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[444] Another brick in the wall – the *Greensill* decision and Australia's International Tax Policy Settings

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On 28 April 2020, the Federal Court released its decision in *Peter Greensill Family Co Pty Ltd (trustee) v FCT* [2020] FCA 559 (reported at 2020 WTB 17 [435]) regarding the taxation of non-taxable Australian property (**non-TAP**) distributions made to by the trustee of an Australian discretionary trust to a non-resident beneficiary. The decision reinforces the Commissioner's view as set out in *Draft Taxation Determination TD 2019/D6*, that Div 855 of the ITAA 1997 does not disregard non-TAP capital gains distributed to non-resident discretionary beneficiaries.

The decision of Thawley J provides welcome clarification around an issue that has been the cause of much friction between taxpayers and the Commissioner for a significant period of time. It is unfortunate, and perhaps an indictment on the tax system, that it has taken so long to receive judicial clarification of these issues. Many taxpayers and their advisers have grappled with the same issue as Mr Greensill over many years but, as is typical for issues such as these, not many individual taxpayers have the financial resources or the will to litigate.

The facts and arguments

Over the course of the 2015, 2016 and 2017 income years, the Australian trustee of the Peter Greensill Family Trust made distributions to Mr Greensill, a resident of the UK and a non-resident of Australia, totalling just under $60 million (together with the in specie distribution of a further parcel of shares). The distributions represented 100% of the non-TAP capital gains made by the trustee.

The Taxpayer argued that the capital gains distributed to him were capital gains "from a CGT event" which were to be disregarded pursuant to s 855-10(1) ITAA 1997, and as such, the gain was not liable to be assessed to the trustee under s 98 of the ITAA 1936.

The Commissioner argued that Div 855 did not disregard the Taxpayer's capital gain as it did not stem "from" a CGT event, as required under s 855-10(1). Rather, Mr Greensill was deemed to have made the gains as a result of the application of s 115-215(3) of the ITAA 1997. The Commissioner also contended that the trustee was liable for the tax under s 98 regardless of whether or not s 855-10 applied to Mr Greensill.

A complicated dance

Thawley J spent 9 pages carefully piecing together the manner in which 3 separate divisions of the tax acts applied to the circumstances at hand. To a layperson, what was a simple question – "Does a non-resident beneficiary of an Australian family trust pay tax on distributions of non-TAP capital gains?" – required the consideration and application of:

- Division 6 of the ITAA 1936 which deals with the regime for taxing trust income where a beneficiary is non-resident at the end of the relevant year of income;
- Subdivision 115-C of Pt 3-1 of the ITAA 1997 and Div 6E of Pt III of the ITAA 1936 which provide another set of rules for trusts with net capital gains; and
- Division 855 of the ITAA 1997 which provides another set of rules concerning the capital gains of foreign residents.

Thawley J agreed with the Commissioner and concluded that Division 855 is not available to a non-resident beneficiary for at least CGT Event A1 and CGT Event E5 (to the trustee on the in specie distribution) for gains attributed via Div 115 as the CGT Events happen to the trustee and are attributed to the beneficiary, rather than the gains being *from* a CGT Event happening to the beneficiary. Noting at paragraph 50:

It is true that Mr Greensill had capital gains attributed to him under Subdiv 115-C for the purpose of permitting him to apply any capital losses or discounts available to him. However, that is not a "capital gain … from a CGT event" within the meaning of s 855-10(1).

His Honour held that s 855-10(1) was not relevant to the facts of the case, as the provision covers gains made as a result of CGT events, and does not operate to disregard any capital gain deemed to be a gain made by the beneficiary under Subdiv 115-C. The deemed capital gains of a beneficiary, being their share of the "amount of the capital gain" (s 115-225(1)(a)) was a reference to the actual gain of the trust estate, stemming indirectly from a CGT event, and not the result of any capital gain of the beneficiary themselves. The purpose of deeming a capital gain to the beneficiary was to allow them to make use of any capital losses or capital gain discounts available to them, rather than to acknowledge any gain arising "from" a CGT event experienced by the beneficiary themselves. Thawley J noted at paragraph 55:

… the statutory context suggests that "from", when used in s 855-10(1) in the phrase "from a CGT event", should be understood as requiring a direct connection between the capital gain and the CGT event. It was not intended to apply to an amount which is "attributable to a CGT event" which occurred to another person, even where that person is a trustee.

His Honour relied on the notes to the provisions and the explanatory memorandum (**EM**) to the *Taxation Laws Amendment Bill (No 7) 2000*, which inserted s 115-215(3), to support the interpretation in para 60 that:

[I]n context, s 855-10(1) indicates that the capital gain to be disregarded is that which is made by an entity immediately as a consequence of the happening of a CGT event; a capital gain which is attributable to a beneficiary, because of a CGT event happening to a CGT asset owned by a trust, was not intended to fall within the phrase "a capital gain … from a CGT event". The capital gain deemed to have been made by the beneficiary under s 115-215 of the ITAA 1997 is not a "capital gain … from a CGT event" within s 855-10(1).

Statutory interpretation and policy

The Commissioner's technical arguments were well-made and consistent with the views espoused in Draft Tax Determination TD 2019/D6. Yet the unfairness and frustration that inevitably accompanies that position was clear in the submissions made by the taxpayer.

Stop for a moment and put yourself in Mr Greensill's shoes. If he had held the shares directly, his tax bill would have been … nil. If he had held the shares through a fixed unit trust where he held the only unit, his tax bill would have been … nil. Because he held the shares in his family trust, his tax bill is … a large one. How would you feel? I have had this discussion on numerous occasions with clients and it is not an easy one.

The policy arguments in support of disregarding Mr Greensill's capital gain, and for adopting a broader interpretation of the relevant provisions of Division 855, were in my opinion well-argued by the taxpayer. However, you can only work with what you have got.

Thawley J devoted considerable time to the policy arguments and the purpose of Division 855. He proceeded to warn against the use of assumed policy objectives where interpreting legislation to ascertain its purpose, stating at para 70:

Much of the applicant's argument proceeded upon an assumption that there existed a policy objective of not taxing foreign beneficiaries of resident trusts in respect of CGT events in relation to CGT assets which were not taxable Australian property. The applicant's process of construction then analysed the statutory provisions through this lens. This approach falls foul of the caution expressed in Certain Lloyd's Underwriters v Cross (2012) 248 CLR 378 at [26] that a danger to be avoided in construing a statute is making an a priori assumption about a statute's purpose and construing the statute to coincide with the assumption. The correct process is the inverse: the purpose is to be derived from what the legislation says, not from an assumption about the desired or desirable operation of the provisions.

There was a time when Australia wanted to be kind to non-residents. A time when Australia strove to be recognised internationally as a favourable destination for capital and investment. Supporting the growing Australian funds industry was a key driver behind many of the recommendations made in 2003 by the Board of Taxation in response to the Government's review of international taxation arrangements (**RITA**). These recommendations formed the basis for the introduction of Subdivision 768-H and then Division 855. Those halcyon days are long gone.

The statutory interpretation questions are difficult and, in my opinion, seeking to rely on the policy rationale for Division 855 is fraught. That is because the policy rationale in this case is completely confused.

Thawley J rightly placed emphasis on the comments from the EM that introduced s 768-605, the predecessor to s 855-40, which extends the treatment for non-resident individuals to those who hold indirect interests in non-TAP assets through a fixed trust. Many tax advisors have commented on the decline in quality of explanatory materials

over recent years, with some seemingly put together almost as an afterthought with the balance of the commentary being left to the ATO to produce through products such as "law companion rulings". The *Greensill* decision provides a salutary reminder of just how crucial the guidance in an EM can be, and how careful thought must be put into every sentence that goes into it.

It is worth reproducing the expression of policy intent from 2004 that has caused so much friction, so much time and expense for both the Commissioner and taxpayers (emphasis added):

These amendments are not confined to foreign residents with interests in widely held unit trusts. The amendments will apply to interests in closely held trusts and trusts that are not unit trusts. This is to ensure the benefits of the measures apply as widely as possible, irrespective of the trust arrangements through which the foreign resident invests. However, the trust in which the foreign resident has invested and all relevant trusts in the chain must meet the definition of 'fixed trust' in the Income Tax Assessment Act 1997 (ITAA 1997). ***This is to ensure that there is no discretion available to the trustee to provide benefits to parties who are not beneficiaries of the trust. This is important to the integrity of the amendments****.*

The best way I think I can describe the stated policy intent behind s 768-605 (and by implication section 855-40) is that it is bipolar. It is both Jekyll and Hyde. It recognises the inherent unfairness in taxing the same economic gain on the same asset in the hands of the same individual differently. However, in the very next breath, it bluntly discriminates between fixed trusts and discretionary trusts – and thus the policy basis for differentiating gains made through non-fixed trusts is established. A single incomprehensible sentence.

What is the real integrity concern referred to here? It seems to me to be so poorly articulated, it is rendered incapable of meaning. Yes, the trustee of a fixed trust does not have any discretion when providing benefits to unitholders, and the trustee of a discretionary trust clearly does have discretion. But in every discretionary trust deed I have ever seen, the trustee is clearly restricted to providing benefits only to beneficiaries, and to do otherwise would be a breach of their fiduciary duties. We have some of the strongest general anti-avoidance provisions in the world, and a host of other integrity provisions like ss 99B and 100A that can operate to provide some comfort in cases of outright scheming and connivance. Discriminating between fixed and non-fixed trusts to solve a loose and ambiguous integrity concern is not a basis for departing from the well-founded principle of horizontal equity.

Where to from here?

Australia's quagmire of policy settings around the cross-border taxation of capital gains, particularly those circumstances that involve gains flowing through trusts (domestic or otherwise), make it incredibly difficult for taxpayers, and for experienced advisers, to understand and comply with their tax obligations. The resulting uncertainty detracts from the efficacy of the tax system as a whole as issues of interpretation take many years to finally make it to the courts, with most taxpayers not willing or able to litigate and test the positions being adopted by the Commissioner. Yes, test case funding can be made available in certain limited circumstances, but that can't be the default solution. Clear, consistent and principled policy settings are the solution.

In my view, the *Greensill* decision (pending any appeal) is simply one more issue that must be fixed. There are a host of other international tax issues that are unsatisfactory from a policy perspective, including:

- The denial of foreign income tax offsets on foreign discounted capital gains: *Burton v FCT* [2019] FCAFC 141. A clear case of economic double taxation caused only by the mechanics of how Australia brings discounted gains to tax.
- The disaster that is the tax treatment of foreign capital gains flowing to Australian beneficiaries of foreign trusts. The Commissioner's view, set out in Taxation Determinations TD 2017/23 and 24 (reported at 2017 WTB 52 [1818]) is that capital gains made by a foreign trustee in respect of non-taxable Australian property that are distributed to Australian beneficiaries will be taxed in the hands of the beneficiary as ordinary income pursuant to s 99B of the ITAA 1997 and not as a capital gain.
- The current approach of the Commissioner to determining corporate residency and the interpretation of the term "resident of Australia" in subsection 6(1) of the ITAA 1936. This issue is currently the subject of a further review by the Board of Taxation (the first being conducted back in 2003 as part of the same RITA process mentioned above).

The question is not whether a re-examination of the relevant policy settings is necessary but whether the political will exists, especially when fixing some of these issues will clearly not be revenue-accretive for the government.

The impact of our residence definition

As a final observation, I should add that the mix of policy settings and outcomes is placing a ridiculous amount of pressure on our domestic definition of "resident" for tax purposes. I have written previously about the shortcomings of our current individual residency test, which dates back to when Zeppelins were the primary form of air transport. The myriad of different tax outcomes that now specifically turn on residence is not helping things, and the stakes are often high. The ATO rulings system and the courts are drowning in residency-related issues, and the storm will not dissipate until we have more common-sense outcomes on some of these fundamental issues.