Income Tax Case Update
07/03/2024

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Hello everybody, and welcome to today's webinar, Income Tax Case Update. My name is Susannah Gynther from Wolters Kluwer CCH Learning, and I will be your moderator for today. A few quick pointers before we get started. If you're having sound problems and can hear me, please toggle between audio and phone. Hopefully, you can see this instruction on the screen. If you're looking for today's PowerPoint, please have a look in the handout section on the GoToWebinar panel.

And just a reminder that you will be sent an email letting you know when the e-learning recording is available. You can ask questions at any point during the presentation by sending them through the questions box. I will collect those questions and ask them at the Q&A towards the end of today's presentation. CCH Learning also offers a subscription service, which many people have termed, "Netflix for professionals." It provides members with access to our entire library of recordings as well as live webinars for a competitive flat fee. That's for over 500 hours of content. For CPD purposes, your viewing is logged automatically.

Your presenter today is Bruce Collins, founder and principal solicitor of Tax Controversy Partners. Bruce is currently helping clients to resolve all types of tax issues with the ATO and SROs. Before moving into private practise in 2017, Bruce worked for over 35 years in the Tax Office, a third of his time as a senior executive in what is now Client Engagement Group, covering most ATO functions.

Bruce was the leader of the technical and case leadership area in aggressive tax planning and then private wealth for several years prior to leaving the ATO, as well as having previously been the strategic and technical leader for many of the ATO's compliance programmes and ATO's law clarification programmes and a member of the ATO Test Case Litigation Panel in several roles. In those roles, Bruce was heavily involved in leading a number of ATO tax litigation programmes, mostly targeting income tax, risks and issues. I will now pass you over to Bruce to commence today's presentation.

Bruce Collins:

Thank you, Susannah. People should be able to see my screen. So today we're going to be talking about a number of income tax related cases, which have come out over the last year or so. Hedges, DiStefano, Stark, Meakins, B&F Investments, Bendel, PepsiCo, PQBZ, DQTB, Rawson Finance, Active Sports Management, and McEwen. McEwen's a funny one. It's actually about an R&D matter where there's some relevant commentary, but it's more of an information commissioner issue in terms of its content, but it's context is clearly income tax.

So before we kick off, it's always good to know who the audience are. So from our perspective, we would like to try and find out who's in the audience. So we're going to run a quick poll, which Susannah will administer. So if you are an accountant or a tax agent, press A. If you're a lawyer, press B. If you're a financial planner, press C. If you're a student, press D and otherwise E. So over to you, Susannah.

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Thank you very much, Bruce. So please put a click in the radio button next to the answer that best describes you. That would be really great. And just a reminder, of course, if you do have any questions, please put them into the questions pane during the presentation and we'll get to those questions at the end of the presentation. I will just give you a few more seconds to get your votes in and then we'll close the vote. Okay, I'm going to close that vote and let's have a little look. So 93% are accountants or tax agents with 7% lawyers. Back to you, Bruce.

Bruce Collins:

Okay, thanks for that. And next question is really going to be around where people work. In private practise, tick A. In public practise, including the ATO, tick B. And otherwise, hit other, C. Back to you, Susannah.

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No worries. So I've just launched that. So again, just click in the radio button that best describes your situation. I'll just give you a few more moments to get your votes in, so please do so. That would be great. Okay. I'm going to close the vote and let's have a little look at what people said. Okay. So 63% are in private practise, with 30% in public practise and 7% other. Back to you, Bruce.

Bruce Collins:

Okay, thanks. Just gives me an opportunity to focus the presentation a little bit more on the audience. So thank you very much for doing that. Thanks, Susannah, for your help in running the polls. So the first case we're going to look at is actually the Richmond case. It's a case involving a mining lease which was owned by effectively parties in a joint venture.

Joint ventures are peculiar in the sense that they have some characteristics a bit similar to a partnership, but they're not a partnership. And as a result, it gives rise to a range of questions about the characterization of an interest in the joint venture and the assets owned by the joint venturers. So in this case, the joint venture agreement required a right of purchase to the joint venture members in the terms where the taxpayer, in this case, Richmond, had to pay 1.5 mil plus GST.

Confidential information would be available to him, and within 18 months, Richmond would have to incur a minimum of the 1.5 million on exploration expenditure on the mining tenement. Where the mining expenditure was met, then Richmond had the option to define at least 30,000 metric tonnes of copper being on the tenement. So in 2017, a bit later than the agreement was executed, Richmond basically paid the money. So the question then becomes: what happens next?

The commissioner assessed the transactions negatively, and the question therefore in the case was about whether the assessment was excessive or otherwise incorrect, and if so, what it should have been. The requirement for the taxpayer to demonstrate in an AAT or federal court case to show what the taxable income is, as opposed to just attacking the process by which the commissioner reached the conclusion about the assessment, is actually something to be a recurring theme in this session, as in almost everyone, about income tax law.

So the taxpayer also argued about whether there would've been an allowable deduction pursuant to 8-1 one or Division 40, the capital allowance regime, in respect of the payment. So in other words, it was either a payment of an allowable deduction as necessarily incurred in running a business or in earning assessable income, or it was a capital allowance depreciation amount for the time value of the other relevant asset.

Now, exploration expenses have specific rules in Division 40, and the taxpayer argued therefore that those particular provisions would apply, and therefore there would be a decline in value claim over time. Now, there's a real question about interests in a joint venture and then tracing into the mining tenement itself or whether there's, in fact, a contract to acquire the profits or the proceeds from the mining activity.

In one, you've got an interest in a tenement; in another, you've got an interest in the product coming from the tenement. And the commissioner argued that the taxpayer wasn't entitled to a deduction based on the revenue capital distinction. So 8-1 was out because of the negative limb in 8-1 and the taxpayer obviously argued the contrary.

Now, that threw the question into strong contrast around whether there was an entitlement to deduction. And the Tribunal found that Richmond had failed to discharge that onus of proving the assessment was excessive, and therefore the objection decision was affirmed. Now, the Tribunal reasoned that the facts were that Richmond had acquired a right to access and entitlement to information, but that didn't change the fundamental character of the expenditure.

And the Tribunal agreed that the commissioner's argument was correct that the purchase agreement, in a sense, attempted to mischaracterize the true substantive nature of the transaction. And the Tribunal didn't accept the characterization of the payment as being for the acquisition of that information, which might be depreciable under the capital allowance regime. So the key takeaway for this one is that you have to remember the capital revenue distinction, and also that you can't simply re-characterise something by describing it as something when it's not.

There's a wonderful line in one of my favourite High Court cases where the High Court basically says that, "The power to make laws with respect to lighthouses doesn't enable you to choose or determine what a lighthouse is." So in other words, you can't just describe something as one thing when it's clearly not. And therefore, this case also provides guidance on the taxpayer's onus of proving the assessment was excessive. In this case, the taxpayer didn't discharge that onus and therefore was left not winning.

Now, Hodges was a solicitor in a partnership. Sorry, that should say deed of retirement rather than deed of requirement. Apologies. Bloody autocorrect. Sometimes if you put a Q instead of a T and they're next to each other on the keyboard somewhere, maybe they're five keys away, I can't remember. But whatever happened there, apologies for the typo. So in retiring, the question was whether a proportionate share of goodwill and work in progress was going to be flowing.

And the commissioner assessed via default assessment on the partnership distribution that was received, the capital gains from disposal of the goodwill before the discount and the payment of the work in progress. So the question was based on the retirement deed and the partnership deed, whether Hodges was actually entitled to receive the capital proceeds for the disposal of this interest in the goodwill.

The decision was that the court dismissed the appeal with costs against, which is never a good thing. And subsequently, special leave to the High Court was denied. He was obviously very keen to contest it, but the High Court didn't agree that it was worthy of contest. Now, Hodges argued that the retirement deed was the source of the right to the retirement money, and the partnership deed would've resulted in nil amounts being paid to him and therefore, there was no capital gain arising from entry into the retirement deed.

So the court remarked that unlike the position of general law, the capital gains provisions are drafted on the basis that each partner has an interest in each partnership asset. And again, this is a feature of partnership law, which is pretty clear. You have a traceable interest in each of the assets of the partnership and that's why you return capital gains in an individual schedule, not in a partnership return. And the court therefore rejected Hodges' contention regarding the calculated net sum as a matter of construction of the relevant deeds.

So the takeaway here is that you've got to look at the legislative history of the partnership construct and the relevant legislation. Look at the complexity of the partnership structure and then look at how that influences, in different ways, the calculation of the taxable income. And it also provides guidance on the proper construction of partnership agreements and what their later consequences will be when you look at how the tax law then works on the construct of the partnership agreement itself.

Now, DiStefano was a case around essentially a person who was an experienced business person who had a long history of investing in rental properties. Purchased a house in New South Wales near Port Stephens, funded from a bank mortgage, only expected to return income a few weeks a year. Long-term tenant moved in, taxpayer made interest payments and all of the other on-costs that you get. Tenant reported extensive defects, stated that effectively there were structural damage, serious safety hazards, moisture ingress et cetera.

Property was deemed uninhabitable. DiStefano's father then suffered a stroke, and there was a delay as a result of caring for him according to the evidence in making the repairs. During that time, there were other real estate purchases being made and other activities. But the question was whether there was continuity in the commercial purpose, the income producing purpose for holding the property when there was this long hiatus when the property was just sitting there.

And this is another thing we'll come back to. Nexus needs to be tested on an ongoing basis. The immediate decision to acquire a property is one point at which nexus is tested, but every year you need to test the nexus against what is happening with the other property over time. So this was a question about whether the nexus had been lost, and therefore whether the expenses incurred during that hiatus period when the property wasn't rented, interest and all of those holding costs, whether they remain deductible under 8-1 or not.

So the contention from the taxpayer was obviously that it was continuous and therefore, that the expenses would be allowable and citing the ATO public ruling. And the ATO conversely argued that enough was enough since the vacancy had been for a very long period. So what was interesting was the Tribunal took the contrary view to the commissioner's position. So the Tribunal set aside the objection of decision and said, "Well, look, the original intention was the intention and the intention was intention as opposed to enough was enough."

Now, the Tribunal considered the... 8-1 is structured with a set of positive tests and then a set of negative tests, the positive limbs and negative limbs. So the first limb was there was no assessable income, but the question was whether the original intention to earn assessable income continued to prevail. And so the real issue is whether the holding cost of the property having lost their connection with the earning of assessable income or not.

And the Tribunal focused on the idea that there was an established commitment to an assessable income from the property, and that that connection hadn't been lost because the subsequent activities were slow. In other words, inactivity was not fatal. So the idea that slow progress might mean that there's a loss of that nexus test, or a want of commitment to the earning of assessable income, makes this case an interesting one. It's interesting because the commissioner will routinely argue to the contrary when somebody's had a long hiatus and they're not doing anything with the property and you end up with a negative decision.

And that will be contested. And as we'll see with another case later, it can go either way. And the idea of the Tribunal saying that there might be some delay in the execution of the project that would become untenable, in other words, it reaches a point of fatality for the nexus remaining extent. So in that circumstance, you've got to watch out and you've got to be continually vigilant to make sure that that doesn't happen. So it's not just a done deal that once you've had an initial intention, whatever else happens later, it does get tested every year. But there's a presumption that that commitment continues until there's strong evidence that there's a want of commitment to the achieving of assessable income.

Now, Sladden's an interesting case. This is a person who had... She had a couple of policies of insurance with National Mutual, a life protection plan and a professional income protection plan. Sadly, she was diagnosed with breast cancer and she made a claim in respect of the income protection benefits as a result. And with these policies, quite frequently, they include a carve-out for not having to pay premiums during the period when you're making a claim for income protection.

So in late 2013, the taxpayer was also diagnosed with Sjogren's syndrome, which is an acute inflammatory condition, as I understand it. And that meant that she continued to receive payments under that policy or those policies. So our National Mutual merged with AMP or it sold its insurance book to them anyway. And the taxpayer appointed a representative to negotiate with the insurer to try to commute the income protection benefit. AMP offered a million, and she understood, the taxpayer, that income protection amounts would be taxable on the basis the amounts would not be characterised as personal injury amounts.

Now, the question about personal injury is of course that such capital gains that occur from that are actually disregarded for CGT purposes, and that the double counting rules then mean that it won't also be counted as ordinary income. But the question was whether the amounts were accessible as ordinary income or statutory income. And it's only a question if it's ordinary income, obviously whether the net capital gain would apply and whether there would be a discount for capital gain.

So you've got the idea that it might be personal injury, it might be a discountable capital gain or it might be some form of ordinary income. The arguments were that the taxpayer argued that it wasn't ordinary income as the payment was an undissected lump sum comprising both capital and income amounts and therefore it should all be treated as capital. That's a brave argument. And also, the taxpayer argued the deed wasn't a sham and the payment was determined by the terms of the deed.

This is a slightly tricky argument for taxpayers to mount because part of the problem is that they run the case on the basis that you interpret the deed according to its form but not its substance. And as we'll see that that leads to some interesting debate about how that works. So the objection decision was affirmed. Effectively, the taxpayer lost. Tribunal stated there was no dispute that the monthly income protection amounts, under the two policies, were assessable income in substitution, under the substitution principle, for the amounts of income that she would otherwise have received, which would all have been taxable.

And the lump sum was just replacing the monthly income and that didn't change the character. The Tribunal expressly rejected the idea that the terms of the deed determined the character and goes to not form, but goes to substance. And held that the reality was that the applicant and AMP negotiated and resolved to commute the applicant's entitlements and consideration of the payment of the settlement sum. So the character of the payments that were being commuted, therefore, didn't change just because it was commuted.

So it's important that when you're negotiating on anything involving a potential characterization between the capital revenue distinction, that do you actually have documentation that supports that. So if she'd made a claim in the first place for a capital-related transaction rather than straight under the income protection, say it was a life insurance policy with a death benefit, which you could claim in advance if you had a terminal disease or something like that.

That would've actually changed things quite a bit. But these were actually regular income protection payments which were always going to be income. And so later drafting of a deed which tries to re-characterise is just too late and it's too lacking in substance. And it would be easy to argue that such a deed was either a sham or fraudulent in terms of trying to misdescribe the elements in the claimed damages which were just done to achieve the desired tax outcomes. Part IVA would probably also apply, by the way, even if you didn't succeed in arguing sham or fraud. Because the deed itself could actually be Part IVA scheme. That doesn't come up in the case, but that's just an aside.

Now Bains is a case involving taxi industry. At one stage before ride-sharing became a thing, what happened was that taxi plates were incredibly expensive, and they accrued in value because they were scarce. Whenever the state regulators issued new plates, there would be a decrease in the value of current taxi plates and then the value would go up. But you needed to have a taxi plate registration in order to operate as a taxi. Ride-sharing killed that distinction because people could simply use any car that met the standard for the relevant ride-share provider.

So Bains and his wife had purchased three sets of taxi plates at different times, and the idea was that they had a value. And then subsequently because of ride-sharing, they became valueless. The purchases were initially funded by bank loans. Obviously, ride-sharing killed a certain amount of the certainty around the value of taxi plates. So various state governments introduced different sorts of schemes at different points in time with subtly different characters.

And so there are a number of cases involving these issues. So in Victoria, there was a hardship fund and there was a transition assistance payment payable to taxi plate holders during that period. And then there was a fairness fund, which was a different regime set up as well. So effectively, of the amounts that they had paid for the plates, Bains and his wife ended up with not a dissimilar amount of money in total, but still less than they had started with. And the commissioner assessed the 250K paid under the fairness fund as assessable income.

And when Bains objected, the commissioner disallowed the objection. So the real question is whether it's ordinary income according to 6-5 or whether it's a capital gain assessable under the CGT provisions or whether it might be exempt. So Bains argued the payment was not assessable as it was made in recognition of financial hardship and effectively, as a result of the destruction of value and the taxi licences.

And the commissioner argued that it was in substitution for the ordinary income that would've been received as part of the running of the taxi business. The Tribunal set aside the objection decision, and the reasoning is interesting because as I mentioned, there are different regimes in different times and in different jurisdictions.

Now, Berghofer was an earlier case where the Queensland government had provided a grant which was specifically described as reimbursing business expenditure previously incurred. Now, that's different to what the Victorian government used to describe their payment under that fund that generated the 250K. So as a result, the reasoning for the payment being made, the express intention made by government in Victoria was to deal with the unfairness due to the negative impacts of the policy reform which allowed ride-sharing to proliferate.

In other words, the government decision had destroyed the value of these businesses. And the key takeaway was that the Tribunal recognised that not all payments received by a person in business are income of that business. They could be something else. And as a consequence, the objection decision was set aside. So it's important to recognise in these cases that you've got to look at what the payment made by government is for. This happens with grants and subsidies paid by government. Some of them are taxable, some of them are specifically exempted, but some of them also fall into a question of characterization as to whether they should fall on which side of which line.

Do they relate to the underlying asset, the taxi plates, and thus they might be either capital gains or they could be ordinary income of the business? They could be discountable capital gains, they might not be et cetera. So it's important to look at what the circumstances are that lead to the grant or payment under some sort of government programme or subsidy so that you can actually work out what its character is.

And this case makes it more complicated for determining the answer to that question. If Berghofer had been followed, then perhaps you'd say that all of these sorts of payments were likely to be treated in that fashion. But actually, now we've got a yes and no scenario depending on which state you're in and which fund is actually making the payment.

Now, Stark was an employee who accepted a role at 55 with company A, and he was also offered another role by company B. He accepted the offer with company B and withdrew his previous acceptance of the offer from company A. So he made a choice, fork in the road, as to whether he would work for A or B. Now, unfortunately, after taking the job with company B, his employment was terminated a year or so later. And the problem is that he felt obviously that he had some claim, and he claimed for wrongful dismissal and other things, and reached a settlement of 555K. The deed was executed in 2009.

Now, the settlement was dissected into two amounts, 50K for general damages and 505,000 for lost earnings. Stark was found to be unable to secure further employment based upon ageing circumstance. Now, Stark perhaps wisely asked the commissioner whether the 505K would be taxable via a private ruling. The commissioner found in favour of the amounts being treated as an eligible... Sorry, an employment termination payment. Sorry, just went back to the old terminology for a second there.

And on objection to the private ruling, because obviously Stark wanted an answer that wasn't taxable, rather than being an ETP. On objection, the commissioner instead determined that the amount was ordinary income, and that shows the risks of objecting to partially favourable decisions because you can end up with a worse decision in some circumstances. Now, in the litigation case, the question was whether the payment should be excluded from CGT on the basis that it was capital and a payment in compensation for his right to earn future income, a personal injury in effect.

And not for the loss of his past earnings, because Stark argued that, effectively, it was a payment compensation for a wrong or injury he suffered while he was working. And on appeal, Stark argued that the AAT had incorrectly not considered the application of that, and also argued that it was a genuine redundancy payment. Now, this case is one which again shows a risk that people run. The AAT is a cost-free jurisdiction. The federal court is not. So not only did he lose on appeal in the federal court, but it was dismissed with costs against.

So as a consequence, it's worth mentioning that that's a risk that everybody runs in that circumstance. So the reasoning was effectively that Stark was self-represented, never a particularly good thing. I wouldn't represent myself in court by choice. Three of the grounds were invalid, and the court still considered the grounds and still found that they failed. And the evidence showed that Stark was terminated due to a disagreement with management, not as a genuine redundancy of this position.

And there was no admission of liability for any such wrong or damage that he'd suffered. So there was no scope to actually consider that. And again, the structuring of the deed was one of the things that was actually bad for Stark in this case. But also, it was one of those things where even if you tried to restructure the deed to change the characterization, it doesn't mean you're going to actually get the right answer. It's better to make a claim in the first place that articulates what would be the beneficial tax treatment rather than try to retrofit it later on. And here, there wasn't even any retrofitting, so it's better to get advice. But if it's too late, sometimes you can't do anything to fix the scrambled eggs. You can't unscramble them.

Now, Meakins is about the deductibility of holding costs for undeveloped land. If you contrast this with the earlier case we talked about where you've got somebody who is earning assessable income and then stopped, here, you've got somebody who is actually purchasing vacant land for the purpose of theoretically developing it via a company structure with a company, a sole trustee for a trust. So the idea was that they purchased the vacant land for 1.3 mil. They did it with existing plans for a house having been included in the sale documentation.

Initial loan was paid out, and there was a refinancing a few years later, but the property was really not rented out from 2007 to 2017. So there's a long period of lack of any commercial activity on the property. In 2018, there was a small amount of rental income for storage and access to the site. And then there was a payment being made by Meakins' husband for use of the property for car parking from 2009 to 2016. So related party dealings are always questionable, and the use of a company controlled by a relative, particularly a spouse, doesn't seem to really justify getting the negative gearing benefits for the relevant loan and the interest income and other expenses flowing from it.

So the question was whether the holding expenses were deductible for the relevant periods and whether the administrative penalties applied were correct and whether they should have been remitted in the taxpayer's circumstances. Meakins' argued, at the time of purchase and since, she'd always had a subjective intention to develop the property and that would result in the derivation of assessable income. And the delays in the development included issues from the adjoining land et cetera, and having tried to acquire adjoining land.

The commissioner argued that taxpayers could not expect rental income when development hadn't commenced, and had made no efforts to progress the developments. Therefore, they weren't doing any of the things that would be indicia of a business-like activity being conducted. Decision was the objection decision was firm, so taxpayer lost. Now, if you go back to Steele's case, one of my favourite cases back in '99, you've got the idea that there was a pattern of activity there that was present in Steele that is lacking here.

So over the 17-year period, Meakins' had made no effort to develop the property beyond the initial drawings which had been shared at the time of sale. It was a lack of substantial action to do anything at any point in the ownership period in contrast to the earlier case we discussed where there was earlier activity, and then there was a hiatus where there was none. And it was more likely, therefore, from the perspective of the Tribunal that this was a case where the property was being held on capital account. And therefore, the Tribunal noted that Meakins' had failed to discharge the onus of proof or establish that the penalties were excessive.

Separate issue, but in neither case, was there enough evidence to show that that was the case. So nexus is important. For an expense to be deductible under A1, or indeed under most of the other provisions where there's a purpose test built in, you have to actually demonstrate a positive case to show that that nexus exists. Intention without action is not enough, and there needs to be action towards that intention in order for you to be able to demonstrate its existence. Now, again, the nexus arguments can run both ways.

If you're running at a loss, you want it to be revenue so you can claim a deduction. If you're making a profit, you may want it to be capital, so it's a discountable capital gain. So simply arguing it without evidence of actual activity, things that support the argument, you're in trouble from the get-go. Now, again, here's another property developer case where there was a subdivision and there was a whole bunch of money coming through. There was also gains from other property sales during the period.

The tax return lodged on the basis of capital account and claimed the 50% CGT reduction under the small business CGT rules and rollover for the remaining 50%. Now, the company which was owned and as a director, the daughter of the property developer himself, they'd sold a bunch of other properties et cetera, and on capital account as trustee for the trust. The issues were therefore whether the profit on the sale of properties were on revenue or capital.

And if capital, whether Frontlink qualified for the CGT concession, particularly around the combination of the turnover tests and the maximum net asset value. Now, because of the fact that the property developer father had a range of companies and there was some big dollar figures attached to these transactions, you therefore are thrown into contrast on whether those are going to be counted or not.

So Frontlink and the company and the other taxpayers argued that the trust was established for the daughters to protect all the wealth from going to the son. And the properties purchased were always intended to be operated as farms. There was no intention to sell at a profit. There's of course capital treatment where you can get a discount. There's revenue treatment, there's carrying on a business, and then there's of course the isolated profit-making scheme or undertaking characterization, which is also revenue.

And the idea, if you've bought property to operate as a farm, then you are going to be holding it for long-term use. Therefore, the asset is a capital asset, therefore you might get the CGT discount. Now, the taxpayers also argued that the trust and the company in question didn't act in accordance with Sam's intentions. Sam was the father. And if you think about it, the way that the regime works for the CGT discount et cetera, is going to be that you have to show that the other company isn't going to act with the instructions, directions, or wishes of the potentially associated person.

Now, the taxpayers argued that they shouldn't be aggregated because they didn't act in concert, and therefore that should be excluded from that calculation. And the commissioner argued the transactions were on revenue account because they had trading stock. The sales income was ordinary income per 6-5 and the Myer Emporium principle around the isolated profit-making scheme or undertaking.

The objection decision was affirmed, other than some minor matters along the way, and further submissions were required on penalties and SIC. Now, the argument that your father, who is a property developer, isn't going to be involved in decision making about a property that you own that ends up being developed, does seem perhaps a little bit disingenuous. And Sam, the father, provided evidence that he was unaware of zoning changes in relation to the area and its likelihood to occur at the time of acquisition of the property and subsequently when the intention might have changed.

And there was an option agreement, which was a fairly sophisticated vehicle used for part of that transaction. And again, that tends to indicate a business-like purpose. So the evidence of the intentions of the parties and the supporting indicia of whether they're carrying out a business or engaging in capital activity is important. And where the intention changes at a point in time as a result of supervening events, it's important to get that documented as well.

Now, the oral evidence at hearing was not convincing from either the taxpayers or Sam. So reading the decision, the subtext for me was this was a pretty typical case where the evidence wasn't accepted because it was a bit too convenient. And so we'll see what happens with these matters in future. But the oral evidence, you can never rely upon how the Tribunal is going to receive it. If the taxpayer or the witness third party is convincing it may work, but otherwise maybe not.

Bechtel was effectively engaged in a large-scale construction project, and they received a contract for liquefied natural gas in Queensland. There were a lot of employees involved, and they were FIFO employees, flying in, flying out, from various places. And they had to organise their own travel from their home to the airport, and they received a project allowance to the inconvenience of working in a remote location. But that was not for travel.

So the question was whether the travel deductions would've been allowed to the individual FIFO employees under 8-1, thus for FBT purposes whether it would be otherwise deductible for the purposes of FBT. So the company argued the facts were substantially similar to John Holland, which is a case which was decided back in 2015 where the employee's contracts started their employment when they got to the airport and they were FIFO workers. And then, when they flew from the airport to the mine site, they were actually paid, and then they only ended their shift when they got back.

Now, the commissioner argued that John Holland was different because the employees in question weren't travelling during their work activities in this case. The appeal was dismissed with costs again, showing that issue about if you run the case in the federal court, you can actually get costs awarded against you. The court reasoned that the case was substantively different from John Holland because they only began their shift once they started at the work site, not when they in fact arrived at the airport.

And they weren't therefore travelling between two places of work. Rather, they were going between their home and their current work location. And the travel wasn't incurred when the employees were producing income, it was required so they could get there. Going back to the Laney and Hale, the seminal case on that.

So the interactions between FBT and income tax can be tricky, and when there's long-term contracts and things change, the deductibility of the expenses can change and you need to revisit the contracts accordingly. And when allowances are being offered, it's important to describe what they're for, and to relate them to those potential tax rules. And the characterization for the employee will often, maybe even always, determine the deductibility and FBT status for the company employing them.

B&F investments is the next one we're going to talk about. So this case was previously referred to as the Bblood case in the Tribunal. So this is the appeal to the federal court. Now, it featured a discretionary trust with a corporate beneficiary being introduced into the ownership structure of a private company with substantial retained earnings. After that insertion, there was a $10 million share buyback which triggered the distribution of the retained earnings.

So the case is a major one on 100A, but also the trust reimbursement provision in 1936 Act. And it also involves the potential application of the dividend-stripping rules in Part IVA. There were two concurrent appeals, one by the corporate beneficiary about the tax treatment of the relevant payments, and the other by the corporate trustee under the assessment made under 100A to turn off the distribution to the company and to have the money flow back up.

Importantly, the company being a corporate beneficiary receiving the distribution of the dividend amount, would simply get the franking credits and not pay tax. So the arguments were that that would happen, the discretionary trustee shouldn't be liable as the amount had actually been distributed, the statutory income had been distributed even though there wasn't cash flowing with it. And the taxpayer argued the arrangement wasn't

covered by 100A, it was not a dividend-stripping arrangement, it was not a scheme to which Part IVA would otherwise apply.

Commissioner conversely argued that 100A applied, as the cash benefit of the income flow was not directed to the corporate beneficiary and then fell within the scope of 100A. In the alternative, the commissioner also argued that the arrangement would not be effective as it would be a dividend-stripping operation. And in the further alternative, the commissioner argued that the Part IVA would apply to otherwise deny the relevant tax benefits flowing from the scheme.

Decision was taxpayers effectively lost on 100A for the corporate trustee, and as a result, the corporate beneficiary succeeded in the concurrent appeal but with no benefit because they simply weren't going to be taxed on the unfranked dividend that would flow once the dividend-stripping provisions applied. But that was because the corporate trustee didn't get the money under this because it was treated as a reimbursement agreement that was received by the corporate trustee of the discretionary trust.

So the reasoning was that the transaction was an arrangement to which 100A applied, and therefore the distribution was cancelled and then the corporate trustee was taxable. And therefore, there couldn't be anything left to operate on from the dividend-stripping rule perspective. This case is actually good news to the commissioner in the sense that it supports the 100A strategy that represents a warning to exercise caution with establishing and implementing such arrangements. It's got to be read with the Guardian decision as well, because the findings by the court about the circumstances are different between those two cases. But it's definitely worth having a look at this one if you're interested in 100A.

Now, Bendel is another case involving currently a significant issue in the tax system, which is about unpaid present entitlements and the interaction with Division 7A. So this is a pretty typical case. You've got a trust that declares to a corporate beneficiary an amount which remains unpaid for several years. In this case, two sets of amounts. And as a result... Oh, by the way, the group carried on business as a tax agent, but was also involved in property development activities.

The main issues were therefore whether the companies were providing a financial accommodation to the trust in respect of the amounts that remained unpaid, and therefore whether their loans, as a form of financial accommodation under their definitions in 109D(3), which would make them deemed dividends under 109D(1). Now, the secondary question is whether the dividends were paid out of company profits under 109Z and would therefore be included in the net income of the trust estate for the discretionary trust for the purpose of section 95.

And therefore, whether the beneficiaries of the trust were therefore assessable in their proportion of those deemed dividends applying the proportionate approach for post Bamford. So the commissioner strongly argued in this case, putting forward with full force the arguments contained in the UPE strategy that any form of UPE is a form of financial accommodation and all of the other tax consequences therefore flowed from that characterization.

The taxpayers argued to the contrary, and they also argued that there was a potential application of 6-25, which is the non-overlap rule for not taxing income twice under different provisions. In the alternative, the taxpayers also argued that the 109RB discretion should have been exercised, and they also challenged the penalties in terms of the level of penalty set under the culpability rules and then whether the commissioner should have exercised the 298-20 discretion to remit any remaining shortfall penalties.

So the objection decision was set aside, except for some non-UPE issues, along with the shortfall penalties on the other matters which were both remitted to the commissioner, noting that the tax agent status of the taxpayer meant that maybe higher penalties would be applicable. Now, the reasoning is really crucial. The definition of loan here didn't go so far as to cover UPEs as their creations of equity. That's not an accommodation in the sense required for the definition in 109D.

And due to the exclusion of the UPE amounts, it wasn't necessary to consider that double taxation overlap elimination provision 6-25. Now, the Tribunal took a position that many practitioners have advocated around the UPE strategy that UPEs aren't a financial accommodation. Case is on appeal, so we hope we'll get some guidance pretty soon and that that'll give us clarity. But in the meantime, both the commissioner and practitioners and their clients need to be careful in this area because it's entirely possible that the Federal Court of Appeal will agree with the Tribunal, not the commissioner, in which case my money would be on the ATO recommending to treasury that there be some sort of legislative change to deal with this.

Now, PepsiCo is a complicated international arrangement about royalty withholding tax. So it may not apply to a lot of clients that smaller practitioners have, but there's some interesting issues in it which are worthy of consideration. So PepsiCo and Stokely van-Camp, who owned Gatorade, and they're called SVC in this, entered into an agreement with Schweppes Australia to do bottling. And they effectively agreed to only permit Schweppes to produce those party's products in Australia via the use of information and intellectual property owned by the other parties in one sense.

But the contract itself in those EBAs were actually around providing concentrate, the flavour that goes into the stuff that is bottled. Now, the questions therefore rose whether the EBAs were subject to royalty withholding tax under both section 128 of the '36 Act and also the US Australia DTA. Or in the alternative, if that was not the case, whether the arrangement had been put together to divert profits away from Australia and therefore be covered by the DPT regime under Part IVA.

Now, for the royalty withholding tax stuff, the commissioner argued that the payments were consideration for the use of the IP or know-how and therefore would be covered by that. The taxpayers argued to the contrary. The commissioner argued that the taxpayers had obtained benefit and therefore had set up such a scheme on the basis that it was set up to look like it was royalty free. And the taxpayers argued to the contrary to counterfactuals were ineffective.

Now, the decision was that a royalty withholding tax applied and that the DPT would otherwise have applied. Now, the reasoning was that the EBAs, to some extent, covered IP and know-how that would've triggered royalty withholding tax. And the DPT would've applied as the first counterfactual proposed by the commissioner, which was that they would've simply entered into a royalty liable contract should have been considered.

Now, taxpayers who set up contracts to try and get a particular tax liability run the risk that they will fail in substance or they'll be caught by the parts of Part IVA. What complicated the arrangement, as this one was, you can't just state that something has a particular character and expect it to work. The bundle of rights are still analysed et cetera.

Now, Buzadzic is the next case. It's a pretty typical asset betterment, a default assessment case. The taxpayer here in the Tribunal failed and then appealed to the federal court and run the same arguments. And there was a whole bunch of income flying through, and the evidence from the taxpayers had not been particularly well-received by the Tribunal. And the grounds of appeal were various and whether they represented questions of law was a major issue, because that's what you can appeal to the federal court against a decision of the Tribunal.

The appeal was dismissed, the submissions were very inconsistent with the established principles underlying the legislation and especially around the standard of proof. And there was little to no evidence to support any of the contentions. While documentation is king in staying... you've got to stay on top of your tax affairs, but when you actually get to challenging it, if you don't have the evidence, you are going to fail. And you need to show evidence that demonstrates the alternative taxable income, not just challenge the process which this case included a bunch of [inaudible 00:54:22] to challenge the process. And then to the next-

CCH Learning:

Can I just quickly just interrupt very quickly? And just to remind you, we are starting to run a bit out of time, so please just be aware of that. Thank you.

Bruce Collins:

No worries. I'll skate through the last couple. This is a DPN case, a director penalty notice, and it was about whether a company director of a company in liquidation can actually lodge an affidavit when the company's in liquidation to respond to the articulation of the amounts inside the DPN. And the taxpayer failed entirely.

The collection activities. At the moment, there's lots of DPNs going by, so people need to look at that and particularly the question about whether the company challenges the assessments before the DPN issues and before the company goes into liquidation because the directors will lose control afterwards. TKYY was a case involving a person who said that they were involved in a business activity, and they failed to demonstrate that there was really a business. And it turned out that it wasn't because they were being scammed by their partner, girlfriend at the time.

The question was whether the amounts were carrying on business activities where the income should have been returned or whether they should be able to claim interest deductions. They lost. And the reasoning was that they lost because the money that they received was used for personal purposes, and the other money was borrowed on the basis of other uses and just not for paying the amount. So as a nexus test.

Tax lawyers and accountants are held to higher standards. This person failed because of that. This case is actually one involving a citizen of Malaysia but was also a citizen of PNG. Question about whether they were a resident and what the status of their income would be. The objection decision here was set aside. They succeeded effectively in convincing the Tribunal on the question of the character of the receipts as to whether they were income or not. And so the Tribunal accepted the assessments were excessive accordingly.

Now, the evidence supported here and there was some contemporaneous material and this one was actually accepted. I've actually got to run through this one as well. There was an adjustment fee. The question was whether the taxpayers were carrying on a business or not. The commissioner argued it was a hobby. Decision was set aside for the first taxpayer and proportionately remitted penalties. Second taxpayer decision was affirmed.

So hobby versus business is always going to be slightly complicated and therefore you need to worry about those issues. And the lack of evidence, again, was fatal to the case, particularly for the second taxpayer. And documentation is king again. Rawson Finance is the long-running saga of the Nudie fruit juice franchise owners.

And the idea here was that they were accused of having lied in various points to the Tribunal and the courts, and whether the evidence that was provided was falsified [inaudible 00:57:46] weakened the case. And ultimately, the orders were made by the federal court to set aside the full federal court decision on the basis it was procured by fraud. Takeaway is: tell the truth, don't lie. And sham and fraud often concurrently run in arguments on cases like these.

Active Sports Management was an R&D activity case. The question was whether it was actually R&D or not. The eventual finding was that it wasn't, and there was a lack of documentation to show that it could have been. And so you've got to do more than just say that something's R&D to have it work. Now, the last one on the list is actually, as I mentioned at the outset. This is about an R&D case, but it's really about whether the commissioner is permitted to disclose information to third parties in the course of carrying on inquiries.

And in this case, it was to fund a group for the taxpayer. And the finding was that in the course of their duties, the commissioner is allowed to forward such information over time in the course of their duties. So back to you, and sorry about the skating through there. I must admit I lost track of a bit of time in the middle, but hopefully people can read the site pack and it's relatively self-explanatory. But I'm open to questions now.

CCH Learning:

Thank you very much for that, Bruce. I'll just check I'm showing the right screen. Yes. Thank you very much for that, Bruce. We will be spending the next few minutes taking questions. So just a reminder to please type them into the questions pane to give you some time to type those up, I will mention our upcoming webinars. So coming up, we're looking at non-commercial loss rules for individuals. We're also starting to look at the ins and outs of super and a broad look at the contributions and pensions.

In our FBT 2024 series, we're looking at understanding entertainment and meals. We're also going to be discussing the tax implications of business structures and the latest developments around lease accounting in regards to IFRS 16. Oh, apologise, a small typo there. That's meant to be an I for IFRS. And also our turbo-boost performance through high-quality feedback.

So if you're interested in those or any of our sessions, please head to our website and see what's right for you. So let's have a little look. Oh, sorry. I went a little bit far there. Let's have a little look at our questions. I have a question from Arthur. Arthur is asking Division 7A reform has been on the cards for many years. What is the bottleneck?

Bruce Collins:

Oh, well, that's a hell of a question. I think the problem is that Division 7A is intended primarily to prevent people doing what Division 7A captures. So while it's a clunky regime, it's intended to be clunky so that it is a disincentive for people to make informal distributions of company profits. So it's intended to be draconian in a sense, to urge people not to be subject to it.

So as a result, while there's a bunch of noise at the margins around how Division 7A applies to things it shouldn't, and it makes it very hard for taxpayers to comply, the answer to that is just pay dividends rather than making loans or distributions of property. And if you are going to do it, then you'll be subject to Division 7A. So there's not a lot of appetite in government to make substantive changes to it. And whatever they introduce, it's going to still have that disincentive built in.

The UPE issue, like the previous changes, they made changes to the law around corporate limited partnerships a few years ago. Because of the fact that people were saying that a corporate limited partnership wasn't a company, therefore Division 7A didn't apply. So move your structure into a CLP and then you'd be exempt. The government dealt with that because it was a revenue leakage.

Unless there's a revenue leakage, there's not a lot of incentive for government to fix things. But Div 7A is a noisy area of tax administration, and I don't know that government's that minded to make the chapter and verse changes that we might all want. But the Board of Tax recommendations are still outstanding, some of them. And so there's still areas to improve, but there's a lot of other things on the legislative agenda. So it's got to make it to the top of the pot to actually be boiling over at the top.

CCH Learning:

Thank you very much for that, Bruce. So there you go, Arthur. I also have a question from Michael. Michael was asking in regards to the PepsiCo and Sladden case, what scope is there for taxpayers to structure tax outcomes by careful drafting of agreements?

Bruce Collins:

Well, I think that there is scope to structure things within the scope of what the arrangement is. You can't just change the name of the agreement or the definition within it and change the tax consequence of the substance. But if you're making a case like Sladden, where the commutation was actually for an income flow, and PepsiCo was a case involving the provision of a bundle of things, you can dissect them in a way which is different to change the outcome, but there's got to be some basis for that dissection.

You can't just make it up and say, "Because the document says that, that's all you have to worry about." And that's what was argued in both of those cases. So as a consequence, we've got the issue that at times, there is an option early on to change what you're negotiating on. And if you negotiate for the right thing, you can change the tax consequence or partly change it. But by the time you've gotten halfway through the negotiations and you're already dealing with the substance of A, you can't say it's B instead or it's half B. And it's hard therefore to retrofit.

Sometimes the analysis of the underlying transaction can be such that you could say, "Well, look, the parties agreed that this was the circumstance or the parties have been negotiating on this capital issue and there's this other revenue issue that's part of it." And maybe you can do a bit of back-fitting, but retrofitting the entire thing to change the character is actually just not going to fly.

CCH Learning:

Thank you for that, Bruce. I hope that helps you there, Michael. I also have a question from Sarah. Sarah was asking, "Does the Bendel decision mean that the ATO's UPE strategy is dead in the water?"

Bruce Collins:

Yeah. Well, look, I don't think it's dead in the water, but it's certainly taking some high seas over the top of the bow at the moment. It's obvious that the Tribunal reasoning was very similar to what a lot of practitioners have said, myself included in debate about whether a UPE is financial accommodation. A decision not to pursue something that you have a right to in equity is different to making a loan and advancing the money to somebody substantively as well as conceptually.

So the UPE strategy, I think, is in doubt at the moment, and we'll see what the federal court appeal says, and maybe beyond that, depending on how high it climbs the chain of precedent. But my money, as I mentioned earlier, is on the idea that if the ATO loses in court, it's quite likely they will seek an amendment to address that.

Unlike the question I answered earlier where there's revenue leakage, there's quite likely to be a legislative response. And UPEs were a major area of revenue leakage when the UPE strategy was introduced. There were hundreds of millions of dollars in UPEs and Div 7A amounts flowing from them. So it was not a small potato.

CCH Learning:

Thank you very much for that, Bruce. And I hope that helps you, Sarah. Just have time for one more question here. This is from James. James was asking what impact does the Blood appeal decision in B&F investments have for advisors regarding risks for section 100A?

Bruce Collins:

Yeah. Well, that's another question that everyone's wondering about. You contrast Guardian and Bblood, the B&F investments case being Bblood, what you have is effectively different findings of fact that influence the outcome. They're not always going to be able to rely upon a judge or a Tribunal member agreeing with a view of facts, which means that your arrangement fails to be a reimbursement agreement.

You contrast Logan's decision in Guardian with Thawley's decision in... And you've got essentially chalk and cheese. So the facts are different, therefore the outcome was different. But the problem is that 100A's intended to be an onerous provision. It's intended, again, to discourage people from doing what the provision applies to. So as a preventative provision, it's serving its purpose at the moment. I think everyone needs to be careful about it.

I think that there is some scope for argument that the commissioner may be overreaching on some of the arrangements that they're dealing with at the ATO level at the moment, and therefore they are out there pushing the edge of the envelope. But the provision is powerful. It has an unlimited period review, and as a consequence, if the commission turns up and knocks on your door, I'd be getting professional advice on any cases where there's a potential 100A issue.

And there are a lot of them out there. So if you're a tax lawyer, think about barristers. And if you're a tax agent, think about tax lawyers, because the ATO are out there and they're doing things and therefore there is a substantial risk of that happening.

CCH Learning:

Thank you very much for that, Bruce. I do hope it helps you there, James. Well, that does bring us to the end of our questions for today. But please, Bruce's details are there on the screen, so if you do have any questions, please reach out and I'm sure that Bruce will be able to help you. So in terms of next steps, I would like to remind you all to please take a moment to provide your feedback when exiting.

We've asked you a couple of questions about today's webinar, so it's really important for us to hear your opinions. It's also a reminder that shortly after today's session, you will be emailed when you are enrolled into the e-learning recording, which can be watched multiple times.

And you'll have access to the PowerPoint transcript and of course the CPD certificate. I would very much like to thank Bruce for the session today, and to you, the audience for joining us. We do hope to see you back online for another CCH Learning webinar very soon. Please enjoy the rest of your day. Thank you very much.

Bruce Collins:

Thanks a lot everyone.