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PRACTITIONER ARTICLES

[904] Impact of *Greensill* on "Exit Tax"

by Nicole Sammel, Nicole Sammel Tax Lawyers

The Full Federal Court confirmed in *Peter Greensill Family Co Pty Ltd (Trustee) v FCT* [2021] FCAFC 99 that if a resident discretionary trust distributes a capital gain re a non-TAP asset to a non-resident beneficiary, the beneficiary will be taxed on the capital gain. Specifically, the case confirmed that the beneficiary cannot disregard the capital gain under s 855-10 of ITAA 1997: see 2021 WTB 24 [535].

Some commentators say this outcome is not coherent from a policy perspective – and they suggest the Government legislate to override the impact of *Greensill* (assuming the decision is upheld on appeal to the High Court).

However, in my view, the outcome in *Greensill* is coherent from a policy perspective, at least in one respect – it significantly hampers the ability of a resident taxpayer to avoid "Exit Tax" (defined below) when they become non-resident. This article attempts to explain why. (Nevertheless, *Greensill* does not perfectly secure the imposition of Exit Tax and some residual weaknesses in the Exit Tax regime are also addressed below.)

1. The legislature's policy aim

If a taxpayer owns an asset that increases in value while the owner is resident, then, as a matter of policy, the taxpayer should be taxed on that increase in value. The taxpayer should not be able to avoid the tax by becoming a non-resident. This policy aim is enunciated in the Explanatory Memorandum to the 1986 Bill which introduced the predecessor provisions of CGT events I1 and I2.

2. Direct holding – does Exit Tax apply?

In the case where an individual taxpayer holds an asset directly, the above policy aim is achieved via Subdiv 104-I (ss 104-160 and 104-65).

To understand why, assume that:

- a resident individual, Nicole, acquires a non-TAP asset that is not a business asset, (eg, shares in a company that does not own Australian land);
- Nicole pays $0.01 to acquire the shares (eg, because the company is a start-up);
- when the shares are worth $100,000, Nicole ceases to be resident; and
- subsequently, Nicole sells the shares for $150,000.

The effect of Subdiv-104-I is that when Nicole ceases to be resident, either:

1. CGT event I1 happens and Nicole must pay CGT on the increase in the value of the shares since she acquired them. (This means Nicole will have a capital gain of $100,000, which can be reduced by the CGT discount, if applicable.) Nicole will have no further CGT liability when she sells the shares; or
2. Nicole can elect (under s 104-65) for CGT event I1 not to happen in which case the shares are deemed to be TAP assets from the time Nicole ceases to be resident. As a result, Nicole will be taxed, when she sells the shares, on the increase in the value of the shares since the time she acquired them. (This means Nicole will make a capital gain of $150,000, which she might be able to reduce by a partial CGT discount, if applicable.)

Either way, Subdiv 104-I ensures that Nicole will pay tax on the increase in value of her shares while she was resident. She will pay tax on this increase either when she ceases to be resident or when she ultimately disposes of the shares.

I will refer to this tax on the increase in value of the shares while Nicole was resident, regardless of how and when it becomes payable, as "Exit Tax".

3. Indirect holding via a trust – does Exit Tax apply?

Will Exit Tax apply to Nicole re the shares if, instead of acquiring the shares directly, she establishes a trust (which she controls) and the trust acquires the shares? And will the answer depend on what type of trust Nicole establishes?

To investigate this, I have assumed the fact pattern in Part 2 above, but have adapted it so that instead of Nicole, personally, acquiring and disposing of the shares, a trust (controlled by Nicole) does so; and the trust then distributes the capital gain from sale of the shares to Nicole. I have also assumed that Nicole makes the election under s 104-165 so that CGT event I1 does not happen when she becomes non-resident. Specifically, the adapted fact pattern is:

- a trust (controlled by Nicole, a resident individual) acquires a non-TAP asset that is not a business asset (eg, shares in a company that does not own Australian land);
- the trust pays $0.01 to acquire the shares (eg, because the company is a start-up);
- when the shares are worth $100,000, Nicole becomes non-resident;
- Nicole elects, under s 104-165, that CGT event I1 does not happen when she becomes non-resident;
- subsequently, the trust sells the shares for $150,000 (making a non-revenue gain); and
- the trust distributes the $150,000 gain to Nicole.

I have considered whether Exit Tax will apply to Nicole under the adapted fact pattern where the trust is any of the following: a resident discretionary trust, a resident fixed trust, a foreign discretionary trust and a foreign fixed trust. (By "fixed trust" I mean a "fixed trust" as defined in section 995-1; by "discretionary trust" I mean a trust that is not a "fixed trust"; by "resident trust" I mean a "resident trust for CGT purposes" as defined in s 995-1; and by "foreign trust" I mean a "foreign trust for CGT purposes" as defined in s 995-1.)

Here are my conclusions (based on analysis of domestic law only; I have not considered the impact of tax treaties).

Trust Type	**Will Exit Tax apply to Nicole?**	**Why?**
	(Assumes Nicole makes s 104-165 election so that CGT event I1 does NOT happen.)	
1. Resident discretionary trust	**YES**	*Greensill*
2. Resident fixed trust	**Probably YES (unless the gain is foreign sourced).**	CGT event E4
3. Foreign discretionary trust	**NO**	CGT event E4 does not apply

Trust Type	**Will Exit Tax apply to Nicole?**	**Why?**
4. Foreign fixed trust	**YES (unless the gain is foreign sourced)**	CGT event E4

A summary of the analysis behind my conclusions is set out in Part 8 below.

4. Impact of *Greensill* re Exit Tax

As shown in row 1 of the table, the impact of *Greensill* is that Exit Tax will apply to Nicole if the shares are acquired by a resident discretionary trust (where the gain from the sale of shares is a non-revenue gain).

Had *Greensill* been decided the other way (ie, had *Greensill* been decided in favour of the taxpayer), then Exit Tax would not apply to Nicole in these circumstances. This is because, when the trustee sold the shares and distributed the capital gain to Nicole, Nicole's s 115-215(3) capital gain would be disregarded under s 855-10.

In short, had *Greensill* been decided the other way (ie, in favour of the taxpayer), then a resident investor in Australian shares could avoid paying CGT on an increase in the value of the shares while the investor was resident, by:

- using a resident discretionary trust to acquire the shares; and
- becoming non-resident prior to the trustee selling the shares (where the gain from sale is a non-revenue gain).

5. Does *Greensill* impose "too much" tax?

Readers may point out that the effect of *Greensill* is to tax Nicole not only on the increase in the value of the shares while she was resident, but also on the increase in value of the shares between the date Nicole ceased to be resident and the date the trustee sells the shares. This is true, but it is no different to the result which would arise if Nicole had owned the shares directly and made a s 104-165 election to disregard CGT event I1 (see Part 2 above).

Further, if Nicole wishes to avoid this outcome (so that she is taxed only on the increase in value of the shares up to the date she becomes non-resident) she can achieve this by replacing the resident trustee with a non-resident trustee as soon as possible after she becomes non-resident. This will trigger CGT event I2 (which happens when a resident trust becomes a non-resident trust) with the effect that the increase in value of the shares up to the date the trustee becomes non-resident will be taxed, but any subsequent increase in value of the shares will not be taxed. (This is because, after CGT event I2 happens, any gain from the future sale of the shares will be made by a foreign resident discretionary trust in respect of a non-TAP asset and distributed to a non-resident beneficiary: see TD 2017/23.)

6. Residual weaknesses re Exit Tax regime

Nevertheless, *Greensill* is not effective to secure the imposition of Exit Tax in all scenarios where a resident beneficiary of a trust becomes non-resident after the trust's non-TAP assets have increased in value.

Specifically, if Nicole uses a trust to acquire shares while she is resident, she becomes non-resident after the shares have increased in value and she elects for CGT event I1 not to happen, there are at least 3 scenarios in which Exit Tax will **not** apply to Nicole.

1. As shown in rows 2 and 4 of the above table, Exit Tax will not apply if the shares are acquired by a **fixed trust** and the gain from sale of the shares is **foreign sourced**.
2. As shown in row 3 of the above table, Exit Tax will not apply if the shares are acquired by a **foreign discretionary trust**.

3. The above table shows outcomes only for non-revenue gains from the sale of shares. If the gain is instead a **revenue gain**, then Exit Tax will not apply to Nicole if the gain is **foreign sourced**.

The fact that Exit Tax does not apply in these 3 scenarios seems to be a "weakness" in the Exit Tax regime.

(However, in practice, it may be difficult for a resident investor to "orchestrate" any of these 3 scenarios. This is because:

- scenarios (1) and (3) require the gain from sale of the shares to be either or both (i) a revenue gain; and (ii) foreign sourced. Since there can be uncertainty in determining whether a gain is on revenue account or foreign sourced, taxpayers may be wary about tax planning that relies on a favourable determination about these issues; and
- scenario (2) requires the shares to be acquired by a foreign discretionary trust. In practice, this may not be as simple as it sounds because, for so long as Nicole (the controller of the trust) lives in Australia, there is a risk that the central control and management of the trust will be in Australia; and if so, that the trust will in fact be an Australian resident trust.)

7. Conclusion

Greensill ensures (largely) that a resident investor cannot avoid tax by using a resident discretionary trust to acquire assets and becoming non-resident after the assets have increased in value. The Government is likely to keep this in mind when it considers whether and how to amend the law in response to *Greensill*.

However, even if the Government does not change the law in response to *Greensill*, there will remain residual weaknesses in the Exit Tax regime.

8. Summary of analysis behind conclusions in table in Part 3

Here is a summary of the analysis behind my conclusions in the table in Part 3 above.

Resident discretionary trust

- Will Exit Tax apply to Nicole (assuming Nicole makes the s 104-165 election so that CGT event I1 does NOT happen)?: YES.
- Why?: Nicole's s 115-215(3) capital gain cannot be disregarded under s 855-10: *Greensill*.

Resident fixed trust

- Will Exit Tax apply to Nicole (assuming Nicole makes the s 104-165 election so that CGT event I1 does NOT happen)?: PROBABLY YES (unless the gain is foreign sourced).
- Why?: Nicole's s 115-215(3) capital gain will be disregarded under s 855-40. However, due to Nicole making the election under 104-165, Nicole's interest in the fixed trust will be deemed to be a TAP asset from the time she becomes non-resident. As a result, when the trustee pays the share sale proceeds to Nicole, there is potential for CGT event E4 to apply re Nicole's interest in the trust.

Re CGT event E4:

- if the payment from the trustee is reasonably attributable to a foreign sourced gain, CGT event E4 will NOT happen: 104-70(9);
- if the payment is not reasonably attributable to a foreign sourced gain, CGT event E4 will happen if the payment is NOT included in the Nicole's assessable income: s 104-70(1)(b). The payment will not be included in Nicole's assessable income unless s 115-220 has the effect of including the payment in Nicole's assessable income under s 98A. I think s 115-220 probably does not have this effect (though the issue is untested). If CGT event E4 applies, it may be possible to partly reduce the amount of the E4 capital gain under s 104-71(4) if the trust's s 95 net income includes a discount capital gain.

Foreign discretionary trust

- Will Exit Tax apply to Nicole (assuming Nicole makes the s 104-165 election so that CGT event I1 does NOT happen)?: NO.
- Why?: Nicole will not have a s 115-215 (3) capital gain because the shares were disposed of by a foreign resident trust in respect of a non-TAP asset: see TD 2017/23. And since the trust is a discretionary trust, CGT event E4 will not apply to the payment by the trustee: TD 2003/28.

Foreign fixed trust

- Will Exit Tax apply to Nicole (assuming Nicole makes the s 104-165 election so that CGT event I1 does NOT happen)?: YES (unless the gain is foreign sourced).
- Why?: Nicole will not have a s 115-215 (3) capital gain because the shares were disposed of by a foreign resident trust in respect of a non-TAP asset: see TD 2017/23. However, due to Nicole making the election under s 104-165, her interest in the fixed trust will be deemed to be a TAP asset from the time she becomes non-resident. As a result, when the trustee pays the share sale proceeds to Nicole, there is potential for CGT event E4 to apply re Nicole's interest in the trust.

Re CGT event E4:

- if the payment is reasonably attributable to a foreign sourced gain, CGT event E4 will not happen: 104-70(9);
- if the payment is not reasonably attributable to a foreign sourced gain, CGT event E4 will happen because the payment from the trustee is NOT included in the beneficiary's assessable income (and the payment is thus "caught" by s 104-70 (1)(b)). Further, there is unlikely to be any reduction of the E4 capital proceeds under s 104-71.

[905] Deputy Commissioner's address to TIA Transfer Pricing Conference

by Jerry Reilly, Senior Tax Writer, Thomson Reuters

The ***keynote address*** given by Hector Thompson, ATO Deputy Commissioner (International) to the Tax Institute's 2021 transfer pricing conference on 9 September 2021 outlines ATO perspectives on the current state of play in the currently very dynamic international tax environment.

In the course of his speech, Mr Thompson poses this question:

"What happens when an international tax system that has been reasonably stable for one hundred years runs up against rapid changes in the global business landscape (including digital disruption) that provides increased opportunities for shifting profits around the world?"

Mr Thompson is an economist, but previously trained as an historian, and it is in that capacity he provides, in the first part of his speech, a really interesting historical account going back to the 1920s of how that stability came about and how, in more recent years, it has been undermined. Recommended for those with an interest, but I won't distract the general reader here with details. The second, longer part of the speech answers the question with a survey of the BEPs measures ("BEPS 1.0"), domestic law initiatives, and the pursuit of the two Pillars (which Mr Thompson refers to as "BEPS 2.0") which he suggests revisits some lines of inquiry from the 1920s that perhaps some had assumed were settled.

BEPS measures

Mr Thompson referred, in particular, to 3 BEPS measures which he considers likely to have specific relevance to BEPS 2.0 (in the sense of establishing the "infrastructure" to facilitate it).

1. **Country by Country (CbC) reporting (Action 13).** In the OECD's third annual peer review report (which reports on each jurisdiction's domestic legal and administrative framework, its exchange of information network,

