTAs contain tie-breaker tests for dealing with dual residents, although the tests can vary between different DTAs so this always needs to be approached carefully.

When labour costs are capital in nature

TR 2023/2 explains when labour costs related to constructing or creating capital assets (tangible or intangible) could potentially be classified as capital expenses. Capital expenses cannot qualify for an immediate deduction under the general deduction rules in section 8-1 ITAA 1997.

While remuneration paid to employees and contractors is often revenue in nature and can be claimed as an upfront deduction, this won't always be the case. The ruling confirms that labour costs will be capital in nature if they are incurred specifically in relation to the construction or creation of a capital asset. On the other hand, labour costs that only have a

remote or incidental connection with the capital asset should not be capital in nature and will often be deductible.

The ATO notes that employees might be specifically employed for both constructing or creating capital assets and other duties, in which case an apportionment of the expenses will need to be considered.

While working through this analysis could be difficult in some cases, the ATO provides the following examples of costs that are likely to be on revenue account even though an infrequent, minor or incidental amount of the individual’s time is devoted to the construction or creation of capital assets:

- A human resource manager responsible for all of the employees or personnel of an established and ongoing business, including employees or personnel constructing or creating a capital asset;
- A finance manager responsible for all of the ongoing financial aspects of an established and ongoing business, including the finance aspects of constructing or creating a capital asset;
- A general manager responsible for overseeing the ongoing operations of an established and ongoing business, and who spends some time overseeing the construction or creation of a capital asset; and
- A general counsel responsible for all general legal affairs of an established and ongoing business, including the legal aspects of constructing or creating a capital asset.

Final ATO guidance on income derived from fame

The draft determination setting out the ATO’s revised position on income derived from an individual’s fame and image has now been finalised by the issue of TD 2023/4, with no substantial changes compared to the draft guidance.

In the past, some individuals have sought to transfer or license the right to use their fame or image to a related party such as a company or trust. This was done on the basis that any subsequent income received from third parties for the use of these rights would be taxed in the hands of the related party.

This has not historically been a clear area of the law. Back in 2017, the ATO issued a draft practical compliance guideline PCG 2017/D11 for sportspeople that basically set out a 10% safe harbour threshold that could potentially be adopted in situations like this. However, this guideline was withdrawn a year later.

In the final determination released this month, the ATO now confirms that under Australian law, an individual with fame has no property in that fame, and it is not possible to transfer any interest in their fame to another entity. As a result, any income derived in connection with an individual’s fame should be recognised as ordinary income of the individual rather than being treated as income of a related entity. In that case, the related entity is receiving an amount that is being applied or dealt with on the individual's behalf.

While the determination also indicates that an individual with fame can exploit that fame by authorising others to use their fame for a fee, this arrangement would still not vest any property in the individual's fame in the other entity. As a result, a related entity is not able to enter into a licensing agreement with a third party to exploit the fame of an individual and recognise the income from that activity. Rather, that income should be recognised by the individual.

The tax outcomes can be different where a related entity engages the individual with fame to provide services. For example, the individual with fame may be engaged by the related entity to attend product launches and promotional events for a third party. In these circumstances, contractual payments by the third party to the related entity can be assessable to the related entity. However, both the PSI rules and the general anti-avoidance provisions under Part IVA would still need to be considered. The ATO’s general position in that income derived from the personal services of an individual should ultimately be taxed to that individual.

The ATO indicates that it will not devote compliance resources to apply the views expressed in the determination in connection with income derived before 1 July 2023 from arrangements that are consistent with the principles outlined in PCG 2017/D11 and which were entered into before the publication of the determination.

Commissioner's discretion on the control rules for connected entities

TD 2023/D2

This draft determination outlines the ATO's approach in exercising their discretion with respect to a specific aspect of the connected entity rules, mainly in connection with calculating aggregated turnover.

The connected entity rules are relevant in determining whether an entity has access to various concessions in the tax laws, including the small business CGT concessions, other small business concessions such as simplified depreciation, shorter periods of review, temporary full expensing on depreciating assets, company loss carry back rules, etc.

As a starting point, the rules generally provide that an entity (i.e., the 'first' entity) will control another entity where it (together with its affiliates) holds a percentage of at least 40% of the relevant interests in another entity.

However, and where the first entity (together with its affiliates) has a control percentage of at least 40% but less than 50% in another entity (the 'test entity'), the Commissioner can exercise their discretion to determine that the first entity does not control the test entity.

To exercise the discretion, the Commissioner must broadly conclude the test entity is controlled by another entity or entities that does not include the first entity and its associates.

For these purposes, 'control' broadly refers to control over the matters typically associated with ownership of a business, such as entitlements to income and capital of the entities. It also refers to participation in decision making on key matters affecting the test entity's constitution, funding, structure and management.

In identifying whether the test entity is controlled by another entity or entities, the ATO sets outs some other noteworthy observations:

- A higher ownership percentage is an indicator of control. However, it is not always required for the other controlling entity identified by the Commissioner to have a control percentage interest of 40% or more under the 'normal' tests.
- Another party having sole or primary responsibility for the day-to-day management of the affairs of the test entity, while not irrelevant, does not of itself constitute control for the purposes of the ATO's discretion; and
- It is possible to show that the test entity is controlled others by reference to a group. The ATO would generally expect to see that group has agreed to and does operate as a single controlling mind (for example, legal arrangements are entered into where the parties agree to act jointly in relation to the test entity)

At a very high level, the Commissioner's discretion would typically only become relevant in limited scenarios where a client group has a significant interest in a business entity (i.e., above 40%) without a majority interest but where it's possible to show that there is an unrelated party (or parties together) that in fact controls the entity.

Interaction between the NALI and CGT rules

TD 2023/D1

This draft determination provides detailed guidance on the interaction between the CGT provisions and the non-arm's length income (NALI) rules applicable for superannuation funds. It explains how to calculate a fund's statutory income that is NALI (and therefore tax payable at penalty rates) where a capital gain arises as a result of non-arm's length dealings.

A capital gain made by a superannuation fund is NALI where it arises as a result of a scheme where the parties were not dealing with each other at arm's length and one or more of the following applies:

- The amount of the capital gain is more than the amount the superannuation fund might have been expected to derive if the parties had been acting at arm's length; or
- In gaining or producing the capital gain, non-arm's length expenditure (NALE) is incurred (including nil expenditure) in respect of a CGT asset that is less than the amount of expenditure that the superannuation fund might have been expected to

incur if those parties were dealing with each other at arm's length.

The amount that is included in NALI is determined by reference to the amount of the non-arm's length capital gain, and cannot exceed the superannuation fund's net capital gain,

Where a superannuation fund's net capital gain for the income year is nil due to the application of capital losses, the draft determination clarifies that the fund will have no amount of NALI referable to the non-arm's length capital gain.

Alert on SMSFs and property development projects

The ATO has released TA 2023/2, a new taxpayer alert setting out concerns with certain property development arrangements involving SMSFs.

Broadly, the arrangements involve client groups establishing special purpose vehicles (SPVs), such as partnerships or separate entities, in which the SMSF participates and which conduct property development activities. Profits from those activities are then diverted to the SMSF through non-arm’s length transactions.

Examples from the ATO include situations where the related entities provide building services at less than arm’s length rates, or lend funds to the SPV. These result in diverting profits attributable to a property development project that would otherwise be taxed at the corporate or marginal tax rates of other parties to an SMSF, being a concessionally taxed entity.

A range of tax issues and other implications can arise from these arrangements. This could include the application of the non-arm’s length income rules, the disqualification of individuals as trustees or the SMSF being issued a notice of non-compliance.

Updated risk framework for corporate tax residency

PCG 2018/9DC1

Draft amendments have been made to the practical compliance guide that deals with the central management and control test. This test can become relevant when determining whether a foreign incorporated company is a resident of Australia.

As a result of the ATO revising its view back in 2018, the practical compliance guide contained a transitional period for foreign incorporated companies to make changes to ensure their central management and control is not in Australia (and therefore reduce the risk of the company being classified as an Australian resident) where certain conditions are met. This transitional period will end on 30 June 2023.

With the transitional period ending, the ATO has added a new risk assessment framework with the purpose of assisting foreign-incorporated companies on this test.

The framework itself contains a list of risk factors that allow taxpayers to determine their overall risk rating (i.e., low, moderate or high risk) on this issue, which then impacts on the likelihood of ATO compliance activity.

While still in draft form, it may be prudent for advisors of foreign incorporated companies concerned with the location of central management and control to review the framework to determine their client’s overall risk rating. The risk framework should be reviewed together with TR 2018/5 which contains the ATO’s view on this issue.

Cents per km rate for 2023

LI 2023/23 states that the cents per kilometre rate for the 2024 income year (i.e., from 1 July 2023) is 85 cents per kilometre. This will be relevant for taxpayers who choose to apply the cents per kilometre method when calculating income tax deductions for their work-related car expenses.

Reasonable travel and overtime meal allowance rates

The ATO has released its annual determination setting out the Commissioner’s reasonable amounts (TD 2023/3) for the purposes of the substantiation exception for the 2024 income year in relation to claims made by employees for:

- Overtime meal expenses - for food and drink when working overtime;
- Domestic travel expenses - for accommodation, food and drink, and incidentals when travelling away from home overnight for work; and
- Overseas travel expenses - for food and drink, and incidentals when travelling overseas for work.

In broad terms, an employee does not need to satisfy the normal strict record keeping rules if they receive a bona fide travel or overtime meal allowance and the deduction they are claiming does not exceed the ATO's reasonable rates. However, it is important to recognise that appropriate records still need to be met to justify any deductions that are being claimed and deductions can only be claimed for expenses that have actually been incurred.

WPN holder exemption from STP

Legislative instrument LI 2023/22 extends the exemption from STP reporting obligations for taxpayers who have a Withholding Payer Number (WPN) but not an ABN. The exemption will now continue until **30 June 2033** (another 10 years).

Cases

ATO win against *Nudie Juice* family group

The ATO has won a long running battle against the Binetter family, founders of *Nudie Juice*.

The action started in 2006 with a Project Wickenby audit of Rawson Finances Pty Ltd (Rawson). Rawson was one of several entities owned and controlled by members of the Binetter family. At that time, the Commissioner issued notices of assessments for the years 1997 to 2008 and penalty assessments for the years 2001 to 2008. The assessment included as assessable income three "loans" obtained by Rawson, totalling $4.5m, from the Mercantile Discount Bank (MDB) in Israel in 1997, and disallowed deductions for interest on the alleged loans.

Rawson contested the assessment and commenced merits review proceedings before the AAT. The essence of Rawson's case before the Tribunal was a "business practice" case, being that its former director, Erwin Binetter, and his family had a business practice of obtaining loans from Israeli banks on the basis only of personal guarantees. Rawson submitted that the Tribunal should infer that Rawson followed the same business practice as its related entities, and that its loans from MDB were not supported by any security beyond personal guarantees. The AAT found in favour of Rawson finding that Rawson had established that the Commissioner's taxation assessments were excessive.

The Commissioner then appealed to the Federal Court. The Federal Court allowed the Commissioner's appeal, but this was later set aside by the Full Federal Court on appeal by Rawson. At that time, Jagot J observed that the funds transfer was "unusual" and that it was "apparently inexplicable" that "any bank was willing to lend a company with no assets and no apparent means of repayment $4.75 million without any security and was content to take no action whatsoever when the asserted borrower failed to pay interest for more than 7 years in total". Indeed.

And that's where is would have stayed if it had not been for the liquidation of two Binetter family entities (see BCI Finances Pty Limited (in liq) v Binetter (No 4) [2016] FCA 1351). The liquidation, and information from banks in Israel and evidence by Bank officers in Israel, unveiled a bonanza of evidence for the Commissioner's pursuit of Rawson. The Commissioner alleged that the new evidence established that the Tribunal and Full Court decisions were obtained by fraud on the part of Rawson unbeknown to the lawyers representing Rawson.

The Commissioner alleged that the new evidence established that the loans to the Binetter family entities, including Rawson, were secured by secret cash deposits, and in the case of Rawson and another Binetter family entity, Advance Finances Pty Ltd, those deposits were held by family members using a code name. On the basis of the new evidence, the Commissioner submitted that Rawson's case that its loans were secured only by personal guarantees was knowingly false and misleading and, on this basis,

sought to set aside the Full Court decision on the ground of fraud.

The new evidence overwhelmingly established that the decisions of the Tribunal and the Full Court were obtained by fraud on the part of Rawson through Andrew Binetter (Erwin's son). Accordingly, the Court held that the decision of the Full Court of the Federal Court should be set aside on the ground that it was procured by fraud.

This case is one of a series untangling the Binetter family's position. See also ATO settles case against Israel Discount Bank and ATO Wins $137 Million from Binetters' Israeli Banks after 16-year Pursuit.

More information

Commissioner of Taxation v Rawson Finances Pty Ltd [2023] FCA 617

ATO welcomes decision in Commissioner of Taxation v Rawson Finances

Section 100A and creating a mismatch between trust income and taxable income

B&F Investments Pty Ltd ATF Illuka Park Trust & Anor v FC of T [2023] FCAFC 89

This case is an appeal from the Bblood case (*BBlood Enterprises Pty Ltd v Commissioner of Taxation* [2022] FCA 1112) involving a trust (IP Trust) which received a distribution from another trust in the group establishing a new corporate beneficiary (BE) that was made presently entitled to the income of the trust. Two key additional steps were then taken:

- A variation of the trust deed to change the definition of income to "income according to ordinary concepts" (from previously being income as defined by section 95 ITAA 1936 – i.e., taxable income); and
- The trust becoming entitled to a deemed dividend amount as a result of a share buyback.

As BE Co was presently entitled to the trust income of the IP Trust, BE was therefore taxable on the deemed dividend. However, due to the variation to the definition of trust income the buy-back proceeds (including the deemed dividend) were not income of the IP Trust according to ordinary concepts, which meant that BE was not entitled to payment of the proceeds of the deemed dividend. The buy-back proceeds were retained by the trust and treated as an increase to the corpus of the IP Trust.

The ATO applied section 100A on the basis that the arrangement constituted a reimbursement agreement as it was entered into with the purpose of enabling the IP trust to retain the income, but the income being taxable to the corporate beneficiary rather than the trustee under section 99A (i.e., resulting in a tax benefit).

The original decision upheld the Commissioner's application of section 100A, and this was confirmed by the Full Federal Court. The Full Federal Court clarified some key point concerning the operation of section 100A, including:

- A retention of trust funds by a trustee may constitute the payment of money to a person other than a beneficiary for the purposes of the definition of 'reimbursement agreement';
- Advisers formulating and implementing an arrangement, with the knowledge and assent of the controllers of the relevant entities, can have the relevant purpose of obtaining a tax benefit and are taken to be parties to the 'reimbursement agreement';
- The purpose of obtaining a tax benefit is assessed at the time of entry into a 'reimbursement agreement' and can be the purpose of any party to the agreement, including parties other than the taxpayer and associated entities;
- Unlike the general anti-avoidance rules in Part IVA, section 100A does not require a comparison with what might otherwise have occurred had the scheme not been entered into. It is sufficient to consider why the parties entered into the reimbursement agreement.

However, the taxpayer was successful in arguing that an assessment issued to the corporate beneficiary was excessive. The Commissioner had previously issued an assessment to BE which was not amended following the original decision. The Full Federal Court stated that while the Commissioner can issue alternative assessments which are necessarily inconsistent, once the true state of facts is determined and the liability of

the correct taxpayer (i.e., the trustee here) has been established, the alternative inconsistent assessment (to the company beneficiary) is necessarily excessive and should be reversed.

Deductibility of settlement payments after business ceases

Commissioner of Taxation v Wood [2023] FCA 574

In this case, a company had previously provided consulting services for another business. After the arrangement ceased, the recipient of the services became aware of allegedly unauthorised transactions and commenced legal action seeking damages. A settlement was reached and the taxpayer (an employee of the company) paid a settlement amount (offset by a separate settlement amount to which he was entitled from the recipient business) for which it claimed a deduction under section 8-1. The ATO disallowed the deduction on the basis that it was not incurred in gaining or producing assessable income and was also capital in nature.

The Federal Court affirmed the original decision of the AAT in finding that the settlement payment was deductible. In particular, the payment was found to be incurred in the course of gaining or producing the taxpayer's assessable income as an employee of the company and was related to their actions in that capacity. The fact that the expense represented a reduction of past income did not prevent it from qualifying as a general deduction.

The ATO had also argued that the settlement payment was capital in nature as it related to the protection of the taxpayer's reputation and ability to derive income in future. However, the Court found that the correct characterisation of the payment under the terms of the settlement agreement was as a payment bringing to an end the litigation risk arising from the taxpayer's conduct in his employment previously, and was therefore revenue in nature.

Legislation

Parliament was in session between the 13 -27 June 2023 and will not sit again until August 2023.

Before the House of Representatives

Treasury Laws Amendment (2023 Measures No. 3) Bill 2023

The Bill contains several amendments to legislation that may impact on financial advisers and their clients.

For advisers, the Bill includes some changes to the recently introduced 'education and training standards' that financial advisers will need to meet. These are the qualifications standard, exam standard, work and training standard, and the continuing professional development standard.

Financial advisers have until 1 January 2026 to meet the qualifications standard, while continuing to provide financial advice. To meet this standard, existing financial advisers need to complete at most eight units. The amendments in this Bill provide that experienced financial advisers who have been authorised to provide personal advice to a retail client for a minimum of 10 years and have a clean disciplinary record, are not required to complete an approved qualification by 1 January 2026 to meet the qualifications standard.

The changes mean that financial advisers who are also registered tax agents are not required to meet the additional education requirements to be a 'qualified tax relevant provider'.

The Bill also contains changes to the first home super saver (FHSS) scheme to allow individuals to amend or revoke their applications provided a FHSS scheme amount has not already been paid to the individual. Individuals will also have up to 90 days to request a release authority after they enter into a contract to purchase or construct a home (previously this was just 14 days).

Treasury Laws Amendment (Making Multinationals Pay Their Fair Share—Integrity and Transparency) Bill 2023

This Bill introduces two previously announced measures that primarily impact on groups that have cross border business structures and dealings.

Reporting subsidiary information

The amendments will require Australian public companies (listed and unlisted) to provide a 'consolidated entity disclosure statement' for each financial year commencing on or after 1 July 2023 as part of their annual financial reporting obligations under the Corporations Act. Basically, the rules will require public companies to disclose information about subsidiaries in their annual financial reports.

Amendments to the thin capitalisation provisions

These changes reflect a significant shift from the current approach and are designed to limit the debt deductions (e.g., interest expenses) that an entity can claim for tax purposes based on the amount of debt used to finance its operations compared with its level of equity. The major change is the replacement of existing asset-based rules with earnings-based rules which are in line with those recommended by the OECD.

Importantly, the existing $2m de minimis threshold is retained, so many smaller businesses should continue to be unaffected by the rules.

The amendments replace the current classifications of 'inward investor' and 'outward investor' with a new 'general class investor' concept, consolidating the existing classes. Broadly, this means that these new rules will apply to all non-bank entities.

The new earnings-based tests involve:

- A fixed ratio test (replaces the existing safe harbour test) which allows an entity to claim net debt deductions up to 30 per cent of its 'tax EBITDA', (the entity's taxable income or tax loss adding back deductions for interest, decline in value, and capital works). Further, this test provides a special deduction for debt deductions that were disallowed under the fixed ratio test in a prior year, if the entity's net debt deductions are less than 30% of its 'tax EBITDA' for the current income year. Debt deductions disallowed over the previous 15 years can be claimed under this special deduction rule, subject to certain conditions.
- A group ratio test that replaces the existing worldwide gearing test. The group ratio test disallows debt deductions to the extent that the entity's net debt deductions exceed the group ratio earnings limit for the income year. This test operates in a similar fashion to the fixed ratio test and requires an entity to determine the ratio of its *group's* net third party interest expense to the *group's* EBITDA for an income year.
- A new third party debt test, which allows debt deductions to be deducted where those expenses are attributable to genuine third party debt which is used to fund Australian business operations. The third party debt test allows all debt deductions which are attributable to third party debt and that satisfy certain other conditions.
- The introduction of new provisions relating to the creation of debt deduction. These rules disallow debt deductions to the extent that they are incurred in relation to debt creation schemes.

Passed Parliament

Treasury Laws Amendment (2023 Measures No. 2) Bill 2023

This Bill contains a series of measures, including some of the 2023-24 Federal Budget measures:

- Amending the Medicare levy and Medicare levy surcharge income thresholds.
- Clarifying the tax treatment of primary producer registered emissions units (carbon credits) as primary production income for the purposes of the FMD and income averaging rules. This applies for carbon credits first held after 1 July 2022. The taxing point for carbon credits is also changed to the time of sale.
- Reducing the GDP adjustment factor for PAYG and GST instalments in the 2023-24 income year to 6%.
- Expanding the Home Guarantee Scheme to joint applications from "friends, siblings, and other family members" and to those who have not owned a home for at least 10 years.

Treasury Laws Amendment (2022 Measures No. 4) Bill 2022

This Bill, introduced to Parliament back in November 2022, has finally been passed and should provide

practitioners and their clients with certainty on a number of key measures. These include:

- The introduction of a digital games tax offset. This is a refundable tax offset for companies equal to 30% of the company's total qualifying Australian development expenditure, which is aimed at expenditure incurred in relation to the development of a game that is made available to the general public over the internet. The offset is capped at $20 million per company (or group of companies). The offset will be available for expenditure incurred from 1 July 2022.
- The Skills and Training Boost, which provides small businesses (with aggregated annual turnover of less than $50 million) with access to a bonus deduction equal to 20% of eligible expenditure for external training provided to their employees. The additional deduction is available for expenditure incurred from 29 March 2022 until 30 June 2024.
- The Technology Boost, which provides small businesses with a bonus deduction equal to 20% of their eligible expenditure on expenses and depreciating assets for the purposes of their digital operations or digitising their operations. The bonus deduction is limited to $20,000 per year (i.e., on eligible expenditure up to $100,000) and applies to expenditure incurred from 29 March 2022 until 30 June 2023.
- Amendments to clarify that digital currencies (such as bitcoin) are not treated as a foreign currency for tax purposes even if they are adopted as a legal tender by a foreign country.
- The Commissioner has the power to make legislative instruments determining the kind of alternative records that can be kept and retained by employers to comply with FBT record keeping obligations. The aim is to reduce the compliance burden associated with gathering and retaining FBT records.