Coster Galgut
Chartered Accountants

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TAX U PDATE – JANUARY 2023

What did I miss?

The ATO has released its final position on the application of section 100A targeting situations where a trust appoints income to a beneficiary but there is an agreement / understanding at the time of the distribution that the real benefit of the funds will be provided to someone else (unless this is part of an ordinary commercial or family dealing). We now have both the final ruling (TR 2022/4) and the practical compliance guide (PCG 2022/2).

Plus, the ATO's response to the ground breaking High Court decision on the distinction between contractors and employees. Also of interest is the December's CPI rate that impacts on superannuation and retirement income streams. Finally, there is a crackdown coming for the sharing economy following the passage of legislation imposing a reporting obligation on sharing platforms – lots of data will be coming through to the ATO from 1 July 2023!

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From Government

Non-arm's length expense rules for super funds

As many superannuation advisers will be aware, the Government is considering potential amendments to the non-arm's length income (NALI) provisions which apply to superannuation funds. As part of this process Treasury has released a consultation paper relating to the aspect of those rules dealing with non-arm's length expenses.

Superannuation stakeholders have raised concerns about the disproportionately severe outcomes that can arise for breaches of these rules, especially in connection with general expenses of a superannuation fund. In some circumstances a breach of the rules in connection with general expenses could potentially result in *all* of the income of a super fund being considered NALI income and taxed at the highest marginal tax rate (see LCR 2021/2).

The Treasury paper sets out a potential approach that could be used to seek a better balance between maintaining the integrity of the tax system while providing a greater level of certainty for funds so that the consequences of any breaches would be proportionate to the magnitude of the breach. The potential amendments include:

- SMSFs and small APRA regulated funds would be subject to a factor-based approach which would set an upper limit on the amount of fund income taxable as NALI due to a general expenses breach. The maximum amount of fund income taxable at the highest marginal rate would be 5 times the level of the general expenditure breach, calculated as the difference between the amount that would have been charged as an arm's length expense and the amount that was actually charged to the fund. Where the product of 5 times the breach is greater than all fund income, all fund income will be taxed at the highest marginal rate.
- Large APRA-regulated funds would be exempted from the NALI provisions for general expenses.

Treasury is seeking consultation on whether there could be any potential unintended adverse consequences from the potential amendments.

Submissions can be made until 21 February 2023.

More information

Non-arm's length expense rules for superannuation funds - Consultation paper

From the Regulators

Reducing the eligible age for downsizer contributions

From 1 January 2023, taxpayers who are aged 55 years or older can choose to make a downsizer contribution into their super fund of up to $300,000 per person from the proceeds of selling their home.

It is important to note that there is a 90 day time limit for making a downsizer contribution. This means that eligible taxpayers who received the proceeds of sale prior to 1 January 2023 (e.g., sold their home in late 2022) can make a contribution from 1 January 2023, provided this still falls within 90 days of receiving the proceeds.

The required age to make a downsizer contribution was 60 from 1 July 2022 until the end of December, and 65 before that time.

More information

Further eligibility age change for downsizer contributions

December CPI increase and the impact on super and retirement income streams

Following the release of the December 2022 CPI figures, the general transfer balance cap (TBC) will increase from $1,700,000 to $1,900,000 from 1 July 2023. This could provide tax effective retirement pension and non-concessional contribution opportunities for some of your clients.

Individuals who commence a retirement phase income stream for the first time after 1 July 2023 will have access to the full $1,900,000 limit. For some individuals there may be a benefit in deferring the commencement of a retirement income stream until on or after 1 July 2023.

Where the complexity lies with the transfer balance system is that clients who have commenced a retirement phase income stream before 1 July 2023 will have a personal TBC that is different to the general TBC. This is due to the fact that indexation only applies to the individuals unused TBC. Based on the proportional indexation rules we face a situation where a client could have a personal TBC anywhere between $1,600,000 and $1,900,000. Your client's personal TBC and eligibility for indexation is shown on the ATO Portal and under their My Gov Login so this should be checked before commuting or commencing any retirement phase pensions.

The Average Weekly Earnings statistics that determine indexation of the superannuation contribution caps will be released on 23 February 2023. We will bring you the latest updates after the release.

New lodgment deferral function coming in 2023

In a small win for tax agents, the ATO has announced that it will be introducing a new mechanism for tax agents to request lodgement deferrals for their clients, following feedback that the current process was irritating for many agents.

The new process will allow for real-time visibility of the status of requests and quicker processing times.

The ATO expects the new function to be launched in Online services for agents in the first half of 2023.

More information

New lodgment deferral function coming in 2023

Rulings, determinations & guidance

Finalised guidance on section 100A

TR 2022/4 section 100A reimbursement agreements

Section 100A is a specific integrity provision aimed at situations where income of a trust is appointed to a beneficiary but the economic benefit of the distribution is provided to another party. When section 100A applies, the trustee is taxed on the income at penalty rates rather than the presently entitled beneficiary being assessed.

The ruling explains how section 100A operates from a technical perspective and looks at the four key elements that need to be considered in determining whether section 100A is triggered.

The following three requirements need to be satisfied in order for section 100A to apply:

- The present entitlement must relate to a reimbursement agreement;
- The agreement must provide for a benefit to be provided to a person other than the beneficiary who is presently entitled to the trust income; and
- A purpose of one or more of the parties to the agreement must be that a person would be liable to pay less income tax for a year of income.

It is then necessary to look at whether the 'ordinary dealing exception' applies. This is because the rules don't apply if the agreement has been entered into in the course of ordinary family or commercial dealing.

The ruling discusses each of these elements in detail and includes a number of examples, particularly in relation to what is considered an ordinary family or commercial dealing. The ruling also refers to recent and ongoing cases that deal with the operation of section 100A. As these cases move their way through the courts it is possible that the ATO will need to make some amendments to the ruling to ensure that it reflects case law in this area.

PCG 2022/2 Section 100A reimbursement agreements - ATO compliance approach

In addition to the final tax ruling on section 100A the ATO has released a final practical compliance guideline (PCG) which explains how the ATO differentiates risk and will apply compliance activities in connection with section 100A.

The PCG sets out a number of scenarios that would be considered low risk and some scenarios that would be considered high risk. The ATO also explains how it would approach this area when dealing with a situation that doesn't specifically fall within the low risk or high risk scenarios outlined in the PCG.

A brief summary of arrangements that the ATO considers low risk include:

- The present entitlement is physically paid or applied for the beneficiary's benefit within a two year period, although this is subject to some exclusions. For example, if the funds are physically paid to the beneficiary within two years but the beneficiary then gifts these funds to another party then this won't necessarily be considered a low risk scenario
- The funds are paid to a joint bank account that the beneficiary holds with their spouse and the funds are used to meet household expenditure
- The funds are retained by the trustee and certain conditions are met, including that the funds are used as working capital in a business carried on by the trust and the beneficiary controls the trustee
- Arrangements that are treated as ordinary family or commercial dealings in TR 2022/4

However, the following scenarios are generally considered high risk from a section 100A perspective:

- The beneficiary is a company or trust with losses and the beneficiary is not part of the same family group as the trust making the distribution
- A beneficiary company or trust returns the funds to the trustee (i.e., circular arrangements)
- The beneficiary is issued units by the trustee of the trust (or a related trust) with the amount owed for the units being set-off against the entitlement
- Adult children are made presently entitled to income, but the funds are paid to a parent in relation to expenses incurred before the beneficiary turned 18

Practitioners who are familiar with the draft version of the PCG should carefully review the final version because there are some additional examples and the ATO has modified its approach to certain scenarios.

The ATO's response to the High Court's decision on the employee / contractor distinction

TR 2022/D3 pay as you go withholding - who is an employee?

Following some recent and prominent High Court decisions in this area, the ATO has released a draft ruling which explains how to determine whether a worker should be classified as an employee for PAYG withholding purposes. The ruling focuses on determining whether someone is an employee under the ordinary meaning of the term but doesn't look at the extended definition of employee that is used in the context of the superannuation guarantee system.

The ATO emphasises that whether an individual is an employee is a question of fact to be determined based on an assessment of the entire relationship between the parties. If the worker and engaging entity have committed the terms of the relationship into a written contract then the analysis needs to be performed with reference to the legal rights and obligations in the contract. That is, the key focus is on the terms of the contract rather than the subsequent conduct of the parties.

The label used by the parties to describe the relationship is not determinative of the classification. Labels which are inconsistent with the rights and obligations under the contract should be ignored when classifying the worker.

In determining whether a worker should be classified as an employee there are a range of factors that need to be considered. The ATO indicates that the key distinction between an employee and an independent contractor is that:

- An employee serves in the business of an employer, performing their work as a representative of that business.
- An independent contractor provides services to a principal's business, but the contractor does so in furthering their own business enterprise; they carry out the work as principal of their own business, not a representative of another.

In addition to looking at whether the worker is serving in the engaging entity's business, it is important to consider the extent to which the business can control how, where and when the workers perform their work.

Aside from these two key factors there are a number of other indicia that could be relevant in classifying the worker, including:

- The ability to delegate work;
- Whether the contract is on a results basis;
- Which party provides the tools and equipment;
- Risk; and
- Generation of goodwill.

In the draft ruling, the ATO states that where a worker engages to perform work for a business as a partner of a partnership or through a company or trust then this may indicate an intention by all parties not to create an employment relationship. However, a different conclusion may be reached if a worker uses an interposed entity but is also directly a party to the contract with the engaging entity.

PCG 2022/D5 Classifying workers as employees or independent contractors - ATO compliance approach

In addition to the updated draft tax ruling, the ATO has issued a draft PCG which explains how the ATO will allocate compliance resources in connection with the classification of a worker as an employee or independent contractor.

The PCG starts by outlining some of the consequences of a worker's classification. This is a brief but useful checklist for both engaging entities and workers.

The draft PCG then outlines the risk framework that will be used by the ATO for worker classification issues, based on the actions taken by the parties when entering into the arrangement. It is important to recognise that the draft PCG does not extend to employment law issues, state based issues or the income tax affairs of the worker (e.g., whether they are subject to the PSI rules etc).

The PCG sets out four risk categories, which are based on a number of factors, including:

- Whether there is evidence to show that the parties have agreed on the classification;
- Whether there is evidence that the parties understand the consequences of the classification;
- Whether the performance of the arrangement has deviated significantly from the terms of the contract;
- Whether the party seeking to rely on the PCG has obtained specific advice confirming that the classification is correct; and
- Whether the party seeking to rely on the PCG is meeting various tax, superannuation and reporting obligations.

Company residency transitional period extended

PCG 2018/9 Central management and control test of residency: identifying where a company's central management and control is located

The ATO has updated this PCG to indicate the transitional period for non-resident 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) will come to an end on 30 June 2023. When the PCG was originally issued the Commissioner indicated that the ATO would not apply resources to review or seek to disturb a foreign-incorporated company's status as a non-resident during the transitional period if it is able to meet the criteria set out in paragraph 102 of the PCG and during the transitional period it:

- Makes changes its governance arrangements, so that its central management and control is exercised outside Australia by the end of the transitional period;
- Does not commence carrying on business in Australia (other than because its central management and control is exercised in Australia);
- Does not undertake or enter any artificial or contrived arrangements that affect the location of its central management and control; and
- Does not undertake or enter any tax avoidance scheme whose outcome depends on whether it is a resident or non-resident.

Cases

Section 100A and Part IVA

FC of T v Guardian AIT Pty Ltd ATF Australian Investment Trust; FC of T v Springer [2023] FCAFC 3

This is one of two cases currently making their way through the courts which look at the potential application of the reimbursement agreement rules in section 100A ITAA 1997. As indicated above, section 100A is primarily aimed at situations where a trust appoints income to a beneficiary but there is an agreement / understanding at the time of the distribution that the real benefit of the funds will be provided to someone else (unless this is part of an ordinary commercial or family dealing).

Very briefly, the taxpayer was an individual who controlled the relevant trust and several trading companies. For a number of years, the general position was for the trust to distribute its income to the trading companies based on the needs of each entity. However, a new corporate beneficiary was set up in the 2012 year in connection with the taxpayer's retirement process and because the existing companies were winding down. All of the shares in the company were held by the trust.

In both the 2012 and 2013 years the corporate beneficiary was made presently entitled to the income of the trust. The company subsequently paid dividends back to the trust, which appointed the income to the individual, who was a non-resident.

The ATO assessed the trustee on the basis that section 100A applied to the arrangement. In the alternative, the ATO determined that Part IVA applied to ensure that the individual should be assessed on the relevant income.

The primary judge in the Federal Court found that there was no reimbursement agreement in relation to the 2012 income year and that section 100A was not triggered. The primary judge found no evidence of an agreement that the funds would be passed either back to the trustee (as the shareholder of the corporate beneficiary) or the individual at the time the present entitlement arose.

While the position was slightly different with respect to the 2013 income year, the primary judge found there was no concrete plan that the distribution was being made to the company with the understanding that the funds would then be passed onto either the trustee or the individual.

The Commissioner appealed the decision in relation to both the 2012 and 2013 income years, arguing that it was necessary to focus on the representatives of the accounting firm that assisted with the group. For example, the Commissioner argued that at the time the present entitlement arose in relation to the 2013

income year there was an understanding within the accounting firm that the corporate beneficiary would pay a dividend back to the trust and that this understanding could be imputed to the taxpayer.

However, the Full Federal Court upheld the decision of the primary judge in connection with section 100A. While the Commissioner was able to show that the later payment of a dividend by the corporate beneficiary was not "wholly conjectural", there was no agreement at the time the present entitlement was created which involved the payment of a dividend. As a result, section 100A could not apply and there was no need to consider whether the arrangement was an ordinary commercial or family dealing.

While the Commissioner's appeal did not succeed in relation to section 100A, it is important to note that the Full Federal Court found that Part IVA did apply in relation to the 2013 income year. The arrangement involved the distribution of income to a company which was taxed at the corporate tax rate, with that income then being paid back to the trust in the form of franked dividends, which could then be distributed to a non-resident beneficiary without any further Australian tax. Had the trust initially distributed that income directly to the non-resident beneficiary (rather than ensuring that the income passed through the company first) the beneficiary would have been taxed at higher rates.

The Full Federal Court found that while the arrangement involving the 2012 income year was the product of an evolving set of circumstances, the arrangement involving the 2013 income year involved the implementation of a strategy that had been developed within the evolution and implementation of the 2012 arrangement. The court found that the 2013 arrangement was entered into or carried out with the dominant purpose of enabling the non-resident beneficiary to obtain a tax benefit.

The important reminder here is that general anti-avoidance provisions such as Part IVA can potentially apply, even if specific integrity provisions don't apply to a particular arrangement. Practitioners need to be especially careful when considering arrangements that involve the insertion of additional steps that don't seek to serve any commercial or non-tax purpose.

Legislation

The first sitting of Parliament for 2023 commences on 6 February. We will keep you updated of any important changes.

Sharing platform provider reporting obligations

Treasury Laws Amendment (2022 Measures No. 2) Bill 2022

This Bill received Royal Assent on 12 December 2022 and contains the following amendments:

- Sharing economy platform providers will be required to provide information on transactions undertaken on the platform to the ATO. Broadly, this amendment involves expanding the taxable payments reporting system (TPRS) to apply to certain transactions made through an electronic platform. The reporting rules apply to taxi services (including ride sourcing) and short-term accommodation from 1 July 2023. The rules commence from 1 July 2024 for all other reportable transactions.
- Removal of the non-deductible $250 self-education expenses threshold.
- Expanding eligibility for downsizer contributions to allow individuals aged 55 and above to make downsizer contributions to their superannuation from the proceeds of selling their main residence.
- Enabling the Commissioner to direct an entity to complete an approved record keeping course where the entity has failed to comply with record keeping obligations as an alternative to existing financial penalties.
- Increased Tribunal powers for small business tax decisions. This would enable small business entities to apply to the Small Business Taxation Division of the AAT for an order staying, or otherwise affecting, the operation or implementation of decisions of the Commissioner that are being reviewed by the AAT.