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ATO PROVIDES CERTAINTY ON LEGAL PROFESSIONAL PRIVILEGE CLAIMS

The Australian Taxation Office (ATO) has published its recommended approach to respond to formal notices requiring production of documents; specifically, for identifying communications covered by Legal Professional Privilege (LPP) and making LPP claims where the taxpayer does not wish to provide those communications to the ATO.

ATO Deputy Commissioner Rebecca Saint explained that the protocol had been developed to address ATO concerns where LPP claims were inappropriately asserted, either deliberately or through taking short cuts, with the result that key materials, facts, and evidence were inappropriately withheld from the ATO.

According to Mrs Saint:

- The ATO wants all taxpayers to get high-quality professional advice and respects the right of taxpayers to keep their legal advice confidential if they so choose, but we also rely on ongoing engagement with taxpayers and the timely provision of information to establish the facts in our reviews and audits.
- This protocol will support the right of taxpayers to keep their legal advice confidential, while at the same time giving taxpayers a robust framework to enable the ATO to have confidence that all other relevant documents have been provided.
- Reckless LPP claims over non-privileged documents unduly hinder ATO investigations and lead to extended disputes about information gathering, instead of focussing on the resolution of the substantive issue.
- These issues have largely arisen in relation to privilege claims made by large businesses that have received a formal notice as part of a dispute or audit activity. However, the vast bulk of our engagements with large businesses are done without recourse to formal information gathering powers.
- The ATO can compel the production of information and documents as part of our investigations. However, we cannot compel the production of information or documents where the underlying communication is privileged. The courts have supported the ATO's view that we can request details of LPP claims. Whilst we respect and accept appropriate claims, we require sufficient information to be able to decide whether to accept, review, or challenge a claim of LPP.

- Failure to take reasonable care when making LPP claims in response to a formal notice may result in non-compliance with the notice. There can be serious implications for non-compliance with formal information gathering notices, including prosecution. The protocol will help taxpayers and advisors have confidence about their LPP claims and ensure that they are meeting their legal obligations under the notice.
- Adoption of this voluntary protocol will see a more efficient resolution of LPP claims for taxpayers and the ATO. Businesses that choose not to follow the protocol and do not provide sufficient information to support their LPP claim, can anticipate further enquiries from the ATO.

The ATO continues to encourage taxpayers to obtain professional tax advice, including high quality legal advice, and the protocol restates the ATO's continued strong support of LPP. However, it also clarifies that the ATO cannot and will not simply accept blanket claims for privilege or claims that do not provide sufficient underlying contextual information to allow the ATO to make a decision on what to do with a claim.

The protocol covers all LPP claims made by legal or non-legal practitioners regardless of the firm or business structure.

The ATO has undertaken extensive consultation following the publication of the draft protocol in September 2021. Key stakeholders included the Law Council of Australia, large law firms, Big 4 accounting firms, relevant government agencies, and members of the National Tax Liaison Group and the Large Business Stewardship Group. All of this feedback has been carefully considered, and much is reflected in the updated final protocol. In addition to the protocol, the ATO is also publishing a detailed compendium which sets out the key feedback obtained during the consultation process, and the ATO's response to the feedback.

Australia continues to have one of the strongest corporate tax systems in the world. Our most recent estimate (for 2018–19) is that large corporates paid about 92% of their income tax at lodgement or with little intervention from the ATO. After ATO compliance action, this performance increases to an estimated 96%.

The Federal Government will consult on restoring the previously understood application of fringe benefits tax (FBT) to car parking benefits.

FBT applies to parking provided by employers to their employees where there is alternative parking commercially available. It was previously understood that car parks that effectively charge penalty rates for all-day parking (to encourage shorter stays) do not represent genuine alternative parking arrangements for commuters and so should not trigger FBT liabilities.

Recent court decisions overturned this understanding so that any alternative paid parking would trigger the liability. These decisions were reflected in an ATO Taxation Ruling due to take effect from 1 April 2022.

The consultation will identify appropriate modifications to the definition of 'commercial parking station' with a view to restoring the previously understood interpretation, which better reflects the policy intention of the law. This will also reduce the potential FBT burden on some employers, helping them attract employees back into the workplace.

The Government will consult with all affected stakeholders. The new definition will apply to car parking fringe benefits provided from 1 April 2022.

Kindly note that from 1.4.2021, car parking fringe benefits only apply to entities with an annual turnover exceeding $50 million.

TAXATION OF GAINS FROM THE SALE OF PROPERTIES HELD IN A TRUST

Commissioner of Taxation v Carter

This decision impact statement (DIS) outlines the ATO's response to *Commissioner of Taxation v Carter [2022] HCA 10*.

The main issue in this case was the taxation of gains from the sale of properties held in a trust. The question for the High Court was whether the default beneficiaries who were entitled to those gains under the deed remained liable to tax despite validly disclaiming their right to those gains after year end.

All legislative references in this Decision impact statement are to the *Income Tax Assessment Act 1936*.

Brief summary of facts

The Commissioner had determined that in each of the years in issue (2010-11 to 2013-14), the Whitby Trust had earned income from the development and sale of certain property.

By the end of each of the relevant income years, some or all of the income of the Whitby Trust was not subject to an effective determination by the trustee (Whitby Land Company Pty Ltd). Under the trust deed, any such income was to be held on trust in equal shares for the 5 children of Mr Caratti (the default beneficiaries).

The assessments

The core trust taxation rules are contained in Division 6 of Pt III. Key provisions within that Division are sections 97 and 99A. Under section 97, a beneficiary who is presently entitled to a share of the income of a trust for a particular year includes in their assessable income that share of the trust's net (taxable) income for that year. Where a share of the income of a trust is income to which no beneficiary is presently entitled, the trustee is assessed on that share of the trust's net (taxable) income under section 99A.

The Commissioner raised alternative assessments against:

- Whitby Land Company Pty Ltd as trustee of the Whitby Trust; these were section 99A assessments, and
- the default beneficiaries; of the 5 takers in default (Christina Caratti, Natalie Carter, Alisha Caratti, Nicole Caratti and Benjamin Caratti), Benjamin was a minor at the relevant time and the trustee was assessed on his behalf in a representative capacity under section 98 on his 20% share of the net income. The other default beneficiaries were assessed on their respective shares under section 97.

The default beneficiaries subsequently executed a series of disclaimers in respect of their default entitlements. In particular, the third (and final) disclaimers were expressed broadly to disclaim any and all rights and interests conferred by the deed to any income.

Administrative Appeals Tribunal proceedings

The trustee and the 4 default beneficiaries of age challenged the Commissioner's decision to disallow objections against the assessments for the 2010-11 to 2012-13 years (for the trustee) and the 2013-14 year (for those default beneficiaries).

The quantum of the income being brought to tax in the relevant years was not disputed by the litigants; rather, they disputed who was properly assessable on that income.

In a decision handed down on 23 December 2019, the Tribunal (constituted by DP O'Loughlin) affirmed each of the Commissioner's relevant objection decisions. As to the default beneficiaries of age, the Tribunal concluded that none of the disclaimers executed were effective at general law. On that basis, the Tribunal did not need to express views on whether the disclaimers would have worked to disapply section 97 had they been effective.

Federal Court proceedings

Three of the 4 default beneficiaries of age (but not Christina Caratti, nor the trustee of the Whitby Trust) appealed the Tribunal's decision to the Federal Court. The appeal was heard by the Full Court.

In a decision handed down on 17 August 2020, the Court concluded (contrary to the Tribunal's decision) that the third disclaimers executed by the Caratti daughters were effective at general law to disclaim the entirety of their default interests, Further, the Court concluded that for section 97 purposes, the daughters were (as a result of the disclaimers) not presently entitled to income within the meaning of section 97 as at 30 June 2014 - in other words, that the disclaimers were retrospectively effective for tax purposes. Therefore, section 97 did not apply to assess the Caratti daughters on any share of the trust's net (taxable) income.

High Court proceedings

On 23 April 2021, the High Court (Gageler, Edelman and Gleeson JJ) granted the Commissioner special leave to appeal. The grounds of appeal solely concerned the discrete issue of whether a valid (legally effective) disclaimer executed by a default beneficiary has the effect of retrospectively avoiding the application of section 97.

The High Court, constituted by Gageler, Gordon, Edelman, Steward and Gleeson JJ, heard the appeal on 9 November 2021.

On 6 April 2022, the High Court unanimously allowed the Commissioner's appeal with Gageler, Gordon, Steward and Gleeson JJ delivering a joint judgment in favour of the Commissioner and Edelman J, in agreement, writing separately.

Issues decided by the High Court

The High Court emphasised that the resolution of this case turned on the proper construction of Division 6 and, in particular, the time at which a beneficiary must be presently entitled to income of a trust to engage section 97.

The statutory construction of section 97

The High Court observed that the criterion for liability in Division 6 turns on the right to receive an amount of distributable income, not its receipt.

The High Court accepted the Commissioner's submission that a beneficiary's liability is based on 'present entitlement', which turns on the facts existing at the time immediately before the end of the income year. In line with the well-known authorities of Bamford Harmer and Zeta Force, the High Court confirmed that beneficiaries are to be assessed on their share of the trust's net (taxable) income based on their present entitlement to a share of the trust income immediately before the end of the relevant income year.

The High Court emphatically rejected the respondents' contention that the phrase 'presently entitled' should have regard to later events that would disentitle the beneficiary.

The majority decision concluded that:

... the question of the "present entitlement" of a beneficiary to income of a trust must be tested and examined "at the close of the taxation year" ..., not some reasonable period of time after the end of the taxation year.

This was similarly expressed by Edelman J:

A "present entitlement" to a share of the income of the trust estate in s 97(1) is an entitlement at the "present" time of the determination, being the end of the relevant financial year, whether or not that entitlement is later the subject of defeasance by a disclaimer.

The High Court observed that the competing construction (put by the respondents) was '... contrary to the text of s 97(1) and the object and purpose of Div 6', adding:

It would give rise to uncertainty in the identification of the beneficiaries presently entitled to a share of the income of a trust estate and the subsequent assessment of those beneficiaries. ... The uncertainties that would arise, and which would apply with equal force to the Commissioner, trustees, beneficiaries and perhaps even settlors, would also not be fair, convenient or efficient.

While the majority did acknowledge that unfairness can arise where a beneficiary is not aware of its entitlement to trust income, their Honours noted that this is a function of the operation of Division 6 and the fact that subsection 97(1) is drafted to tax a beneficiary by reference to present entitlement not receipt. The High Court noted that this is similar to the apparent unfairness identified in Bamford, the High Court in that case recognising that this arises because subsection 97(1) taxes a beneficiary on a share of the trust's net income, not the distributable income to which they are entitled, and does so regardless of whether distributable income is received.

ATO view of decision

The High Court decision settles an important practical question as to how trust income is to be brought to tax when relevant trust entitlements are disclaimed in a legally effective manner sometime after financial year end.

It tells us that such disclaimers do not disturb what would otherwise be the tax result. Beneficiaries who have an interest in, or entitlement to, trust income should now take this into account if they were otherwise considering not accepting that interest or entitlement and instead looking to disclaim it.

Implications for impacted advice or guidance

ATO Interpretative Decision ATO ID 2010/85 Trust income: disclaimer of an entitlement to trust income expressed the view derived from earlier authority that a beneficiary who has validly disclaimed an entitlement to trust income is not presently entitled to a share of the income of the trust estate for the purposes of section 97.

The Commissioner has withdrawn this ATO ID and will also update relevant website guidance to reflect the view of the High Court.

USE OF SOPHISTICATED STRUCTURES AND INTERNATIONAL FINANCIAL INSTITUTIONS TO OBFUSCATE TAX SITUATIONS

The Joint Chiefs of Global Tax Enforcement (J5) commended a decision announced today by Puerto Rico's financial institution regulator. The move to suspend the operations of a financial institution in Puerto Rico follows a global effort launched by J5 two years ago.

The Office of the Commissioner of Financial Institutions (OCIF) of Puerto Rico issued a Cease and Desist order and suspended the operations of Euro Pacific International Bank. The action was commended by the J5, who had, two years prior, conducted a global day-of-action to put a stop to the suspected facilitation of offshore tax evasion and money laundering by the bank.

Known as Operation Atlantis, the 2020 day-of-action was the first major operational activity for the J5. During the day of action, each country independently executed enforcement actions consistent with the legal requirements in their countries. These actions included intelligence and information gathering, search warrants, interviews, production orders and subpoenas.

The 2020 day-of-action occurred as part of a series of internationally led investigations that revealed a number of clients used a series of sophisticated structures and international financial institutions to obfuscate their tax situations. These conscious attempts were for the purpose of evading their tax obligations and/or laundering the proceeds of their crimes.

"There is no doubt that OCIF's work sends a strong message to others that the Puerto Rican financial industry will not be a haven for tax evaders or illegal conduct. We stand here together today to display the strong partnership we have with OCIF and to commend their leadership for taking decisive action," said Jim Lee, Chief, Internal Revenue Service Criminal Investigation. "We are also here with our J5 partners, celebrating four years together this week, showing the world the power of coordination, collaboration and partnerships. The actions announced today are an example of the wide-ranging tools available only through our collaboration with partner agencies. The independent actions taken by OCIF today represent an all-inclusive compliance effort that the J5 chiefs are committed to furthering in an effort to assist bringing to justice those who avoid paying taxes or commit other financial crimes."

The Chiefs explained that while they supported the actions taken by OCIF, the outcomes were not the result of a joint investigation and OCIF's decisions were independent of the J5. The J5 did not participate in the investigation by OCIF but welcomed the result.

"This announcement by the OCIF today is an important milestone for Operation Atlantis. Four years ago, the J5 set out to tackle international tax crimes and money laundering. We are already achieving significant operational results. Our approach is also helping to spark outcomes on an even broader scale," said ATO Deputy Commissioner and J5 Chief Will Day. "Ceasing a financial institution's operations stops it from being able to facilitate suspected tax evasion and money laundering. This is the strongest warning globally that offshore tax evasion is being targeted across the J5's efforts."

"When we launched the J5, we were determined to make the world a smaller place for tax evaders. The honest majority can be confident that our approach is working," said Simon York, HMRC's Director of Fraud Investigation and the UK's J5 Chief. "We have a series of tax enquiries, full criminal investigations and intelligence operations already underway and many more to come. Our message is that the game is up for offshore tax evaders and that any UK citizens involved with this bank should come and talk to us."

Chief Lee said that the J5 continued to collectively work hundreds of civil and criminal investigations within the J5 jurisdictions related to entities and individuals associated with Euro Pacific Bank. Those investigations continue unaffected by the actions today.

"FIOD is very pleased to present the results of our collaborative efforts to combat tax crimes. The investigations started some years ago based on intelligence gathered by the FIOD. To maximize the impact on tax evasion and money laundering this information was subsequently shared with our J5 partners. And then leading to these international results proves how much value there is to the J5 collaboration," said Niels Obbink, Chief and General Director, Dutch Fiscal Information and Investigation Service (FIOD). "In a recent court case a suspect was convicted to a multi-year prison sentence. This suspect was sentenced for several different crimes during which he had also used the bank centered in the Atlantis operation for money laundering. Together with the Netherlands Tax authority the Atlantis information is being used to stop tax crime. Other investigations against suspects that held accounts with this bank have recently been started."

Canadian Chief Eric Ferron added, "The Canada Revenue Agency is proud to have contributed our expertise and best practices to assist with this important action. Operation Atlantis illustrates the greater reach our nations have when working as a team to combat not only tax crime, but also money laundering and cybercrime. I look forward to our continued collaboration."

"The actions we have taken today in the Euro Pacific matter are in full compliance with our duty as regulator, pursuant to OCIF's laws and regulations, to protect against irreparable damage the interests of the entity and/or the persons or entities that own funds or assets in the institution and, ultimately, to protect also the solidity and reputation of Puerto Rico's financial system," said OCIF Commissioner Natalia Zequeira Diaz. "Although OCIF has guaranteed the entity's due process under law and regulation, including giving it multiple opportunities to undertake corrective actions, unfortunately, Euro Pacific has a long history of non-compliance with the Law and regulations that govern the Puerto Rico International Financial Center. OCIF will not allow or tolerate any financial entity with a license issued by the Government of Puerto Rico to operate outside the law or ignore the clear mandates of applicable laws and regulations."

Formed in 2018, the J5 works together to gather information, share intelligence and conduct coordinated operations against transnational financial crimes. The J5 includes the Australian Taxation Office, the Canada Revenue Agency, the Dutch Fiscal Information and Investigation Service.

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